

SUMMARY OF PROPOSAL #27
for consideration by the
ARKANSAS TAX REFORM AND RELIEF LEGISLATIVE TASK FORCE

TOPIC: Repeal Income Tax Exemption on Church Passive Investment

Summary of Proposal for Consideration

To repeal the income tax exemption on church passive investment under Arkansas Code § 26-51-206(b), effective for tax years beginning January 1, 2019.

Fiscal Analysis

Repeal of the income tax exemption on church passive investment may result in an unknown per year increase to general revenue based on figures from FY16, as provided by the Department of Finance and Administration’s “Individual & Corporate Income Tax Revenue Impact of Exemptions” presentation to the Arkansas Tax Reform and Relief Legislative Task Force on April 26, 2018.

Legal Analysis

Background

Arkansas currently provides an income tax exemption for income received from the interest on the savings and investments of dedicated funds for a church, the sale of dedicated church property, and the rental of dedicated church property. Arkansas also does not impose income tax on rentals or gains of sales of dedicated property held only as a passive investment by a church.

ACT 1040 of 1987 created this tax income exemption and has not been amended since.

Potential Legal Issues

None.

Other States

- Iowa: Iowa does not have an exemption specific to the passive investment income of churches. Iowa provides an income tax exemption for all entities that are exempt under 26 U.S.C. § 501, which includes entities organized and operated exclusively for religious purposes, to the same extent those entities are exempt under federal law. Passive income that is related to a church’s religious purposes is generally exempt from federal income tax. An exempt entity does not have to file an Iowa corporation income tax return unless it has unrelated business income, which is taxable at the regular Iowa corporation income tax rates to the same extent it is taxable at the federal level. Income from interest, investments, and capital gains are generally considered to be exempt, but income from the rental of real property

is exempt unless the property was acquired through debt financing. (IA St. §§ 422.32 and 422.34)

- Louisiana: Louisiana does not have an exemption specific to the passive investment income of churches. Louisiana provides an income tax exemption for all entities that are exempt under 26 U.S.C. § 501, which includes entities organized and operated exclusively for religious purposes, to the same extent those entities are exempt under federal law. Passive income that is related to a church's religious purposes is generally exempt from federal income tax. An exempt entity does not have to file a Louisiana corporation income tax return unless it has unrelated business income, which is taxable at the regular Louisiana corporation income tax rates to the same extent it is taxable at the federal level. Income from interest, investments, and capital gains are generally considered to be exempt, but income from the rental of real property is exempt unless the property was acquired through debt financing. (LA St. § 47:287.501)
- Mississippi: Mississippi does not have an exemption specific to the passive investment income of churches. Mississippi's income tax rules state that, to the extent an entity is exempt by the IRS from paying federal income tax, the entity shall be determined to be exempt from filing a Mississippi income tax return. Federal law (26 U.S.C. § 501(c)(3)) provides an income tax exemption for churches. Passive income that is related to a church's religious purposes is generally exempt from federal income tax. An exempt entity does not have to file a Mississippi corporation income tax return unless it has unrelated business income, which is taxable at the regular Mississippi corporation income tax rates to the same extent it is taxable at the federal level. Income from interest, investments, and capital gains are generally considered to be exempt, but income from the rental of real property is exempt unless the property was acquired through debt financing. (Miss. Admin. Code 35-III-10.05 § 105)
- Missouri: Missouri does not have an exemption specific to the passive investment income of churches. Missouri has an income tax exemption for corporations that are exempt from income tax under federal law, except to the extent the corporation has unrelated business income. Federal law (26 U.S.C. § 501(c)(3)) provides an income tax exemption for churches. Passive income that is related to a church's religious purposes is generally exempt from federal income tax. An exempt entity does not have to file a Missouri corporation income tax return unless it has unrelated business income, which is taxable at the regular Missouri corporation income tax rates to the same extent it is taxable at the federal level. Income from interest, investments, and capital gains are generally considered to be exempt, but income from the rental of real property is exempt unless the property was acquired through debt financing. (Mo. St. § 143.441)
- Oklahoma: Oklahoma does not have an exemption specific to the passive investment income of churches. Oklahoma has an income tax exemption for corporations that are exempt from income tax under federal law, subject to any

limitations or qualifications under federal law. Federal law (26 U.S.C. § 501(c)(3)) provides an income tax exemption for churches. Passive income that is related to a church's religious purposes is generally exempt from federal income tax. An exempt entity does not have to file an Oklahoma corporation income tax return unless it has unrelated business income, which is taxable at the regular Oklahoma corporation income tax rates to the same extent it is taxable at the federal level. Income from interest, investments, and capital gains are generally considered to be exempt, but income from the rental of real property is exempt unless the property was acquired through debt financing. (68 Okla. St. Ann. § 2359)

- Tennessee: Tennessee does not have an exemption specific to the passive investment income of churches. Tennessee's income tax applies only to interest and dividends, but Tennessee provides an exemption for capital gains from the sale of real estate and the income from stocks and bonds of nonprofit religious institutions. (TN St. § 67-2-104; TN Dep't of Revenue Income Tax Guide)
- Texas: Texas does not have an exemption specific to the passive investment income of churches. A nonprofit corporation organized for the purpose of religious worship is exempt from the franchise tax, as are corporations exempt from federal income tax under 26 U.S.C. § 501, which includes churches. There do not appear to be any limitations on this exemption. (TX Tax Code §§ 171.058 and 171.063)