

**STATE OF ARKANSAS
DEPARTMENT OF FINANCE & ADMINISTRATION
OFFICE OF HEARINGS & APPEALS**

ADMINISTRATIVE DECISION

IN THE MATTER OF

██████████
██████████
(ACCT. NO.: ██████████)

**WITHHOLDING
PASS-THROUGH
TAX ASSESSMENT**

DOCKET NO.: 17-482

**PERIOD ENDING: ██████████
(\$ ██████████)¹**

RAY HOWARD, ADMINISTRATIVE LAW JUDGE

APPEARANCES

This case is before the Office of Hearings and Appeals upon a written protest dated October 17, 2016, signed by ██████████, on behalf of ██████████
██████████ (“Taxpayer” or “Taxpayer 2”). The Taxpayer protested an assessment of Withholding Pass-through Tax resulting from an audit conducted by Nancy Robertson, Tax Auditor – Sales and Use Tax/Withholding, for the Department of Finance and Administration (“Department”). The Letter ID Number is ██████████.

A telephone hearing was originally scheduled in this matter on June 19, 2017. The telephone hearing was rescheduled for August 23, 2018, but prior to the hearing, the parties requested that the matter be submitted for a decision based upon consideration of written documents. A Briefing Schedule was mailed to the parties on August 22, 2018. The Department was represented by Alicia Austin Smith, Attorney at Law, Office of Revenue Legal Counsel. The Taxpayer was represented by ██████████

¹ The reflected amount includes tax (\$ ██████████), penalty (\$ ██████████), and interest (\$ ██████████).

██████████. The Department's Opening Brief was filed on September 24, 2018. The Taxpayer's Response Brief was filed on October 26, 2018. The Department's Reply Brief was filed on November 27, 2018.

ISSUE

Whether the assessment issued by the Department against the Taxpayer should be sustained? No.

FINDINGS OF FACT/CONTENTIONS OF THE PARTIES

The Department's Opening Brief addressed facts and issues involved in this case and stated, in pertinent part, as follows:

These matters arise from the tax relationships among several entities. Because the issues in the assessments involve the same set of facts and law, this brief consolidates the protests filed by these interrelated entities. The entities hold stock interests in ██████████. Each of these tax-structured entities has reporting and payment requirements with which it has not complied, as detailed herein. The Department correctly assessed each of these taxpayers and the assessments should be sustained.

Exhibit 1 is an ownership chart received from the Taxpayers which shows that the relationships between the entities are structured in such a way that taxable income passes down ██████████ before it is paid out to the end recipient in the chain. Although the Taxpayers have created tax structures that seem complex, in order to invest in either ██████████ stock, **Exhibit 1** demonstrates that the relationships between the entities are actually very simple.

Generally, these types of investment vehicles are structured as follows. A primary entity is formed as a partnership which holds investments in items such as stocks, bonds, commodities, and other valuable instruments. The partners in a primary entity are known as lower-tier entities. The primary entity calculates its income and losses to determine the amount of net share of income to distribute to each of its lower-tier entities. The primary entity is required to file a tax return to report identifying information for its lower-tier entities and the amount of income disbursed to each of them on Form AR1050—Partnership Return. Some lower-tier entities are the end recipient of the income. Primary entities are required to withhold income taxes for lower-tier entities unless the lower-tier

entity presents an AR4PT. *See* Arkansas Code Annotated § 26-51-905. Form AR4PT, the Nonresident Member Withholding Exemption Affidavit, allows the lower-tier entity to forego withholding by the primary entity and file and pay income taxes on its own behalf. The election must be memorialized on Form AR4PT and filed with the Department. *See* Ark. Code Ann. § 26-51-919(c)(5)(A).

Other lower-tier entities may be pass-through entities, meaning that income is diverted to this lower-tier entity before being disbursed to the entity which is the end recipient of the income. Depending on the type of pass-through entity, it may be required to file a corporate income tax return if it has elected to be treated as a corporation, or an individual income tax return if it is treated as a disregarded entity. Single-member LLCs are eligible to be treated as disregarded entities. The pass-through lower-tier entity forwards the income from the primary entity to the next lower-tier entity. If that entity is the end recipient of the income, it files an income tax return on its share. If that entity is another pass-through entity, it forwards the income it received from the first pass-through entity on to the end recipient, or another pass-through entity, which continues the cycle until the income reaches the final recipient. All pass-through entities, including disregarded entities, are required to withhold income taxes for lower-tier entities unless the lower-tier entity presents an AR4PT to elect to forego withholding by that entity and file and pay income taxes on its own behalf. *See* Ark. Code Ann. § 26-51-919(c)(5)(A).

The primary entity is allowed to take deductions necessary to generate the income at the top level, which in this case is investments in either [REDACTED] stock. As the income continues to pass down, lower-tier entities are only allowed to take deductions necessary to generate the income at their level, which in this case is income from holding an interest in a primary entity which owns stock.

It is not necessary to create a system of structured tax entities in order to hold stock investments. In this case, given the various taxpayers' failure to comply with reporting, withholding, and payment requirements, what is a simple transaction is transformed into a series of efforts to obfuscate the true amount of income received and taxes owed.

FACTS

The facts leading to these assessments came to light in [REDACTED] when [REDACTED] was required to file an

amended return for fiscal year [REDACTED] due to an audit by the Internal Revenue Service because it failed to report [REDACTED] of taxable income. [REDACTED] is the primary entity in the [REDACTED] investment arrangement. When [REDACTED] filed its amended return, [REDACTED] reported that it disbursed income in the amount of \$ [REDACTED] to [REDACTED] and in the amount of \$ [REDACTED] to [REDACTED]. **Exhibit 2, [REDACTED]** AR1050 Partner's Share of Income Report. Tax Auditor Nancy Robertson ("Auditor") examined records of the Arkansas Department of Finance and Administration (the "Department") and discovered that neither [REDACTED] nor [REDACTED] had filed an income tax return.

[REDACTED]

[REDACTED] ("Taxpayer 1") and [REDACTED] ("Taxpayer 2") are partners in an investment group, [REDACTED]. When [REDACTED] filed the amended return for fiscal year [REDACTED], it reported that it disbursed \$ [REDACTED] to Taxpayer 1 but did not withhold income taxes. **Exhibit 2, Page 3.** On the same amended return, [REDACTED] reported that it disbursed \$ [REDACTED] to Taxpayer 2 but did not withhold income taxes. **Exhibit 2, Page 2.** The Department assessed Taxpayer 1 for its income taxes based on the direct allocation. The Department assessed Taxpayer 2 for its income taxes based on the direct allocation.

[REDACTED] ("Taxpayer 1") is located at [REDACTED]. Taxpayer executed Powers of Attorney appointing [REDACTED] with [REDACTED] to act as the Taxpayer's representatives herein. **Exhibit 3.** As a result of the Auditor's findings, the Department assessed tax in the amount of \$ [REDACTED], penalty in the amount of \$ [REDACTED], and interest in the amount of \$ [REDACTED] for a total assessment of \$ [REDACTED]. **Exhibit 4.** The Notice of Proposed Assessment was mailed to the Taxpayer on September 1, 2016. The Taxpayer protested the assessment on October 28, 2016. **Exhibit 5.**

In its protest, Taxpayer 1 stated that it is a single-member LLC and a disregarded entity wholly owned by a single partnership such that it is disregarded for federal tax purposes, and therefore not subject to Arkansas income tax. Taxpayer 1 did not provide documents to support this claim. If Taxpayer 1 is a disregarded entity, it is subject to income tax and withholding requirements under both federal and state laws. Disregarded entities have two options: 1) elect to have the primary entity withhold income tax and provide the disregarded

entity with an AR1099PT, or 2) elect to file individual income tax on the AR1040 using Schedule C—Business Income Profit/Loss. On the AR1040, Taxpayer 1 would have listed the disbursement it made to a lower-tier entity as a disbursement of income. The disregarded entity is subject to income tax withholding requirements for the lower-tier entity, unless the lower-tier entity presents an AR4PT and elects to file and pay income taxes on its own behalf. This election must be memorialized on Form AR4PT and filed with the Department. Taxpayer 1's primary entity [REDACTED] did not withhold income tax. Taxpayer 1 did not file an individual income tax return and report the disbursement. According to the document provided by the Taxpayer (**Exhibit 1**), [REDACTED] ("Taxpayer 3"), is the sole member/owner of Taxpayer 1 and is the lower-tier entity. Taxpayer 1 did not withhold income taxes for [REDACTED], and [REDACTED] did not file an AR4PT with the Department. Instead, [REDACTED] filed an income tax return for year [REDACTED] showing that it had no income from partnerships or fiduciaries in Arkansas but instead suffered a loss of \$ [REDACTED]. The return reflected no ownership interest in Taxpayer 1. **Exhibit 6**. The Auditor asked the Taxpayer for verification of the loss and documentation as to why Taxpayer 1 had not filed a withholding return or remitted payment for the disbursement of \$ [REDACTED]. The Taxpayer did not provide any of the requested documentation and has not met its burden in refuting the assessment.

...

[REDACTED] reported that it disbursed income in the amount of \$ [REDACTED] to Taxpayer 1 and [REDACTED] to Taxpayer 2 and did not withhold income tax from either Taxpayer for tax year [REDACTED]. Taxpayers 1 and 2 did not file an income tax return and report the disbursement. Taxpayers 1 and 2 claim to be disregarded entities. Taxpayers 1 and 2 have not submitted sufficient proof from the IRS (Form 8832) to establish that they are disregarded entities. But even disregarded entities are subject to income tax withholding requirements for their lower-tier entities unless the lower-tier entity has elected to forego withholding and file and pay income taxes on its own behalf by filing an AR4PT with the Department. *See Ark. Code Ann. § 26-51-919 (Repl. 2012)*. Taxpayers 1 and 2 have not established that their primary entity, [REDACTED], withheld income tax. Taxpayers 1 and 2 have not established that they reported and paid tax on the disbursement. Taxpayers 1 and 2 have not established that they are disregarded entities. Taxpayers 1 and 2 have not established that they withheld and remitted income tax for disbursements to lower-tier entities. Taxpayers 1 and 2 did not produce copies of any AR4PTs. Taxpayers 1 and 2 have not provided proof that the disbursements were reflected on their

owner's tax returns. In the absence of proof, the assessments were proper. [P. 2-9].

The Taxpayer's Response Brief addressed the contentions of the Department and stated, in part:

This matter arises from the Arkansas Department of Finance and Administration ("Department") examination of [REDACTED] (collectively known as "Taxpayers") tax records. The examination resulted in an assessment for each of the entities listed above.

FACTS

Ownership Structure

[REDACTED]

Taxpayers respectfully provide the following additional clarifying facts with respect to [REDACTED] (" [REDACTED] ") ownership structure. [REDACTED] was a limited liability company ("LLC") treated as a partnership for federal income tax purposes with Arkansas activity up and until [REDACTED] ceased operations during [REDACTED]. Prior to [REDACTED], [REDACTED] ("Taxpayer 1 ") and [REDACTED] ("Taxpayer 2") held interest in [REDACTED]. **Appendix 1.** On [REDACTED], [REDACTED] (" [REDACTED] ") acquired substantially all of the assets of [REDACTED] is a C corporation for federal income tax purposes. Shortly after its acquisition, [REDACTED] was liquidated resulting in Taxpayer 1 and Taxpayer 2 no longer holding an interest in [REDACTED]. After [REDACTED], Taxpayer 1 holds [REDACTED] interest in [REDACTED] and Taxpayer 2 holds a [REDACTED] interest in [REDACTED]. **Appendix 2.**

[REDACTED]

Taxpayers respectfully provide the following additional clarifying facts with respect to [REDACTED] (" [REDACTED] "). [REDACTED] is an LLC treated as a partnership for federal income tax purposes. [REDACTED] ("Taxpayer 3") holds a [REDACTED] interest in [REDACTED]. [REDACTED] ("Taxpayer 4") holds a [REDACTED] interest in [REDACTED]. **Appendix 3.**

Taxpayers contest the following facts outlined in the Department's Opening Brief:

- [REDACTED]
1. *Department assertion:* [REDACTED] ("Taxpayer 1 ") did not provide documents to support claim that it is a single member LLC and is disregarded.

Response: Taxpayer 1 provided the Department a copy of its limited liability company ("LLC") agreement. **Appendix 4.** The agreement states that Taxpayer 1 is wholly owned by [REDACTED], effective [REDACTED].

2. *Department assertion:* If Taxpayer 1 is a disregarded entity, it is subject to income tax and withholding requirements under both federal and state laws.

Response: The Department's assertion that a single member LLC as a disregarded entity is subject to income tax withholding under federal and State law is incorrect. A single member LLC by definition is disregarded for federal income tax purposes and has no identity separate from its owners. Any income or losses are reported on a single member LLC's owner's federal income tax return. Similarly, Arkansas conforms to the federal income tax treatment of single member LLC's and any income or losses are reported on its owner's income tax return. (Ark. Code Ann. §4-32-1313). Thus, Taxpayer 1 did not have an Arkansas income tax withholding obligation as a single member LLC.

3. *Department assertion:* Disregarded entities have two options: 1) elect to have the primary entity withhold income tax and provide the disregarded entity with an AR 1099 PT or 2) elect to file individual income tax on AR1040 using Schedule C- Business Income Profit/Loss.

Response: A single member LLC is not required to withhold on distributions it receives. Specifically, the single member LLC does not exist for tax purposes because of its disregarded nature, to which Arkansas conforms. As a result, any distributions made to a single member LLC are, in fact, made to its owner as the regarded tax entity.

4. *Department assertion:* On the AR 1040, Taxpayer 1 would have listed the disbursement it made to a lower-tier entity as a disbursement of income.

Response: A single member LLC is not required to withhold on distributions it receives. Specifically, the single member LLC does

not exist for tax purposes because of its disregarded nature, to which Arkansas conforms. As a result, any distributions made to a single member LLC are, in fact, made to its owner as the regarded tax entity. Further, to clarify the facts as stated by the Department, the disbursement was made to an upper-tier entity not a lower-tier entity.

5. *Department assertion:* The disregarded entity is subject to income tax withholding requirements for the lower-tier entity, unless the lower-tier entity presents AR4PT and elects to file and pay income taxes on its own behalf.

Response: A single member LLC is not required to withhold on distributions it receives. Specifically, the single member LLC does not exist for tax purposes because of its disregarded nature, to which Arkansas conforms. As a result, any distributions made to a single member LLC are, in fact, made to its owner as the regarded tax entity. Further, to clarify the facts as stated by the Department, the disbursement was made to an upper-tier entity not a lower-tier entity.

6. *Department assertion:* This election must be memorialized on Form AR4PT and filed with the Department.

Response: A single member LLC is not required to withhold on distributions it receives. A single member LLC does not exist for tax purposes because of its disregarded nature, to which Arkansas conforms. As a result, any distributions made to a single member LLC are, in fact, made to its owner as the regarded tax entity. In addition, distributions made from a pass-through entity to another pass-through entity, including distributions made to limited partnerships, are not subject to withholding. (Ark. Regs. §2006-3(E))

7. *Department assertion:* [REDACTED] [Taxpayer 1] filed an income tax return for year [REDACTED] showing that it had no income from partnerships or fiduciaries in Arkansas but instead suffered a loss of \$[REDACTED].

Response: Taxpayer 1 is a single member LLC and does not exist for tax purposes because of its disregarded nature, to which Arkansas conforms. Taxpayer 1 did not file federal or state income tax returns because it is not a regarded entity and thus, is not required to file federal income tax or Arkansas income tax returns. The Department had documentation of Taxpayer 1's status as a partner in [REDACTED] as evidenced by the Department's copy of the [REDACTED] tax return for

the fiscal year [REDACTED] through [REDACTED]. **Appendix 5.** It should be noted that subsequent to [REDACTED], Taxpayer 1 no longer had K-1 activity reported to its owners as it ceased to be an investor in [REDACTED], a pass through entity.

8. *Department assertion:* The Auditor asked the Taxpayer [1] for verification of the loss and documentation as to why Taxpayer [1] had not filed a withholding return or remitted payment for the disbursement of \$ [REDACTED].

Response: The Department had documentation of Taxpayer 1's status as a partner in [REDACTED] as evidenced by the Department's copy of the tax return for the fiscal year [REDACTED] through [REDACTED]. As noted in the facts above, [REDACTED] was a partnership with Arkansas activity up until the time Taxpayer 1 ceased to be a partner in [REDACTED] in [REDACTED]. Prior to [REDACTED], Taxpayer 1 was invested in [REDACTED] as a single member LLC limited partner. Pursuant to Arkansas law conforming to its single member LLC status, the income or loss from [REDACTED] was not reportable to Arkansas by Taxpayer 1. Instead, Taxpayer 1's share of income/loss from [REDACTED] was reportable to Arkansas on the return of its sole owner, [REDACTED] ("Taxpayer 3"). [REDACTED] filed an Arkansas income tax return for the applicable tax period, i.e. [REDACTED].

After [REDACTED], Taxpayer 1 no longer had K-1 activity reportable to its owners as it ceased to be an investor in [REDACTED], a pass through entity. We would direct the Department to Statement 6 of its copy of the [REDACTED] previously referenced return for documentation of Taxpayer 1's status as a partner in [REDACTED]. **Appendix 5.**

9. *Department assertion:* The Taxpayer [1] did not provide any of the requested documentation and has not met its burden in refuting the assessment.

Response: Taxpayer 1 is a single member LLC and does not exist for tax purposes because of its disregarded nature, to which Arkansas conforms. As a result, any distributions made to a single member LLC are, in fact, made to its owner as the regarded tax entity. Taxpayer 1 provided a copy of its LLC agreement. Auditor did not request additional information. **Appendix 4.**

10. *Department assertion:* [REDACTED] ("Taxpayer 2") did not provide documents to support its claim that it is a single member LLC.

Response: Taxpayer 2 provided the Department a copy of its limited liability company ("LLC") agreement. **Appendix 6.** The agreement states that Taxpayer 2 is wholly owned by [REDACTED], effective [REDACTED].

11. *Department assertion:* If Taxpayer 2 is a disregarded entity, it is subject to income tax and withholding requirements under both federal and state laws.

Response: The Department's assertion that a single member LLC as a disregarded entity is subject to income tax withholding under federal and state law is incorrect. A single member LLC by definition is disregarded for federal income tax purposes and has no identity separate from its owners. Any income or losses are reported on a single member LLC's owner's federal income tax return. Similarly, Arkansas conforms to the federal income tax treatment of single member LLC's and any income or losses are reported on its owner's income tax return. (Ark. Code Ann. §4-32-1313). Thus, Taxpayer 2 did not have an Arkansas income tax withholding obligation as a single member LLC.

12. *Department assertion:* Disregarded entities have two options: 1) elect to have the primary entity withhold income tax and provide the disregarded entity with an AR1009PT or 2) elect to file individual income tax on the AR1040 using Schedule C- Business Income Profit/Loss.

Response: A single member LLC is not required to withhold on distributions it receives. Specifically, the single member LLC does not exist for tax purposes because of its disregarded nature, to which Arkansas conforms. As a result, any distributions made to a single member LLC are, in fact, made to its owner as the regarded tax entity.

13. *Department assertion:* On the AR 1040, Taxpayer 2 would have listed the disbursement it made to a lower tier entity as a disbursement of income.

Response: A single member LLC is not required to withhold on distributions it receives. Specifically, the single member LLC does not exist for tax purposes because of its disregarded nature, to which Arkansas conforms. As a result, any distributions made to a single member LLC are, in fact, made to its owner as the regarded tax entity. Further, to clarify the facts as stated by the Department,

the disbursement was made to an upper-tier entity not a lower-tier entity.

14. *Department assertion:* The disregarded entity is subject to income tax withholding requirements for the lower-tier entity, unless the lower-tier entity presents an AR4PT and elects to file and pay income taxes on its own behalf.

Response: A single member LLC is not required to withhold on distributions it receives. Specifically, the single member LLC does not exist for tax purposes because of its disregarded nature, to which Arkansas conforms. As a result, any distributions made to a single member LLC are, in fact, made to its owner as the regarded tax entity. Further, to clarify the facts as stated by the Department, the disbursement was made to an upper-tier entity not a lower-tier entity.

15. *Department assertion:* This election must be memorialized on Form AR4PT and filed with the Department.

Response: A single member LLC is not required to withhold on distributions it receives. A single member LLC does not exist for tax purposes because of its disregarded nature, to which Arkansas conforms. As a result, any distributions made to a single member LLC are, in fact, made to its owner as the regarded tax entity. In addition, distributions made from a pass-through entity to another pass-through entity, including distributions made to limited partnerships, are not subject to withholding. (Ark. Regs. §2006-3(E))

16. *Department assertion:* The Auditor asked the Taxpayer [2] for documentation as to why Taxpayer [2] had not filed a withholding return or remitted payment for the disbursement of \$ [REDACTED].

Response: The Department had documentation of Taxpayer 2's status as a partner in [REDACTED] as evidenced by the Department's copy of the [REDACTED] tax return for the fiscal year [REDACTED] through [REDACTED]. As noted in the facts above, [REDACTED] was a partnership with Arkansas activity up until the time Taxpayer 2 ceased to be a partner in [REDACTED] in [REDACTED]. Prior to [REDACTED], Taxpayer 2 was invested in [REDACTED] as a single member LLC limited partner. Pursuant to Arkansas law conforming to its single member LLC status, the income or loss from [REDACTED] was not reportable to Arkansas by Taxpayer 2. Instead, Taxpayer 2's share of income/loss from [REDACTED] was reportable to Arkansas on the return of its sole owner, [REDACTED] ("Taxpayer 4"). [REDACTED]

██████████ filed an Arkansas income tax return for the applicable tax period, i.e. ██████████.

After ██████████, Taxpayer 2 no longer had K-1 activity reportable to its owners as it ceased to be an investor in ██████████, a pass through entity. We would direct the Department to Statement 6 of its copy Of the ██████████ previously referenced return for documentation of Taxpayer 1 's status as a partner in ██████████. **Appendix 5.**

17. *Department assertion:* The Taxpayer did not provide any of the requested documentation and has not met its burden in refuting the assessment.

Response: Taxpayer 2 is a single member LLC and does not exist for tax purposes because of its disregarded nature, to which Arkansas conforms. As a result, any distributions made to a single member LLC are, in fact, made to its owner as the regarded tax entity. Taxpayer 2 provided a copy of its LLC agreement. Auditor did not request additional information. **Appendix 6.**

...

Applicable Law

A single member LLC is disregarded for federal income tax purposes and has no identity separate and apart from its owners. (IRC Reg §301.7701-2 (c) (2); IRC Reg §1.368-2 (b)). Any income or loss is reported on the single member LLC's owner's federal income tax return. . . . A single member LLC may elect to be treated as a taxable entity (e.g., corporation) separate from its owner by filing Form 8832. (Form 8832-Entity Classification Election). Unless such an election is made, the single member LLC is presumed to be disregarded. A single member LLC needs to affirmatively elect to be treated as a regarded entity otherwise the SMLLC is presumed to be disregarded. (Form 8832 and IRC Reg §301.7701).

Arkansas conforms to the federal income tax treatment of LLCs, including single member LLCs. (Ark. Code Ann. §4-32-1313). Consistent with the federal taxing construct of single member LLCs, a single member LLC is also treated as a disregarded entity for Arkansas income tax purposes. (Arkansas Department of Finance and Administration-Starting a New Business, Arkansas Department of Finance and Administration, (April 1, 2012)). Thus, disregarded entities should not file a partnership return. Rather, because Arkansas conforms to federal tax treatment of single member LLCs,

the owner of the single member LLC is responsible for reporting income and deductions. (Ark. Code Ann. §4-32-1313; Arkansas Department of Finance and Administration-Starting a New Business, Arkansas Department of Finance and Administration (April 1, 2012)).

Partnerships are treated as pass through entities in Arkansas and a partnership's income, gains, losses, etc., flow through to a partnership's members who in turn report income, gains, losses, etc. on their income tax returns. (Ark. Code Ann. §26-51-802). Moreover, every limited liability company having two or more members shall make a return for each taxable year as required for every partnership pursuant to §26-51-802 (Ark. Code Ann. §4-32-1313). Pass-through entities (including partnerships and LLCs) are required to withhold income tax on nonresident member's share of income that is derived from or attributable to sources within Arkansas and distributed to each nonresident member unless one of a number of statutory exception applies. (Ark. Code Ann. §26-51-919(b)(1); Ark. Regs. §2006-3). The pass-through entity is liable to the Director of the Department of Finance and Administration for the payment of the tax required to be withheld and is not liable to the member for the amount withheld and paid to the Director of Finance and Administration.

A pass-through entity is not required when a nonresident member's distributive share of income from doing business in Arkansas is less than \$1,000 per year. (Ark. Code Ann. §26-51-919(b)(1)). In addition, withholding is not required when a nonresident member is an entity that is not required to file a federal income tax return. (Ark. Regs. §2006-3(E)). Further, a pass-through entity is not required to withhold when a pass-through entity is making distributions to another pass-through entity. (Ark. Regs. §2006-3(E)). A pass-through entity includes LLCs, limited partnerships, and entities that are disregarded for federal income tax purposes. (Ark. Code Ann. §26-51-919(a)(4); Ark. Regs. §2006-3(B)(5)).

A nonresident member may also provide a pass-through entity with a signed agreement to file and pay Arkansas income tax by submitting Form AR4PT to the pass-through entity. (Ark. Code Ann. §26-51-919(c) (5), Ark. Reg. 2006-3, Form AR4PT Instructions, Nonresident Member Withholding Exemption Affidavit). If a nonresident does not provide Form AR4PT or is not otherwise exempt from withholding, a pass-through entity must withhold on behalf of its nonresident member (Ark. Code Ann. §26-51-919(c)(5), Ark. Reg. 2006-3, Form AR4PT Instructions).

ANALYSIS

The Department contends that Taxpayers 1 and 2 have not submitted sufficient proof from the IRS to establish that they are disregarded entities. Taxpayer 1 and Taxpayer 2 respectfully disagree with this assertion. Both parties have provided the Department with LLC legal agreements demonstrating that Taxpayer 1 and Taxpayer 2 are each wholly owned by one member. The Department also contends that Taxpayer 1 and Taxpayer 2 need to submit IRS Form 8832 to establish that they are disregarded entities. However, this is an incorrect reference and technical interpretation of Form 8832. In fact, IRS Form 8832 is intended for the opposite purpose of the Department's assertion. Specifically, disregarded entities that elect to be treated as regarded entities separate from their owners are required to file Form 8832. Unless such an election is made, a single member LLC is presumed to be disregarded if it is wholly owned by one member. Neither Taxpayer 1 nor Taxpayer 2 elected to be treated as a tax entity separate and apart from its owner. As a result, no Form 8832 was required or filed.

Irrespective of the above argument, is the Department's position that even if Taxpayer 1 and Taxpayer 2 are disregarded, they are subject to nonresident income tax withholding requirements for any distribution made from an upper tier entity. Taxpayer 1 and Taxpayer 2 are disregarded entities. Under Arkansas law, withholding is not required if a nonresident partner is not required to file a federal income tax return. (Ark. Regs. §2006-3(E)). Furthermore even if we ignore the fact that Taxpayer 1 and Taxpayer 2 are disregarded entities, withholding is not required on distributions made by a pass-through entity to another pass-through entity. (Ark. Regs. §2006-3(E)).

The Department asserts that Taxpayer 1 and Taxpayer 2 did not provide proof that disbursements were reflected on their owner's tax returns. However, Taxpayer 1 and Taxpayer 2 provided a copy of its owner's 2009 Arkansas income tax return showing distributions made to Taxpayer 1 and Taxpayer 2. Taxpayer 1 and Taxpayer 2 provided sufficient proof that they are disregarded entities and that the assessments were not proper.

...

It is the Taxpayer's contention that all requisite documents were submitted to the Department to establish that the Taxpayer's filing methods were consistent with the Arkansas withholding and conformity provisions stated herein and as a result, the Department did not establish that the assessment was proper or that Taxpayers failed to meet its burden of proof. [P. 1-8].

With respect to Taxpayer 2, the Department's Reply Brief stated, in pertinent part, as follows:

[REDACTED]

The Taxpayer provided additional information regarding [REDACTED] ("[REDACTED]"), and stated that [REDACTED] acquired substantially all of the assets of [REDACTED] on [REDACTED]. When [REDACTED] filed its amended return in 2015, [REDACTED] reported that it disbursed income in the amount of \$ [REDACTED] to [REDACTED] ("Taxpayer 1") and in the amount of \$ [REDACTED] to [REDACTED] ("Taxpayer 2"). See **Exhibit 2** to the Department's Opening Brief. [REDACTED] were assessed for income taxes based on the direct allocation.

The Taxpayer states that Taxpayer 1 and Taxpayer 2 are disregarded entities. The Department does not contest that Taxpayer 1 and Taxpayer 2 are disregarded entities. If a single-member LLC does not elect to be treated as a corporation, the LLC is a "disregarded entity" and the LLC's activities should be reflected on its owner's federal tax return. See **Exhibit 22**. The Taxpayer has affirmed that Taxpayer 1 and Taxpayer 2 did not elect to be treated as a corporation and therefore are disregarded entities, whose activities must be reflected on the owner's tax return.

Contrary to the Taxpayer's belief, disregarded entities are not exempt from paying income tax. Disregarded entities are subject to income tax and withholding requirements under both federal and state laws. Typically, the owner of the disregarded entity (the single member LLC) is responsible for reporting the income, but the taxpayers had several options:

Option 1: Taxpayers 1 and 2 had the option of allowing their primary entity, [REDACTED], to withhold and pay income taxes for Taxpayers 1 and 2. Taxpayers 1 and 2 did not allow their primary entity, [REDACTED], to withhold income tax.

Option 2: Taxpayers 1 and 2 had the option of paying the tax directly. Taxpayers 1 and 2 did not file an income tax return and report the disbursements detailed above.

Option 3: As admitted by the Taxpayer in its Response Brief, the owner of the single member LLC is then responsible for reporting the income. Taxpayers 1 and 2 refuse to identify the owner of the

single member LLC. In concluding that they are not responsible for the income tax, the Taxpayers state:

The Department asserts that Taxpayers 1 and 2 did not provide proof that disbursements were reflected on their owner's tax returns. However, Taxpayer 1 and Taxpayer 2 provided a copy of its owner's [REDACTED] Arkansas income tax return showing distributions made to Taxpayer 1 and Taxpayer 2. Taxpayer 1 and Taxpayer 2 provided sufficient proof that they are disregarded entities and that the assessments were not proper.

The parties agree that Taxpayers 1 and 2 received substantial distributions from the primary entity, and that income tax was not withheld on those distributions. The parties agree that Taxpayers 1 and 2 are disregarded entities. The Taxpayers state that "any income or losses are reported on a single member LLC's owner's federal income tax return." The issue is that Taxpayers 1 and 2 refuse to identify the individual owner responsible for paying the tax. In the absence of proof that the unidentified individual owner reported the income, Taxpayers 1 and 2 are responsible for the income distributed to them from the primary entity.

Pass-through entities are required to withhold Arkansas income tax at the highest income tax rate levied under §§ 26-51-201, 26-51-202, and 26-51-205 on the share of income of the pass-through entity that is derived from or attributable to sources within this state and distributed to each nonresident member. Ark. Code Ann. § 26-51-919(b)(1)(A)(i) (Repl. 2012). The pass-through entity is liable to the Director of the Department for the payment of the tax required to be withheld. Ark. Code Ann. § 26-51-919(b)(1)(A)(ii) (Repl. 2012). There are no exemptions available for disregarded entities and the Taxpayers can cite to no such exemption.

For Arkansas Corporate Income Tax purposes, pass-through income is treated as partnership income under Arkansas Individual Income Tax Regulation 1.26-51-802. Some of the partners in primary entities are considered disregarded pass-through entities if they are eligible. See 26 CFR 301.7701-2. A disregarded entity is an eligible entity that is treated as an entity not separate from its single owner for income tax purposes. The LLC's activities should be reflected on its owner's tax return. Disregarded entities have two options in Arkansas: they can 1) have the primary entity withhold income tax and provide the primary entity with an AR1099PT or 2) file individual income tax on AR1040 using Schedule C—Business Income Profit/Loss. Disbursements made to a lower-tier entity

would be listed as a disbursement of income on the AR1040. Ark. Code Ann. § 26-51-919 (Repl. 2012).

The parties agree that [REDACTED] disbursed income in the amount of \$ [REDACTED] to Taxpayer 1 and \$ [REDACTED] to Taxpayer 2 for fiscal year [REDACTED]. Taxpayers 1 and 2 were assessed by the Department for income taxes based on the direct allocation. The Taxpayers failed to present evidence that income tax was withheld on the distributions. Pass-through entities are required to withhold Arkansas income tax and the pass-through entity is liable to the Director of the Department for the payment of the tax required to be withheld.

The Taxpayers failed to present evidence that the owner of the disregarded entities reported and paid income tax on the distributions. The Taxpayers cannot shield themselves from tax liability by simply stating that an unidentified entity is responsible for paying the tax. In the absence of proof that the unidentified individual owner reported the income, Taxpayers 1 and 2 are responsible for the income distributed to them from the primary entity. The Taxpayers failed to present sufficient documents or records and thus had the burden of refuting the Department's assessment. The Taxpayers failed to establish that the proposed assessments were in error. Taxpayers failed to meet their burden by a preponderance of the evidence and the assessments should be affirmed. [P. 2-4].

CONCLUSIONS OF LAW

Standard of Proof

Ark. Code Ann. § 26-18-313(c) (Supp. 2017) provides, in pertinent part, as follows:

The burden of proof applied to matters of fact and evidence, whether placed on the taxpayer or the state in controversies regarding the application of a state tax law shall be by preponderance of the evidence.

A preponderance of the evidence means the greater weight of the evidence.

Chandler v. Baker, 16 Ark. App. 253, 700 S.W.2d 378 (1985). In Edmisten v. Bull Shoals Landing, 2014 Ark. 89, at 12-13, 432 S.W.3d 25, 33, the Arkansas Supreme Court explained:

A preponderance of the evidence is “not necessarily established by the greater number of witnesses testifying to a fact but by evidence that has the most convincing force; superior evidentiary weight that, though not sufficient to free the mind wholly from all reasonable doubt, is still sufficient to incline a fair and impartial mind to one side of the issue rather than the other.

The Department bears the burden of proving that the tax law applies to an item or service sought to be taxed, and a taxpayer bears the burden of proving entitlement to a tax exemption, deduction, or credit. Ark. Code Ann. § 26-18-313(d) (Supp. 2017). Statutes imposing a tax or providing a tax exemption, deduction, or credit must be reasonably and strictly construed in limitation of their application, giving the words their plain and ordinary meaning. Ark. Code Ann. § 26-18-313(a), (b), and (e) (Supp. 2017). If a well-founded doubt exists with respect to the application of a statute imposing a tax or providing a tax exemption, deduction, or credit, the doubt must be resolved against the application of the tax, exemption, deduction, or credit. Ark. Code Ann. § 26-18-313(f)(2) (Supp. 2017).

Withholding Pass-Through Tax Assessment

The Arkansas Income Tax Withholding Act of 1965, Ark. Code Ann. § 26-51-901 et seq. (Repl. 2012), contains the following relevant provisions of law:

26-51-919. Pass-through entities²

(a) As used in this section:

(1) “Lower-tier pass-through entity” means a member of a pass-through entity that is itself a pass-through entity;

(2)(A) “Member” means a shareholder of a Subchapter S corporation, a partner in a general partnership, a partner in a limited partnership, a partner in a limited liability partnership, a member of a limited liability company, or a beneficiary of a trust.

² The 2017 Supplement contains a version of Ark. Code Ann. § 26-51-919 which is applicable to tax years 2018 and thereafter.

(B) "Member" does not mean a Subchapter C corporation as defined in 26 U.S.C. § 1361(a), in effect January 1, 2005;

(3) "Nonresident" means:

(A) An individual who is not a resident of or domiciled in Arkansas during any part of the tax year;

(B) A business entity that does not have its commercial domicile in Arkansas during any part of the tax year; or

(C) A trust not organized in Arkansas; and

(4) "Pass-through entity" means a business entity that for the applicable tax year is:

(A) A corporation treated as a Subchapter S corporation under § 26-51-409, a general partnership, limited partnership, limited liability partnership, limited liability company, or a trust; and

(B) Not taxed as a corporation for federal or Arkansas income tax purposes.

(b)(1)(A)(i) A pass-through entity shall withhold Arkansas income tax at the highest income tax rate levied under §§ 26-51-201 and 26-51-202 on the share of income of the pass-through entity that is derived from or attributable to sources within this state and distributed to each nonresident member.

(ii) The pass-through entity is liable to the Director of the Department of Finance and Administration for the payment of the tax required to be withheld and is not liable to the member for the amount withheld and paid to the director.

(B)(i) A lower-tier pass-through entity shall withhold and pay income tax on the share of income distributed by the lower-tier pass-through entity to each of its nonresident members.

(ii) The director shall apply the tax withheld and paid by a pass-through entity on distributions to a lower-tier pass-through entity to the withholding required of that lower-tier pass-through entity.

(2)(A) On or before the due date for the pass-through entity's composite income tax return described in subsection (d) of this section, a pass-through entity shall file an annual return with the director showing the total amount of income distributed or credited to its nonresident members and the amount of tax withheld and shall remit the amount of tax withheld.

(B) The annual return shall be in an electronic format prescribed by the director.

(3) A pass-through entity shall annually furnish a nonresident member of the pass-through entity with a record of the amount of tax withheld on behalf of the nonresident member no later than the fifteenth day of the fourth month following the end of the pass-through entity's tax year.

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

(1) The nonresident member has a pro rata or distributive share of income of the pass-through entity from doing business in or deriving income from sources within this state of less than one thousand dollars (\$1,000) per year;

(2) The director has determined that the nonresident member's income is not subject to withholding;

(3) The nonresident member elects to have the tax due paid as part of a composite return filed by the pass-through entity under subsection (d) of this section;

(4) The pass-through entity:

(A) Is a publicly traded partnership as defined by 26 U.S.C. § 7704(b), as in effect on January 1, 2005, that is treated as a partnership for the purposes of federal income taxation; and

(B) Has agreed to file an annual information return reporting the name, address, and taxpayer identification number of each member with an annual Arkansas income greater than five hundred dollars (\$500) along with any other information requested by the director;

(5)(A) The pass-through entity has filed with the director on forms prescribed by the director the nonresident member's signed agreement to timely file an Arkansas nonresident individual or trust income tax return, to pay any tax due on the return, and to be subject to the jurisdiction of the Department of Finance and Administration in the courts of this state for the purpose of determining and collecting any Arkansas income tax together with interest and penalties owed by the nonresident member.

(B)(i) The department may revoke the exception from the withholding requirement in subdivision (c)(5)(A) of this section if it is determined that the nonresident member is not abiding by the terms of the agreement.

(ii) At the time of revocation, the department shall notify the pass-through entity that withholding is required for future distributions to the nonresident member whose exception is revoked; or

(6) The income received by the nonresident member is exempt from Arkansas income tax pursuant to § 26-51-202(e).

(d)(1) A pass-through entity may file a composite income tax return on behalf of electing nonresident members reporting and paying Arkansas income tax at the highest income tax rate under §§ 26-51-201 and 26-51-202 on the nonresident member's pro rata or distributive shares of income of the pass-through entity from doing business in or deriving income from sources within this state.

(2) A nonresident member whose only source of income within this state is from one (1) or more pass-through entities may

elect to be included in a composite return filed pursuant to this section.

(3) A nonresident member who has been included in a composite return may file an individual income tax return and shall receive credit for income tax paid on the nonresident member's behalf by the pass-through entity.

(4) On or before the fifteenth day of the fourth month following the close of the pass-through entity's tax year, a pass-through entity shall file an annual composite return with the director showing the total amount of income distributed or credited to its nonresident members and the amount of tax withheld and shall remit the tax due on the composite income tax return.

(e) The director may promulgate rules necessary to administer this section.

Arkansas Income Tax Rule 2006-3 was promulgated to administer the provisions of Ark. Code Ann. § 26-51-919 (Repl. 2012) and provides as follows:

2006-3. WITHHOLDING ON NONRESIDENT MEMBERS OF PASS-THROUGH ENTITIES (10/2007)

This rule is adopted under the provisions of Ark. Code Ann. §§ 25-15-204, 26-18-101 et seq., 26-51-101 et seq. and 26-51-919(e). This rule is necessary to properly administer the withholding provisions of Ark. Code Ann. § 26-51-919 with regard to the taxable income of nonresident members of pass-through business entities.

A. General provisions: Except as provided in Section E, any pass-through entity that makes a distribution to a non-resident member is required to deduct and withhold Arkansas income tax from distributions of taxable income being made with respect to Arkansas source income.

B. Definitions: The following words and terms, when used in this Rule, shall have the following meanings:

1. "Department" means the Arkansas Department of Finance & Administration.

2. "Distributed" or "Distribution" means a non-resident member's distributive share of a pass-through entity's income and shall include a cash payment, a distribution of other property, a credit to the member in lieu of such payment, or the member's distributive share of the entity's income or other gain that is passed through to the member and which is subject to Arkansas income tax. Distributions paid or credited are not subject to withholding under Ark. Code Ann. § 26-51-919 if the distributions paid or credited to the non-resident members are subject to withholding under other provisions of Arkansas law, or represent a return of such member's investment, or a return of capital, or represent

previously taxed income. If distributions are subject to withholding under other provisions of Arkansas law, distributions paid or credited are first considered to be distributed out of a member's current year distributive share of an entity's income or other gain that is passed through to the member and which is subject to Arkansas income tax. Any distributions paid or credited for the year that exceed the member's distributive share of the entity's income or other gain that is passed through to the member are not subject to Arkansas withholding.

3. "Member" means:

- a. A shareholder of an S-Corporation;
- b. A partner in a general partnership;
- c. A partner in a limited partnership;
- d. A partner in a limited liability partnership;
- e. A member of a limited liability company; or
- f. A beneficiary of a trust.

4. "Non-resident" means:

- a. an individual who is not a resident of, or domiciled in, Arkansas during any part of the tax year;
- b. a business entity which does not have a commercial domicile in Arkansas during any part of the tax year; or
- c. a trust that is not organized in Arkansas.

5. "Pass-through entity" means:

- a. A corporation that is treated as an S-Corporation under the Internal Revenue Code;
- b. A general partnership;
- c. A limited partnership;
- d. A limited liability partnership;
- e. A trust;
- f. A limited liability company; or
- g. A pass-through entity does not include any entity listed in (a) through (f) that is taxed as a corporation or is a disregarded entity for federal income tax purposes.**

C. Withholding rate:

1. Corporations, partnerships and LLC's: In the case of S-Corporations, general, limited, or limited liability partnerships and limited liability companies, withholding at the highest income tax rate levied under §§ 26-51-201 and 26-51-202 is required on the Arkansas portion of the taxable income distributed to each non-resident member. In the case of S-Corporations paying the tax on behalf of non-resident shareholders or partnerships filing composite returns on behalf of non-resident partners, the non-resident members' withholding can be claimed on the return filed by the S-Corporation or the partnership.

2. Trusts: With regard to trusts, withholding at the highest income tax rate levied under §§ 26-51-201 and 26-51-202 is

required on the Arkansas portion of the taxable income distributed to each non-resident beneficiary of the trust.

D. **Members not subject to withholding:** The following persons and organizations are not subject to withholding by a pass-through entity:

1. Non-resident members whose income has been determined by the Department not to be subject to withholding;

2. Non-resident members whose income is exempt from Arkansas income tax under § 26-51-202(e);

3. Non-resident members who have a pro rata or distributive share of income of the pass-through entity from doing business in or deriving income from sources within Arkansas of less than \$1,000 per year;

4. Non-resident members who elect to have the tax due paid as part of a composite return (Form AR1000CR) filed by the pass-through entity under § 26-51-919(d);

5. Organizations granted an exemption under Section 501(c)(3) of the Internal Revenue Code;

6. Insurance companies subject to the Arkansas insurance premium tax and therefore exempt from Arkansas income tax pursuant to § 26-57-602; or

7. Non-resident members who have submitted an affidavit (Form AR4PT) that meets the following requirements:

a. In the affidavit, the non-resident member agrees to be subject to the personal jurisdiction of the Department and the courts of Arkansas for the purpose of determining and collecting any Arkansas taxes, including estimated tax payments, together with any related interest and penalties. See Section (J) of this rule for the procedure to be followed in filing the affidavit.

b. For non-resident partners filing Form AR4PT, the inclusion of the partners' income within the composite income tax return (AR1000CR) will satisfy the requirements contained in the affidavit.

c. For non-resident shareholders filing Form AR4PT, inclusion of the non-resident shareholder's income in the composite income tax return will satisfy the requirements contained in the affidavit.

d. For non-resident beneficiaries filing Form AR4PT, the inclusion of the beneficiary's income within the composite income tax return will satisfy the requirements contained in the affidavit.

E. Withholding not required: Withholding by a pass-through entity is not required in the following instances:

1. **When an entity is not required to file a federal income tax return, or properly elects out of such duty;**

2. When a pass-through entity is making distributions of income not subject to Arkansas income tax;

3. When a pass-through entity is making distributions to another pass-through entity. Provided however, the exception set

out in this paragraph does not relieve the lower-tiered pass-through entity from the duty to withhold on distributions it makes which are not otherwise exempt;

4. When a pass-through entity is a publicly traded partnership, as defined by Section 7704(b) of the Internal Revenue Code (as in effect on January 1, 2005), and is treated as a partnership for purposes of the Internal Revenue Code. Provided, however, that the publicly traded partnership has agreed to file an annual information return reporting the name, address, taxpayer identification number, and any other information requested by the Department of each member with an annual Arkansas income greater than \$500; or

5. When a distribution made by a pass-through entity has been determined not to be subject to withholding by the Department.

F. Required reports and due dates:

1. A pass-through entity is required to provide the Department with an annual return (Form AR941PT) that includes magnetic media (a CD or 3.5" diskette) showing to whom the distribution was paid on or before the fifteenth day of the fourth month following the close of the pass-through entity's tax year. The magnetic media must also include the non-resident member's address, social security number or federal employer identification number, the amount of taxable income distributed and the amount of Arkansas income tax withheld and paid on the member's behalf. The magnetic media should be labeled with the form number "AR941PT", the pass-through entity's name, federal employer identification number and the number of records contained on the disk or CD. The final version of the media layout will be posted on the Withholding Website. The annual return may be amended if necessary.

2. (i) A pass-through entity must provide a non-resident member of the pass-through entity with an annual record (Form AR1099PT) of the amount of income distributed and the income tax withheld on behalf of the non-resident member no later than the 15th day of the third month following the end of the pass-through entity's tax year. Copies of AR1099PT, along with AR1096, must be sent to the Department by the same date.

(ii) Pursuant to Ark. Code Ann. § 26-18-505, the Director finds that there is good cause to allow the provision of the annual record (Form AR1099PT) to coincide with the filing date for the annual return (AR941PT). Therefore the date for such filing is extended to the fifteenth day of the fourth month following the close of the pass-through entity's tax year.

3. Each pass-through entity must file with the Department the appropriate income tax withholding return AR941PT on or before the due date of the pass-through entity's income tax return, including extensions.

4. Each non-resident member must enclose a copy of AR1099PT with their Arkansas income tax return as verification for this withholding.

G. Extensions of time to file reports: Any request for an extension beyond April 15 must be made in writing prior to April 15.

H. Credit or refund: Any non-resident member from whom Arkansas income tax is withheld pursuant to the provisions of this rule, and who files an Arkansas income tax return, is entitled to a credit for the amount of Arkansas income tax withheld. If the amount withheld is greater than the Arkansas income tax due, the non-resident member will be entitled to a refund of the amount of the overpayment.

I. Registration: Pass-through entities that make distributions subject to Arkansas withholding must register with the Department using Form AR4ER. IMPORTANT: When completing the AR4ER, check the "Pass Through Entity" box and add the two digit processing suffix number, seventy (70), to your FEIN (ex: 12-3456789-70). YOU MUST use the processing number on all related forms for pass-through withholding tax remittance. If this processing number is not included with your FEIN, processing of your payments will be delayed.

J. Affidavit filing procedures: Non-resident members who elect to file an affidavit (Form AR4PT) agreeing to be subject to the personal jurisdiction of the Department and the courts of Arkansas for the purpose of determining and collecting any Arkansas taxes, including estimated tax payments, and any related interest and penalties, must remit the affidavit to the appropriate pass-through entity. The pass-through entity is to retain the affidavit and file the following information with the Department by the due date of the required annual tax return of the pass-through entity.

1. Content: The name, address, and social security number or federal identification number of the non-resident member having a signed Form AR4PT. All pass-through entities are required to file the non-resident member withholding exemption affidavit information on a diskette or CD with the Withholding Branch of the Department's Individual Income Tax Section.

2. Format: The format for filing the diskette or CD will be in either a spreadsheet format (such as Excel) or a database format (such as Access). The final format will be posted on the Department's withholding tax website by December 15, 2006.

3. Waiver: A pass-through entity may obtain a waiver from the diskette or CD filing requirement if the pass-through entity can demonstrate that a hardship would result if it were required to file on a diskette or CD. Direct waiver requests to the Withholding Branch of the Department's Individual Income Tax Section.

K. Deductions, Adjustments and Credits: The Arkansas income tax due on a composite return (Form AR1000CR) shall not be

reduced by a pass-through entity non-resident member's allowable Arkansas business incentive income tax credits nor any other deductions, adjustments or credits. A non-resident member must file a return on Form AR1000NR to claim any deductions, adjustments or credits.

L. This final rule shall become effective on and after January 1, 2008. [Emphasis added].

The Department agreed that the Taxpayer was a disregarded entity. See Department's Reply Brief – P. 1 - 3. As a duly promulgated rule under the authority of Ark. Code Ann. § 26-51-919(e) (Repl. 2012), Income Tax Rule 2006-3 is controlling authority in a case involving the taxable income of nonresident members of pass-through business entities. No persuasive argument was made to support a finding that the provisions of Income Tax Rule 2006-3(B)(5)(g) and (E)(1) are not applicable and dispositive. Consequently, the Department incorrectly assessed Withholding Pass-through Tax against the Taxpayer.

DECISION AND ORDER

The proposed assessment is not sustained. The file is to be returned to the appropriate section of the Department for further proceedings in accordance with this Administrative Decision and applicable law. Pursuant to Ark. Code Ann. § 26-18-405 (Supp. 2017), unless the Taxpayer requests in writing within twenty (20) days of the mailing of this decision that the Commissioner of Revenues revise the decision of the Administrative Law Judge, this Administrative Decision shall be effective and become the action of the agency. The revision request may be mailed to the Assistant Commissioner of Revenues, P.O. Box 1272, Rm. 2440, Little Rock, Arkansas 72203. A revision request may also be faxed to the Assistant Commissioner of Revenues at (501) 683-1161 or emailed to revision@dfa.arkansas.gov. The Commissioner of Revenues, within twenty (20)

days of the mailing of this Administrative Decision, may revise the decision regardless of whether the Taxpayer has requested a revision.

Ark. Code Ann. § 26-18-406 (Supp. 2017) provides for the judicial appeal of a final decision of an Administrative Law Judge or the Commissioner of Revenues on a final assessment or refund claim denial; however, the constitutionality of that code section is uncertain.³

OFFICE OF HEARINGS & APPEALS



RAY HOWARD
ADMINISTRATIVE LAW JUDGE

DATED: March 28, 2019

³ See Board of Trustees of Univ. of Arkansas v. Andrews, 2018 Ark. 12.