

Income/Franchise:

Arkansas Supreme Court Affirms that Taxpayer's Spin-Off Interest Expenses are 100% Allocable to In-State Domicile

Docket No. CV-24-8, Ark. (12/12/24). In a case involving a company in the business of selling retail motor-fuel products through its retail-fueling stations and the categorization of certain interest expenses related to a corporate spin-off, the Arkansas Supreme Court (Court) affirmed a circuit court's summary judgment for the taxpayer that it could amend its Arkansas corporate income tax returns for the years at issue and allocate 100% of such interest expenses to Arkansas (its state of domicile), rather than apportion them among all the states where it conducts business. The Arkansas Department of Finance and Administration (Department) unsuccessfully argued that the Court should reverse the lower court's decision on the basis of three alternative theories:

URL: <https://opinions.arcourts.gov/ark/supremecourt/en/item/523215/index.do>

1. The company's interest expenses constituted "business-income expenses" and thus were properly apportioned on the original tax returns under a functional test;
2. If the expenses were 100% allocable to Arkansas, then a specific state statute makes them nondeductible; or
3. It is unfair to allow the company this "tax-refund windfall" in Arkansas when it has yet to conversely amend returns in other states.

Among its reasons in holding for the taxpayer, the Court explained that the company's separation from its corporate parent in the spin-off at issue constituted an extraordinary event under the Uniform Division of Income for Tax Purposes Act (UDITPA) rather than a regular business activity. In this respect, the Court concluded, the underlying interest expenses for the borrowed funds for the one-time event to effectuate the "unique spin-off" at issue (*i.e.*, loans were used to fund the spin-off and the taxpayer paid interest on the loans, which resulted in the interest expenses at issue) constituted allocable interest expenses under the "nonbusiness category of the UDITPA."

The Court also explained that it would *not* decline the taxpayer's underlying refund or "adjust the legal outcome" in this case merely "because of unfairness to other states" – noting that "it is for the legislature to legislate and decide policy matters." A dissenting opinion follows. Please contact us with any questions.

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