

Department of Finance and Administration

Legislative Impact Statement

Bill: HB1795

Amendment Number: H1

Bill Subtitle: TO EXEMPT CERTAIN DONATED ITEMS FROM SALES AND USE TAXES.

Basic Change :

Sponsor: Representative Gates

Engrossment 03/03/17 --- House Amendment 1 --- The amendment adds Representatives Ballinger, Cozart, K. Hendren, G. Hodges, Lemons, Lundstrum, A. Mayberry, Pilkington, Richmond, B. Smith, Speaks, Sullivan, Tosh, Womack and Senator A. Clark as cosponsors of the bill. The amendment also corrects the language to reference that the items subject to the provisions of the bill are those originally purchased for resale.

Original Bill --- The bill would amend § 26-52-401 concerning exemption from sales and use taxes to provide an exemption for items originally sold for resale that are later donated to be classified as having been sold for purposes of resale. The bill provides that the sales price for the donated item is the amount received in exchange for the donated item. The exemption would be effective the first day of the calendar quarter following the effective date of the Act.

Under current law, items purchased for resale by manufacturers, wholesalers and retailers are purchased without payment of sales tax with the sales tax to be collected and remitted when the merchandise is sold to the ultimate consumer. If the manufacturer, wholesaler or retailer elects to withdrawn or remove from their inventory items purchased tax free for resale, the sales tax is due in the same amount as would have been paid if the item had not been purchased for resale but purchased for some other use. The bill would end the collection of state and local sales tax on these currently taxed withdrawals from stock.

Revenue Impact :

Fiscal Year 2018

Total Approximate State Sales Tax Loss \$ - 1.061 million

(Estimated Effective Date 10/1/17 --- 8 months reduced tax collection)

General Revenue - 4.5%	\$ - .711 million
Property Tax Relief - .5%	\$ - .079 million
Conservation Fund - .125%	\$ - .020 million
Educational Adequacy Fund - .875%	\$ - .138 million
Highway Fund - .5%	\$ - .079 million
Educational Excellence Trust Fund	\$ - .000
Educational Adequacy (GR Transfer)	\$ - .000
State Central Services	\$ - .023 million
Constitutional Officers	\$ - .011 million

Total Approximate Local City and County Sales Tax Loss \$ - 227,000

Fiscal Year 2019

Total Approximate State Sales Tax Loss \$ - 1.592 million

General Revenue - 4.5%	\$ - .957 million
Property Tax Relief - .5%	\$ - .119 million
Conservation Fund - .125%	\$ - .030 million

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Educational Adequacy Fund - .875%	\$ - .207 million
Highway Fund - .5%	\$ - .119 million
Educational Excellence Trust Fund	\$ - .101 million
Educational Adequacy (GR Transfer)	\$ - .009 million
State Central Services	\$ - .035 million
Constitutional Officers	\$ - .016 million
Total Approximate Local City and County Sales Tax Loss	\$ - 340,000

Taxpayer Impact :

Taxpayer who are currently required to report the sales tax on items withdrawn from stock would no longer be responsible to report these transactions.

Resources Required :

None.

Time Required :

Adequate time is provided for implementation.

Procedural Changes :

Modification to the states sales and use tax rules along with educating staff and the tax community would be necessary.

Other Comments :

The bill provides for an exemption from sales tax for items withdrawn from inventory and donated for another use. The bill does not provide to whom or for what purpose the merchandise is to be donated. As drafted, the bill would allow a business owner to withdraw from inventory and donate merchandise to themselves for the owner's personal use without payment of tax.

The bill does not provide guidance as to the merchandise that was purchased for resale, and included within the business's cost-of-goods-sold and deducted from gross sales when calculating income subject to taxation, is to be adjusted for the purchases of merchandise that were not, after donation, part of the business's cost-of-goods-sold. To clarify the responsibility of the business owner, guidance for the accounting adjustment could be included within the bill.

Legal Analysis :

Amendment H1 to HB1795, engrossed 3/3/17, adds a number of co-sponsors to the bill. In addition, the bill as originally filed provided that items originally sold for resale and later donated are classified as having been sold for purposes of resale. Amendment H1 amends the bill to provide that items originally purchased for resale but later donated are classified as having been sold for purposes of resale.

Under current law, sales of tangible personal property and services can be sold exempt from sales and

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use tax if the property or services were purchased for resale by persons holding sales tax permits who: (1) regularly engage in the business of reselling the property or services; or (2) purchase the property or services for use in manufacturing (but only if the purchased property or services become a recognizable and integral part of the manufactured product). See § 26-52-401(12) and Arkansas Gross Receipts Tax Rule GR-53. HB1795 would amend state law to provide that "items" originally purchased for resale, but later donated, are considered as having been sold for resale for purposes of the "sale for resale" exemption. The bill further provides that the sales price for a donated item is "the amount received in exchange for the item that was donated." There are a number of concerns with the bill as originally drafted and as amended.

First, the bill provides that "items originally purchased for resale" and later donated are "classified as having been sold for purposes of resale". The term "item" is not defined in the bill or in state tax law, and use of the term "item" is inconsistent with the "sale for resale" exemption as it is currently codified (which is an exemption for sales of tangible personal property and services that are later resold). For clarity, it is recommended that the bill be amended to replace the term "item" with "tangible personal property or services".

Second, the provisions of § 26-52-401(12) provide that the "sale for resale" exemption is only available if the sale is made to persons who hold an Arkansas sales tax permit. As the bill is currently written, an item that is purchased for resale but later donated can only be classified as having been sold for purposes of resale if the person to whom the item is donated holds a sales tax permit. All other sales would be considered a taxable withdrawal from stock by the person who originally purchased the item exempt from tax. Further, if a donated item is considered a sale for purposes of the resale exemption, this would make the person to whom the item was donated then responsible for sales tax on the donated item.

Third, as written, the bill does not specifically require that the purchase of the later donated items must qualify for the exemptions found in § 26-52-401(12). Thus, as written, the bill could be interpreted to mean the purchase of property or services that would not ordinarily be exempt as sales for resale could qualify for an exemption, so long as the property or services are later donated. For clarity, it is recommended that the bill be amended to make it clear that the person or entity purchasing the item must be engaged in the business of reselling such items as required in § 26-52-401(12)(A), or that the property or services being purchased must originally have been purchased for use in manufacturing as required in § 27-52-401(12)(B).

Fourth, Arkansas is a member state under the Streamlined Sales and Use Tax Agreement. Section 316 of the Agreement sets forth certain requirements in relation to a member state's ability to enact product-based and use-based exemptions. As the bill does not clearly define what type of purchased "item" qualifies for the exemption, nor does it limit it to the exemptions already set forth in § 26-52-401(12), the exemption created by the bill could later result in a conflict with Section 316 of the Streamlined Sales and Use Tax Agreement. Such a conflict could result in possible sanctions by the Streamlined Governing Board, up to and including expulsion from the Agreement.

Fifth, the bill provides that the sales price for a donated item is the amount received in exchange for the item that was donated. It is not entirely clear what this language means; however, the intent of this language seems to be that any tax due from the sale of the item would be calculated based upon the benefit a person receives in return for the donation. Under §§ 26-52-103 and 26-53-102, the gross receipts or sales price upon which sales and use tax is calculated is defined as the total amount of

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consideration received, is not limited to cash or credit payments, and can include the value of property and services. Taxpayers often receive both tangible (money, merchandise, goods, admission to events, etc.) and intangible (publicity a/k/a free advertising) benefits in return for making donations, yet the bill provides no mechanism to value these benefits for purposes of determining the amount of tax due on the donation.

Sixth, the bill does not contain any record keeping requirements for purposes of verifying entitlement to the exemption for the person making the donation, or for purposes of determining the correct amount of tax due from the person who received the donation; nor does the bill create a mechanism by which a person who receives the donation would report and pay any tax due on the donation.

Lastly, the bill does not limit the exemption to items donated to charity. As written, a taxpayer could purchase an item for resale and later donate the item to anyone (including a family member), and obtain the benefit of the exemption. For clarity, the bill should be amended to clearly explain what types of donations would be eligible for the exemption.

The exemption created in HB1795 will become effective on the first day of the calendar quarter following the effective date of the act.