

corporations. However, Arkansas does adopt federal subchapter S rules per ACA § 26-51-409.

Pursuant to ACA § 26-51-428, ██████ believes it does not need to recognize a dividend from corporate earnings and profits on the Arkansas return and, as such, is requesting a Legal Opinion as to whether or not the Arkansas Department of Finance and Administration (“Department”) would be inclined to agree with ██████ conclusion, under ██████ set of facts below.

Without respect to the large asset addition, ██████ estimates December 31, 2019, federal fixed asset costs of \$333,244,690 and accumulated depreciation of \$292,047,948. ██████ large purchase totals \$8,282,574 and is 100% eligible for bonus depreciation. The total depreciable basis at the federal level nets to \$41,196,742 ($\$333,244,690 + \$8,282,574 - \$292,047,948 - \$8,282,574$). The estimated December 31, 2019, Arkansas fixed asset cost, without regard to the large asset addition, is \$336,980,232 and accumulated depreciation is \$286,829,116. The addition has a cost of \$8,282,574 and current year depreciation of \$1,656,515 at the Arkansas level. Arkansas has a total depreciable basis of \$56,777,175 ($\$336,980,232 + \$8,282,574 - \$286,829,116 - \$1,656,515$). The total federal to Arkansas depreciable basis difference is \$15,580,433 (AR \$56,777,175 - federal \$41,196,742).

██████ 2018 federal ending AAA is \$4,807,626. The estimated taxable income, which includes bonus depreciation, and distributions made during the 2019 tax year would cause AAA to lower to zero with \$4,120,896 of distributions to be classified as a dividend paid from corporate earnings and profits on the federal return.

██████ federal to Arkansas depreciable basis difference of \$15,580,433 results in an estimated Arkansas AAA balance at December 31, 2019, of \$11,459,537 (derived by adding \$15,580,433 to a negative federal AAA balance of \$4,120,896). Because Arkansas’ AAA balance remains positive, none of the distribution is reported as a dividend from corporate earnings and profit.

For the reasons stated above, ██████ believes the federal dividend from corporate earnings and profits is not required to be reported on the Arkansas return. The dividend from corporate earnings and profits on a federal basis would not be taxable on an Arkansas basis at the shareholder individual tax income level. The result will be an Arkansas individual income tax return in which the federal column will show sizeable dividend income, but the state column will show \$0 in dividend income.

On January 7, 2020, ██████ sent the letter attached requesting an Arkansas Legal Opinion on the treatment of distributions on an Arkansas basis. On April 28, 2020, ██████ received a response, also attached, from the Arkansas Department of Finance and Administration's Revenue Legal Counsel. The stated opinion from Arkansas agreed with the position presented within the letter ██████ provided the State of Arkansas dated January 7, 2020.

█████ requests Arkansas Legal Counsel to issue a binding opinion to ██████ and its shareholders with regards to the treatment of ██████ 2019 distributions. The anticipated conclusion is none of the distributions are taxable on an Arkansas income tax basis as ██████ has substantial Arkansas AAA providing for tax free treatment of 2019 distributions. The ██████ EIN is detailed within the body of the opening paragraph to this letter. Each ██████ shareholder is listed within the attached Statement A providing each shareholder's social security number.

This request is nearly identical to your previous request for an opinion. The main difference between the two requests is that the supplemental request identifies your clients (the “Requestors”) in the hopes of receiving a binding opinion issued to each of them.

RESPONSE

Revenue Legal Counsel (“RLC”) cannot provide an answer to your supplemental request because doing so would require it to conduct an audit of your clients and this is not the proper function of a legal opinion.

The taxability of the distributions about which you have inquired is dependent on the balance of the corporation’s AA Account. To determine the AA Account balance, RLC would have to review the corporation’s income tax returns and documentation supporting those returns. The result would essentially be RLC conducting an income tax audit of the Requestors.

That responsibility is delegated to the Office of Income Tax. RLC derives its authority to issue binding opinions from Gross Receipts Tax Rule GR-75:

The propriety of the taxation or exemption of a sale may be substantiated by having a legal opinion rendered by the Department, which states that the sale or transaction is taxable or exempt. A legal opinion may only be relied upon by a seller if it is addressed to him or is tendered by a customer to whom it is addressed and only to the extent that all material facts relative to the sale or transaction in question are contemplated by the legal opinion request and the legal opinion. Requests for legal opinions must specifically describe the person claiming an exemption and set forth all material facts relevant to the questioned sale or transaction.

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As an additional service, RLC has issued income tax opinions to other requestors in the past. For example, I was able to answer your previous opinion request that dealt with legal concepts related to income tax but did not require me to make specific calculations or review the Requestor’s income tax returns. What our past opinions have not done is approve of specific calculations of income tax owed or engage in an audit type function. Doing so would impermissibly blur the line between legal opinion and audit, circumventing the procedures of the Tax Procedure Act.

Therefore, your supplemental request can only be answered to the extent it seeks our interpretation of the law at issue generally. I cannot opine on the treatment of specific distributions made to specific Requestors. As discussed in the response to your original opinion request, distributions that do not exceed an S corporations’ Arkansas AA Account are not included in gross income to

the extent they do not exceed the adjusted basis of the stock. Where the adjusted basis of the stock is exceeded, that portion exceeding the adjusted basis is treated as a gain from the sale or exchange of property. Therefore, an S corporation with a positive Arkansas AA Account balance need not report its distributions as dividends, so long as the distributions do not exceed the adjusted basis of the stock. The same rule applies regardless of whether the S corporation's federal return reflects the payment of dividends.

This opinion is based upon my understanding of the facts as set out in your inquiry and as current Arkansas laws and rules govern those facts. Any change in the facts or law could result in a different opinion. Only the requestor may rely on this opinion, and, pursuant to Arkansas Gross Receipts Tax Rule GR-75(B), this opinion will only be binding on the Department for three (3) years from the date of issuance.

A copy of the Arkansas Gross Receipts Tax Rules referenced in this letter is available online at http://www.dfa.arkansas.gov/offices/policyAndLegal/Documents/et2008_3.pdf.

Sincerely,

Keith K. Linder, Attorney
Revenue Legal Counsel