Gains on Sales of Franchises Held Nonbusiness Income in Arkansas

Article By:

Craig B. Fields

Consistent with the decisions in several other states interpreting the Uniform Division of Income for Tax Purposes Act's ("UDIPTA") definition of nonbusiness income, an Arkansas Circuit Court concluded that gains from the sales of franchises constituted nonbusiness income since the company was not in the business of disposing of franchises. *United States Beef Corp. v. Walther*, Case No. 60 CV-22-2158 (Ark. Cir. Ct. Pulaski Cty. Mar. 10, 2025).[1]

The Facts: United States Beef Corporation ("US Beef"), an Oklahoma corporation, owned and operated fast food franchises in nine states, including Arkansas, for approximately 45 years. In 2018, it sold its franchises to two separate purchasers and liquidated its business. Prior to these sales, the company had not contemplated the sale of the franchises nor had it sold any other franchises.

The company filed refund claims in Arkansas on the basis that the gains constituted nonbusiness income, which the Department of Finance and Administration ("Department") denied. The Department's Office of Hearings & Appeals affirmed the denial, and the company appealed to the Circuit Court.

The Statute: Arkansas continues to use the original UDIPTA definitions of business income and nonbusiness income. As a result, 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. Nonbusiness income is all income that is not business income.

The Decision: Arkansas courts apply both the transactional test and the functional test to determine if income constitutes apportionable business income. The parties agreed the sales of the franchises were outside the regular course of US Beef's business and, therefore, the transactional test was not satisfied.

The Court then had little difficulty in determining that the gains did not satisfy the functional test since, while US Beef may have been in the business of acquiring and operating franchises, it was not in the business of disposing of franchises.

Many states have amended their statutes to define business income as income from “the acquisition, management, *or* disposition of the property” or “the acquisition, management, *and/or* disposition of the property.” Other states have amended the definition of business income to define it as any income apportionable under the U.S. Constitution. This case demonstrates that in states that continue to use the original UDIPTA definition, the acquisition, management, *and* disposition of the property must all constitute integral parts of the taxpayer’s regular business operations for the gain from the sale of a business to be considered business income. Inasmuch as companies are not in the business of going out of business, gains from the sale of entire businesses (or even divisions) will often constitute nonbusiness income under such definition.

[1] While this article was pending publication, the Department of Finance and Administration initiated an appeal of the Circuit Court’s decision to the Arkansas Supreme Court. Watch for future updates as this matter continues.

National Law Review, Volume XV, Number 107