

**SMALL BUSINESS TAX ACCOUNTING
USE OF ACCRUAL BASIS and CASH BASIS ACCOUNTING METHODS**

CORPORATION INCOME TAX REGULATION 3.26-51-401(a)

Pursuant to the authority vested in the Director of the Arkansas Department of Finance & Administration and in compliance therewith, the Director and Commissioner hereby promulgate the following regulation for the proper administration of the Arkansas Income Tax Act of 1929.

1. EFFECTIVE DATE

This regulation shall be effective ten (10) days after it has been filed by the Department of Finance and Administration with the Arkansas Secretary of State.

2. PURPOSE

This regulation has been promulgated to implement and facilitate *Revenue Procedure #2001-76, 2001-52 I.R.B. 613* issued by the Internal Revenue Service on December 11, 2001. Under *Ark. Code Ann. §26-51-401*, Arkansas income tax returns must be prepared using the same accounting method as that used for federal income tax purposes. In order to remain consistent with federal rules on the use of accounting methods, the Director has determined that promulgation of this regulation is necessary.

3. DEFINITIONS

- a) "Qualifying Small Business Taxpayer" shall mean any taxpayer with "average annual gross receipts" of greater than \$1,000,000 but less than or equal to \$10,000,000 that is not prohibited from using the cash method of accounting under *IRC §448*. A taxpayer's average annual gross receipts of \$10,000,000 or less is determined by averaging the annual gross receipts for a three tax year period ending immediately prior to the tax year electing the cash method of accounting. Taxpayers are required to recalculate their average annual gross receipts each tax year. The election to change to the cash method of accounting may be made for tax years ending on or after December 31, 2001.

Example: The averaging is based upon the three years prior to the tax year electing the change. If electing for tax year 12/31/01, the averaging is based upon tax years 12/31/98, 12/31/99 and 12/31/00. If electing for tax year 12/31/02, the averaging is based upon tax years 12/31/99, 12/31/00 and 12/31/01. A "short" year will be considered a tax year in the averaging calculation.

- b) "Eligible Trade or Business" shall mean a trade or business in which the principal business activity is described in a North American Industry Classification System ("NAICS") code other than an ineligible NAICS code. Ineligible NAICS trades or businesses are as follows: 31 through 33 (manufacturing); 42 (wholesale trade); 44 and 45 (retail trade); 211 and 212 (mining activities); 5111 and 5122 (information industries).

A farming operation is also considered to be an ineligible trade or business. However, if a qualifying small business taxpayer is engaged in farming, the cash basis method may apply to the taxpayer's non-farming trades or businesses, if any.

4. CASH BASIS ACCOUNTING for SMALL BUSINESSES

- a) Qualifying small business taxpayers engaged in an eligible trade or business may use the cash receipts and disbursements method of accounting ("cash method") rather than the accrual method of accounting for tax years ending on or after December 31, 2001.
- b) *Revenue Procedure* #2001-76, 2001-52 I.R.B. 613 does not apply to farming operations. However, taxpayers engaged in the trade or business of farming may use the cash method of accounting unless the taxpayer is required to use the accrual method under *IRC* §447 or is prohibited from using the cash method under *IRC* §448.
- c) *Revenue Procedure* #2001-76, 2001-52 I.R.B. 613 does not apply to a taxpayer with average annual gross receipts of \$1,000,000 or less. However, such taxpayers may use the cash method of accounting if authorized to do so under *Revenue Procedure* #2001-10, 2001-2 I.R.B. 272.

5. METHOD of ACCOUNTING

The taxpayer's election of the cash method or accrual method of accounting for the Arkansas income tax return pursuant to this Regulation must be the same method of accounting and for the same tax year as that used for the taxpayer's federal income tax return.

6. QUESTIONS

Questions or requests for additional information on the use of accounting methods by Arkansas taxpayers should be directed to:

Department of Finance and Administration
Revenue Division
Corporation Income Tax Section
P.O. Box 919
Little Rock, AR 72203-0919
(501) 682-4775
FAX (501) 682-7114

Issued this 26th day of June, 2002 in Little Rock, Arkansas.

Richard Weiss, Director
Department of Finance and Administration

Tim Leathers, Deputy Director and
Commissioner of Revenue
Department of Finance and Administration