

Department of Finance and Administration

Legislative Impact Statement

Bill: HB1535

Bill Subtitle: TO AMEND THE DISTRIBUTION AND USE OF SALES AND USE TAX REVENUES.

Basic Change :

Sponsor: Representative K. Hendren

HB1535 would amend Arkansas sales tax and income tax code provisions to reduce sales and income tax rates based on the amount of sales and use tax collections received from out-of-state sellers that have no physical presence in Arkansas. The Act would become effective on October 1, 2017.

The bill provides that the Department of Finance and Administration (DFA) would determine the amount of net general revenues attributable to the collection of sales and use taxes from sellers having no physical presence in Arkansas during the first twelve (12) months of tax collections occurring after the effective date of the act. The net general revenues from these collections over the twelve-month period would be used to calculate a future reduction in the state sales and use tax rate. The reduced tax rate would be calculated to result in future tax collections being reduced by an amount equal to the first 12-months net general revenue tax collections received from the voluntary sellers. The reduced sales and use tax rate would be effective on the first day of the calendar quarter following the issuance of a written notice to all registered sales and use tax account holders.

The bill also amends existing code provisions regarding the distribution of sales and use tax revenues that would be received from sellers having no physical presence in Arkansas that register to collect the tax as a result of a federal law being adopted requiring their collection of state and local sales taxes. Of the general revenues collected as the result of the federal law, the first eighty-five million dollars (\$85,000,000) would be deposited as state general revenues. The remainder of the general revenues received during the first twelve (12) months of tax collections would be used to reduce state sales and use tax rates. Beginning the thirteenth month after the federal law has authorized the tax collections, the remainder of the tax revenue would be used to reduce sales and use tax rates and income tax rates for all taxpayers subject to the 4.5% tax rate.

Revenue Impact :

Sales and use tax general revenues collected from out-of-state sellers having no physical presence in Arkansas during the 12-month period of October 2017 through September 2018 would be used to calculate a state sales and use tax rate reduction that would be effective on the first day of the calendar quarter after the determination and certification of the general revenue amount.

After federal law is adopted that requires out-of-state sellers having no physical presence to collect state and local sales taxes, the first \$85,000,000 of Arkansas collections would be deposited as state general revenues with the remainder used to reduce the state sales and use tax rate and the 4.5% income tax rate. The amount of sales and use tax revenue that would be received as the result of the enactment of federal law is unknown.

Taxpayer Impact :

If the triggers are met, rates for sales and use tax along with individual income tax could see rate reductions.

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Resources Required :

Adequate resources for computer systems modifications are available. Forms, tax tables and instructions along with processing systems would need to be revised.

Time Required :

Adequate time is provided to modify DFA's tax registration system and to begin requiring out-of-state sellers to indicate why they are registering to collect Arkansas taxes.

Procedural Changes :

Modification of DFA's tax registration system will be required to provide for an out-of-state seller who registers to collect Arkansas sales and use taxes to indicate if they are registering as the result of having nexus with Arkansas and are required to collect the Arkansas taxes or are registering to collect tax on a volunteer basis having no physical presence in the state.

Other Comments :

As of February 17, 2017, DFA has 74,831 registered businesses that collect and remit Arkansas state and local sales and use taxes. Of the total registrants, 16,441 are out-of-state sellers collecting and reporting sales and use taxes in the same manner as the 58,390 registered in-state sellers. DFA has no knowledge as to the total number of the out-of-state sellers that have or do not have physical presence in Arkansas. Information of that type is not provided by sellers registering to collect Arkansas sales and use taxes. Even if sellers would have been required in the past to indicate if they had physical presence at the time of registration, a business may create nexus after the initial registration in multiple ways. Physical presence is established by an out-of-state vendor not only by acquiring property located in the state but also when making sales to Arkansas purchasers by soliciting sales through salespersons, solicitors, representatives or consignees who are soliciting sales while in Arkansas.

Since October 2005, when Arkansas became a member of the Streamlined Sales Tax Governing Board, 3,254 out-of-state sellers have registered to collect Arkansas state and local sales taxes when making sales to Arkansas consumers through the terms and requirements of the Agreement. At the time of their registration, most of the sellers were volunteering to begin collecting Arkansas taxes. Since their registration, Arkansas does not have data for the Streamlined registrants as to their possible nexus creating activities since their initial registration. If nexus has been created, they would no longer be volunteers but DFA does not have that knowledge.

The bill does not define which sellers with no physical presence are to be included in the determination of tax collections for the 12-month (October 2017 through September 2018) period. If the bill is referencing volunteer sellers who register during the period and the taxes they report during the 12-month period, DFA would modify the tax registration system to require out-of-state sellers to indicate their reason for registering and change our accounting procedures to separately maintain a record of their tax reported. If the intent of the bill is to determine the amount of tax revenue that is being reported by registrants regardless of their past date of registration, each currently registered out-of-state seller would have to provide their status as to a physical presence in Arkansas in order for DFA to determine the tax collection amounts that would occur during the 12-month period. It is

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unknown if out-of-state registrants would respond to a survey requesting their status for physical presence and if a response was provided to a survey, the accuracy of the information supplied would be unknown. DFA's computer system would have to be modified prior to the receipt of any survey response in order to have the ability to place an indicator on each taxpayer's account registration indicating their status. Sufficient time for data input after modifications to DFA's computer system of the thousands of survey responses would also be unknown.

Legal Analysis :

HB1535 proposes to allocate any collections received from sales and use tax from sellers that do not have a physical presence in the state to, in part, reduce the sales and use tax rate. The state currently has those types of collections from sellers who have voluntarily chosen to collect sales and use tax from Arkansas purchasers. The bill proposes a rate reduction after twelve (12) months of collections. It is unclear whether this refers to current collections or is intended to take effect at some future time because it is not dependent on federal law.

The mechanism proposed by the bill for such a reduction may constitute an unlawful delegation of legislative authority in violation of Ark. Constitution, Article 4, Section 2. *See also Ball v. Roberts*, 291 Ark. 84, 722 S.W.2d 829 (1987). The bill would give the authority to determine the amount of the reduction in the sales and use tax rate to the Director of DFA. While the bill permissibly delegates the authority to determine the amount of sales and use tax collected, it also directs the Director to determine how much the sales and use tax rate should be reduced. Sales and use tax rates are set by statute. The Director is authorized to carry out the specific will of the Arkansas General Assembly without using his discretion. In order to conform to the Arkansas constitution and case law related to the separation of powers, the bill should provide a specific amount of a rate reduction, akin to the specific income tax rates.

The bill creates a different allocation when federal law authorizes the state to collect sales and use tax from sellers that do not have a physical presence in the state, but this portion of the bill has the same unlawful delegation issue. This section proposes to allocate fifty percent (50%) of those collections to reduce the sales and use tax rate and fifty percent (50%) to provide for the current income tax rate reduction for taxpayers who pay at the four and five-tenths percent (4.5%) rate.

The bill is unclear whether if federal law goes into effect if the reductions based on current collections would change, if not, or if the two structures are to exist simultaneously.