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

ADMINISTRATIVE DECISION

IN THE MATTER OF [redacted] **ACCT. NO.:** [redacted]	**REFUND CLAIM DISALLOWANCE** (Corporate Income Tax)
DOCKET NO.: 19-162	**DATE OF CLAIM:** [redacted] **($[redacted])**

RAY HOWARD, ADMINISTRATIVE LAW JUDGE

APPEARANCES

This case is before the Office of Hearings and Appeals upon a written protest dated September 7, 2018, signed by [redacted], CPA ([redacted]), on behalf of [redacted], the Taxpayer. The Taxpayer protested the denial of a refund claim[1] by the Department of Finance and Administration ("Department"). The Letter ID Number is [redacted] and the Claim Period was from [redacted].

A telephone hearing was held on December 4, 2018, at 10:00 a.m., in Little Rock, Arkansas. The Department was represented by Brad Young, Attorney at Law, Office of Revenue Legal Counsel ("Department's Representative"). Present for the Department were Tommy Burns - Tax Auditor, Faye Husser - Audit Supervisor, and Scott Fryer – Assistant Administrator/Corporate Income Tax Section. The Taxpayer was represented by [redacted] [redacted], Certified Public Accountants ([redacted]) ("Taxpayer's Representatives").

[1] Resulting from the Department's reclassification of nonbusiness income to business income.

The record remained open after the hearing for the submission of additional evidence and post-hearing briefs. The Taxpayer's post-hearing brief was filed on January 4, 2019. The Department's post-hearing brief was filed on February 1, 2019.

FINDINGS OF FACT/CONTENTIONS OF THE PARTIES

Exhibit 1 to the Taxpayer's Protest Form is a letter which set forth relevant facts and stated, as follows:

> This protest is being made in connection with Arkansas's denial of Taxpayer's nonbusiness income characterization of gain associated with the sale of [redacted], and a disregarded LLC, [redacted] as reflected on Taxpayer's amended [redacted] Arkansas corporation income tax return (Exhibit 3). For reasons set forth hereafter, Taxpayer disagrees with Arkansas's characterization of said gain and respectfully requests a refund of $[redacted], plus interest.
>
> . . .
>
> [redacted] is part of [redacted], a global provider of [redacted]. The principal business of [redacted] is the [redacted] throughout North America.
>
> [redacted] is headquartered in [redacted], has [redacted] and employs [redacted] people. [redacted], owns various subsidiaries created for each business unit. During the relevant tax period, these business units include [redacted] The [redacted] unit includes, in its entirety, all of [redacted] tangible and intangible assets.
>
> . . .
>
> On [redacted], [redacted] entered into an agreement with [redacted] to sell the company's U.S. based [redacted] for [redacted] ("Transaction"). The Transaction was executed and finalized at [redacted]. For federal corporate income tax purposes, the Transaction was an asset sale, which

included the sale of its interest in , along with plants in , located in and located in . At the time of the Transaction, was a disregarded limited liability company wholly-owned by , which in turn is wholly-owned by . [P. 1-3].

On November 1, 2018, the Department's Representative filed responses to an Answers to Information Request which set forth relevant facts and issues and stated, in pertinent part, as follows:

> According to Taxpayer,[Footnote 1 stated that, "[u]nless otherwise indicated, the Department has drawn its description of business from the facts used in Protest."] , an affiliated company of , is a global provider of . The principal business of is the throughout North America. is a , and its headquarters are in . owns various subsidiaries created for each business unit. During the relevant tax period, these business units included
>
> In a Letter to Stakeholders dated , described the relationship between and its subsidiaries, including . Specifically, under the heading " ," and wrote:
>
> > .
>
> *See* Stakeholder Letter, attached as **Exhibit 1**.
>
> On or around tax year (the tax year at issue in this Protest), instituted a company-wide, multi-year effort to " *See*

Earnings Report (hereafter " Earnings Report"), attached as **Exhibit 2**. In layman's terms, engaged in an of buying and selling lines of business. *See*, generally, . . . (hereafter " "), attached as **Exhibit 3**. As reported by the , was " *See* . . . (hereafter " "), attached as **Exhibit 4**. This included more than in strategic acquisitions and new or expanded facilities, as well as over in divestitures.[Footnote 2 stated that, " sold its . . . for ."]. *See* Earnings Report (hereafter " Earnings Report"), attached as **Exhibit 5**. Since , in addition to selling its , has sold its venture, and its business.

. . .

operated its as part of its portfolio of for at least , from until it sold the business in . *See* . . . **Exhibit 12**. In , when net corporate earnings overall were , remained an income producer for the corporation. *See* attached as **Exhibit 13**; *see also* Earnings Report ( ). In , while announcing the groundbreaking of a , issued a press release that stated, *See* . . . **Exhibit 14**. In , added a production line for . *See* . . . **Exhibit 15**. In , announced that it would begin at a it bought earlier that year in order to capitalize on an expanding market . *See* . . . **Exhibit 16**. In , a corporate spokesperson reaffirmed " and the exploration " " *See* . . . **Exhibit 17**.

When sold its . . . , the sale included all assets relating to the , including

intangible assets. At no time prior to the refund request that is the subject of this Protest did deduct any non-business income related to the intangible assets of its . During that time period, there were no add-backs of non-business income related expenses associated with the . did not add back any depreciation or amortization expenses associated with the and reported $0 non-business income related expenses prior to the divestiture. Amortization expenses reduced the prior year(s)' apportionable business income in Arkansas because historically treated such expenses as a business asset/expense until it filed the amended return refund request for the gain associated with its disposal.

On its amended corporate tax return, reclassified the proceeds from the sale of the intangible assets associated with its from business income to nonbusiness income not allocable to Arkansas. Based on this reclassification, requested a refund in the amount of $. The Department denied refund claim in its entirety. *See* Notice of Claim Denial, attached as **Exhibit 18**. protested the Department's denial and requested an administrative hearing. [P. 1-5].

The Department's Representative contended that: (1) the Taxpayer and its subsidiaries are that filed one [1] consolidated income tax return in Arkansas; (2) for at least , the Taxpayer operated a that included and in Arkansas; (3) the Taxpayer sold the in ; (4) the Taxpayer is contending that the income from the sale of the is nonbusiness income; (5) the Taxpayer initiated a portfolio realignment around (which ultimately included the sale of the); (6) the Taxpayer acquired the by buying it, maintained the by growing and investing in it, and ultimately disposed of the by selling it; and (7) the income from the sale of the was business income.

The Tax Auditor presented testimony consistent with the information contained in the Department's Answers to Information Request and he authenticated exhibits attached thereto. The Tax Auditor also testified that: (1) he reviewed documents associated with the Taxpayer's consolidated return for [redacted] that pay corporate income tax in Arkansas including [redacted]; (2) from [redacted], the Taxpayer operated a [redacted] as part of its portfolio of [redacted]; (3) the [redacted] operated as a business unit of [redacted]; (4) [redacted] is wholly owned by the Taxpayer; (5) all assets of the [redacted], tangible and intangible, were sold in [redacted]; (6) the Taxpayer reported a capital gain related to the intangible assets of approximately $[redacted]; (7) according to the Taxpayer, the intangible assets were goodwill, brand value, trademarks, domain name assignments, and customer relationships; (8) when the Taxpayer filed its original return, it classified the capital gain related to the sale of the intangible assets as income apportionable to Arkansas along with the tangible assets; (9) the Taxpayer filed an amended return and the capital gain related to the sale of the intangible assets was reclassified as nonbusiness income so the Taxpayer requested a refund; (10) he disagrees with the Taxpayer's position that it was unusual for the Taxpayer to sell a line of business;[2] (11) [redacted] had many lines of [redacted] including [redacted]; (12) Department Exhibit 17 indicates that [redacted] was involved in a transaction where a [redacted] was sold in [redacted] and the income was classified as apportionable business income: (13) based upon his research, divestiture is a common corporate practice in general; (14) operation of the [redacted]

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[2] See Department Exhibit 4.

was consistent with the Taxpayer's business practices until it was sold (the was purchased in as part of the Taxpayer's);[3] (15) the proceeds from the sale of the were distributed to shareholders and the remainder was reinvested in the core business (based upon information provided to the Department so far, it cannot be determined if some of a cash dividend paid to the Taxpayer over a two-year period came directly from the sale of the); (16) the contributed to the operations of the Taxpayer's economic enterprise as a whole because the business income from the was reported as part of net taxable income in Arkansas which was included in the Taxpayer's consolidated tax return;[4] (17) for the relevant period, the gain from the sale of the intangible assets of the accounted for of net taxable income; (18) the Taxpayer conceded that the gain from the sale of the tangible assets of the was business income; (19) it is his understanding that the Taxpayer is contending the gain from the sale of the intangible assets of the is nonbusiness income because they were created in the Taxpayer's home office; (20) he disagrees with the Taxpayer's contention regarding the intangible assets because the intangible assets arose out of the regular activities of the including everyday interactions with customers and brand values; (21) he disagrees with the Taxpayer's contention that the intangible assets were created on the date the was sold because the intangible assets are built up over time and are not instantaneously created; (22) typically, things

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[3] See Department Exhibit 12.

[4] Income from the was reported as business income in Arkansas until the was sold.

like goodwill are amortized over a 15-year period so that could explain why the intangible assets were not on the books prior to the date of sale (if they were fully amortized and removed from the balance sheet); and (23) intangible assets like trademarks and customer lists were used in the Taxpayer's [redacted] and they were never classified as nonbusiness or removed from apportionable income.

Upon cross examination, the Tax Auditor testified that: (1) when he refers to [redacted], for the purpose of this hearing, he is talking about the entity which filed the consolidated return[5] in Arkansas; (2) the entities included on the consolidated return had a taxable presence in Arkansas; (3) the articles, attached to the Department's Answers to Information Request regarding [redacted] sales of business, did not specifically refer to [redacted] and could have been related to entities not covered by the nexus combined return; (4) the Taxpayer is 100% owner of [redacted] and [redacted] was 100% owner of the [redacted]; (5) he is not sure if [redacted] had ever sold a business in the past; (6) goodwill arises out of the regular course of a business and creates value over time; (7) in making determinations regarding taxation, he relies on guidance from statutes and regulations; (8) when the [redacted] was purchased in [redacted], it would have been appropriate at that time to amortize goodwill; and (9) the [redacted] was a stand-alone business sold in its entirety.

The Department's Assistant Administrator testified that: (1) goodwill and all other intangible assets existed prior to the date of the sale of the [redacted] [redacted]; (2) the intangible assets were used in Arkansas and they were part of

[5] Not a full federal consolidated group return but a nexus combined return.

the sale of the entire [redacted]; (3) with respect to the [redacted], the tangible assets and intangible assets existed in Arkansas; (4) the gain from the sale of the intangible assets was apportionable business income; and (5) the facts involved in the Getty Oil case are distinguishable from the instant case (the nature of the income was interest from an inter-company loan rather than a capital gain).

The Taxpayer's Answers to Information Request provided, in pertinent part, as follows:

> *a. The appropriate scope of analysis is limited to [redacted].*
>
> In the DFA AIRS, the Department argues that the sale of [redacted] ("Transaction") satisfies the transactional test primarily because the appropriate scope of analysis includes [redacted], and [redacted] divestiture of the [redacted] was part or an overall corporate strategy. To support this conclusion, the Department points to [redacted] Arkansas nexus consolidated return, which includes income from [redacted].
>
> However, the appropriate scope of analysis is limited to [redacted] because Arkansas law requires separate reporting as evidenced by Ark. Code Ann. 26-51-205(b), which states that "Every foreign corporation doing business within the jurisdiction of this state shall pay annually an income tax on the proportion of its entire net income as now determined by the income tax laws of Arkansas." Per Form AR1100CT Instructions "Consolidated returns are permitted under certain conditions only corporations in the affiliated group that have gross income from sources within the State that is subject to Arkansas income tax are eligible to file consolidated income tax returns in Arkansas." Pursuant to Ark. Code Ann. § 26-51-805(a), an Arkansas "affiliated group" is defined pursuant to 26 U.S.C. § 1504(a) and (b), and only includes corporations that have gross income from within the state. Although Arkansas adopts UDITPA and the unitary principle, filing an Arkansas nexus consolidated return does not imply a unitary relationship among the entities included in the Arkansas filing group nor is it required. [redacted] elected to file on a nexus consolidated basis to ease its administrative filing burden. As a result, [redacted] entities included in the Arkansas affiliated group

differ from the entities included in the federal consolidated group or that of other jurisdictions which require a unitary combined filing methodology. Additionally, Ark. Code Ann. § 26-51-805(f) further clarifies that "In computing Arkansas consolidated taxable income or loss to which the tax rate is applied, the separate net income or loss of each corporation which is entitled to be included in the affiliated group shall be included in the consolidated net income or loss to the extent that its net income or loss is separately apportioned or allocated to the State of Arkansas" thereby respecting the separate and distinct operations of each individual corporation of the affiliated group. Therefore, for Arkansas corporate income tax purposes, the appropriate scope of analysis is not [redacted] in its entirety, as reflected in the annual reports and web site referenced by the DFA AIRS, but [redacted] the corporation that recognized the capital gain from the Transaction.

. . .

a. Management of the [redacted]

The Department also argues that the sale of the [redacted] meets the functional test and therefore the income from the Transaction is business income apportionable to Arkansas. In its analysis, the Department relies heavily on a case from the California Supreme Court: *Hoechst Celanese Corp. v. Franchise Slate Board*, 22 P.3d 324 (Cal. 2001). This case is an illustration of how a California court chose to approach the issue of business versus non-business income. This case is not binding precedent in Arkansas, business versus non-business income cases are highly fact specific, and the facts that the California court wrestled with in *Hoechst* are distinguishable from the facts of the Taxpayer.

The *Hoechst* court emphasized the second prong of the functional test in distinguishing between business and non-business income: management. In *Hoechst*, the management of the corporation created the pension plan and trust in order to retain and attract employees, exercised control over the plan, and funded it with its business income. As stated in the Protest, the [redacted] was vertically integrated from [redacted] to [redacted] to processing, however it was not integrated with other business units of [redacted]. Moreover, [redacted] management and employees ran the business autonomously including control of all day-to-day operations. The decentralized operations of [redacted] business units at the time of the Transaction is evidenced by the company-wide multi-year effort to "[redacted] as quoted by the DFA AIRS

from the Earnings Report.

In *Hoechst*, the focus was on an employment plan that provided benefits to *multiple* divisions. In contrast, liquidated a single stand-alone line of business that did not directly support other business units within or as a whole.

b. Disposition of the and related intangibles

The capital gain recognized by as a result of the Transaction was deemed to be related to intangible assets. First, the purchase price was allocated to the real and tangible assets, inventory, accounts receivable, and prepaid expenses accounting for of the proceeds. These assets accounted for of the reported ordinary gain from the sale. The remaining of proceeds were allocated to intangibles resulting in gain equivalent to the proceeds as did not have basis in these assets. As indicated by the balance sheet, there was an increase in the net amortizable intangible assets reported at beginning of year) to the end of year). *See* Exhibit 2. Per the trial balance detail of these intangible assets, the relevant account balances either remained constant or increased throughout the year of the Transaction. *See* Exhibit 4. Accordingly, it is reasonable to assume that none of intangible assets relate to the of intangible assets sold as part of the . Additionally, the balance sheet detail of the itself shows no intangible assets, further demonstrating the intangible assets on books did not relate to the . *See* Exhibit 5. As a result, the substantial capital gain related to intangibles associated with the Transaction was created at the time of the sale due to these intangible assets not being on the books of and having no book or tax basis.

In the DFA AIRS, the Department states that "amortization expense relating to the reduced prior year apportionable business income . . .." However, given that no intangible assets existed on the books of the prior to the sale, there was no amortization expense previously deducted that should have been a nonbusiness expense and allocated accordingly.

Therefore, pursuant to the information provided above, divestiture of the does not satisfy the functional test for purposes of determining income from the sale of the as business income apportionable to Arkansas. [P. 2-5].

The Taxpayer's Representatives contended that: (1) [redacted] is the entity being dealt with in this matter; (2) the Taxpayer filed a nexus combination return in Arkansas which is in essence [redacted] separate filings that are combined for administrative ease; (3) [redacted] entered into a transaction of selling its [redacted] [redacted] (which was very small and immaterial and ran separately from the rest of the [redacted] business); (4) the entirety of the [redacted] was sold and a liquidating distribution was issued to shareholders with the proceeds (rather than being reinvested); (5) the [redacted] was ceased; (6) the sale of the [redacted] [redacted] and the distribution of the proceeds were not in the regular course of [redacted] business; (7) the transactions involved in a [redacted] have nothing to do with [redacted]; (8) the capital gain component of the income from the sale of the [redacted] was properly treated on the Taxpayer's amended return as nonbusiness income; (9) caselaw from other states supports the Taxpayer's position in this matter; (10) even though a nexus consolidated was filed, it should not imply that there was a unitary relationship between the entities in the filing group (there are different entities in the federal filing group); (11) the [redacted] [redacted] not integral to [redacted] overall economic enterprise; (12) the [redacted] [redacted] accounted for less than [redacted] total sales (and had lower margins than [redacted] other business units); (13) the [redacted] was a separate and autonomous line of business both functionally and financially due to [redacted] [redacted]; (14) the [redacted] was ran independently as demonstrated by exhibits attached to the Taxpayer's Answers to Information Request relating to amortizable assets; (15) the gain recognized by the sale of the intangible assets of the [redacted] predominately consisted of the inherent

value of the market share held by in a saturated market where ; and (16) goodwill was the primary intangible asset and was only relevant after the purchaser of the made an offer (it was not in existence before).

ISSUE

Whether the Department's denial of the Taxpayer's refund claim should be sustained? Yes.

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).

A taxpayer bears the burden of proving by a preponderance of the evidence that the claimed refund was erroneously paid and in excess of the taxes lawfully due under Ark. Code Ann. § 26-18-507 (Repl. 2012).

Refund Claim

The State of Arkansas has adopted the Uniform Division of Income for Tax Purposes Act ("UDITPA"). See Ark. Code Ann. § 26-51-701 et seq. (Repl. 2012). In Pledger v. Getty Oil Exploration Co., 309 Ark. 257, 831 S.W.2d 121 (1992), the Court stated that:

> [UDITPA] governs the manner in which Arkansas may impose income and franchise taxes on the earnings of multistate and multinational corporations doing business in the State. UDITPA is designed to fairly apportion among the states in which a corporation does business the fair amount of regular business income earned by the corporation's activities in each state. Under UDITPA, net taxable business income of a corporate taxpayer involved in a multistate business is apportioned by a well-recognized three-factor formula consisting of tangible property, payroll, and sales.

Id. at 261 - 262, 831 S.W.2d at 124.

"Business income" is defined as "income arising from transactions and activity in the regular course of the 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 regular trade or business operations". Ark. Code Ann. § 26-51-701(a) (Repl. 2012). "Nonbusiness income" is defined as "all income other than business income". Ark. Code Ann. § 26-51-701(e) (Repl. 2012).

In Pledger v. Getty Oil Exploration Co., supra, the Arkansas Supreme Court stated that, "business income arises from either of two sources: (1) transactions and activity in the regular course of the taxpayer's business, referred to as the transactional test, or (2) income from the acquisition, management, and disposition of property that constitutes integral parts of the taxpayer's regular business, referred to as the functional test." Id. at 262, 831 S.W.2d at 124 - 125.

The facts in this case preponderate in favor of a finding that the functional test is satisfied.[6] In Union Carbide Corporation v. Huddleston, 854 S.W.2d 87 (Tenn. 1993), the Tennessee Supreme Court stated, in part:

> Other jurisdictions … have applied what is referred to as the 'functional test,' which focuses on the language stating that 'business earnings' include 'earnings from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.' . . . In contrast to the transactional test, **income from the sale of an asset will be considered business income under the functional test if the asset produced business income while it was owned by the taxpayer, regardless of the extraordinary nature or infrequency of the transaction disposing of the property and giving rise to the gain. Therefore, no significance is**

[6] Since satisfaction of either the transactional test or the functional test is determinative under Pledger v. Getty Oil Exploration Co., supra, it is not necessary to address the transactional test in this administrative decision.

> **attached to the fact that a transaction involves a liquidation.** [Emphasis added].

Arkansas Corporation Income Tax Regulation, 1998-1, §2.26-51-701 provides, in pertinent part, as follows:

> [g]ain or loss from the sale, exchange or other disposition of real property or of tangible or intangible personal property constitutes business income if the property, while owned by the taxpayer, was used in the taxpayer's trade or business. However, if the property was utilized for the production of nonbusiness income before its sale, exchange or other disposition, the gain or loss will constitute nonbusiness income.

The infrequency of the sale of an asset is not determinative with respect to satisfaction of the functional test. Additionally, the satisfaction of the functional test hinges upon the extent of a taxpayer's utilization of the property that was sold. In other words, if the property that was sold had an operation function while in the hands of a taxpayer, the sale of the property would satisfy the functional test and a capital gain would be apportionable as business income.

A case previously found to be persuasive authority by the Commissioner of Revenues regarding the functional test is Jim Beam Brands Co., v. Franchise Tax Board, 133 Cal.App.4th 514, 34 Cal.Rptr.3d 874 (2005). In that case, Jim Beam sold all of the stock in Taylor Foods, recognized a gain on the sale of that stock and attempted to report the income as nonbusiness income. Jim Beam argued that the sale of Taylor Foods did not fall within the definition of "business income." In determining the character of the income, the court, citing the California Supreme Court case of Hoechst Celanese Corp. v. Franchise Tax Bd., 25 Cal.4th 508 (2001), explained that a determination of whether the acquisition, management, and disposition of Taylor Food was integral to Jim Beam's regular

trade or business operations required essentially a two-part inquiry. First, the phrase "acquisition, management, and disposition" directs one to examine “the taxpayer's interest in and power over the income-producing property.” (Id. at 524, citing Hoechst Celanese at p. 528.). Second, if it is determined that the taxpayer had sufficient interest in the income-producing property for the purposes of the statute, the statute next directs a review as to whether "the taxpayer's control and use of the property [are] an integral part of the taxpayer's regular trade or business operations." (Id. at 524 citing Hoechst Celanese at p. 529.). Under the first inquiry, the Jim Beam court found that the fact that Jim Beam had acquired, managed, and disposed of the stock of Taylor Food demonstrated that it had an interest in and power over the income-producing property. Under the second inquiry, the court found that, prior to the sale of Taylor Food, Taylor Food’s business operations were an integral part of Jim Beam’s regular trade or business operations. Therefore, the court found that the income derived from the sale was business income under the functional test.

The facts in this case establish that: (1) the [redacted] was an operating division of the Taxpayer (by and through the wholly-owned subsidiary of [redacted]); (2) the Taxpayer had sufficient interest and management control over the [redacted], by and through the wholly-owned subsidiary of [redacted], to enable the sale of the [redacted]; (3) the [redacted] was an integral part of the Taxpayer’s business enterprise by and through the operations of [redacted]; and (4) the [redacted] had produced income for the Taxpayer, by and through the wholly-owned subsidiary of [redacted], since the [redacted]. Because the intangible goodwill and other intangible assets sold in this case constitute an integral part of

the Taxpayer's regular trade or business operations and served an operational rather than an investment function, the capital gain income attributable to the goodwill and other intangible assets satisfy the functional test.[7]

In the instant case, there was no dispute that Arkansas had sufficient nexus to tax the sale of the [redacted]. The Taxpayer classified the capital gain related to the sale of the tangible assets of the [redacted] as income apportionable to Arkansas. The Taxpayer has cited to no persuasive authority to support the position that it is proper to divide the income from the sale of a single business segment into separate components resulting in favorable "nonbusiness" income status for a part of the single transaction. See Arkansas Corporation Income Tax Regulation, 1998-1, § 2.26-51-701. Consequently, since the functional test is satisfied, the Department correctly denied the Taxpayer's refund claim.

DECISION AND ORDER

The refund claim denial is 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.

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[7] The parties submitted post-hearing briefs which addressed the issue of whether the holding in Pledger v. Getty Oil Exploration Co., 309 Ark. 257, 831 S.W.2d 121 (1992), precluded satisfaction of the functional test and it does not. Unlike the instant case, in Getty Oil "the acquisition, management, and disposition of [the asset(s) involved] was not an integral part of the taxpayer's regular trade or business." Id. at 263, 831 S.W.2d at 125.

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.[8]

OFFICE OF HEARINGS & APPEALS

RAY HOWARD
ADMINISTRATIVE LAW JUDGE

DATED: March 20, 2019

[8] See Board of Trustees of Univ. of Arkansas v. Andrews, 2018 Ark. 12.