

Department of Finance and Administration

Legislative Impact Statement

Bill: SB334

Bill Subtitle: TO REDUCE THE SALES AND USE TAX RELATING TO THE PARTIAL REPLACEMENT AND REPAIR OF MACHINERY AND EQUIPMENT USED DIRECTLY IN MANUFACTURING; TO PROVIDE A REFUND MECHANISM FOR CERTAIN SALES AND USE TAXES; AND TO DECLARE AN EMERGENCY.

Basic Change :

Senator Files

Representative Wren

The proposal would add a new section to Arkansas sales and use tax code provisions to provide for a refund of a portion of the state sales and use tax on machinery and equipment purchased to modify, replace, or repair manufacturing machinery and equipment. Services relating to the initial installation, alteration, addition, cleaning, refinishing, replacement, or repair of manufacturing machinery or equipment would also be eligible for the refund.

When purchasing the repair and replacement parts and services, the manufacturer would pay the full 6.5% state sales and use tax to the seller and subsequently file a refund request to DFA for the portion of the tax subject to the refund as outlined in the proposal.

Manufacturers filing sales and use tax monthly returns could claim the refund on their monthly return and offset the refund amount against any sales or use tax due. A manufacturer not required to file a return would file a claim for refund directly with DFA.

The portion of the 6.5% state sales and use tax that is subject to the refund is as follows:

Effective July 1, 2013:	1% portion eligible for refund -- 5.5% net tax rate
Effective July 1, 2014:	2% portion eligible for refund -- 4.5% net tax rate
Effective July 1, 2015	3% portion eligible for refund -- 3.5% net tax rate
Effective July 1, 2016	4% portion eligible for refund -- 2.5% net tax rate
Effective July 1, 2017:	5% portion eligible for refund -- 1.5% net tax rate
Effective July 1, 2018:	5.875% portion eligible for refund -- .625% net tax rate

The Constitutional levies of .125% for Conservation and .5% for Highways are not eligible for refund.

The bill also provides that sellers that fail to collect or remit the sales tax of repair and replacement parts are to be assessed upon audit only the amount of the sales tax that is not subject to subsequent refund.

The proposal contains an emergency clause for an effective date of the date of approval by the Governor.

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Revenue Impact :

FY14 Tax Decrease

Total Impact to State Revenues - \$6.54 million
-\$ 4.84 million --- State General Revenue (4.5%)
-\$.94 million --- Educational Adequacy (.875% tax)
-\$.54 million --- Property Tax Relief Trust Fund (.5%)
-\$ 0 million --- Conservation Tax (.125%)
-\$ 0 million --- Highway Fund (.5%)
-\$ 0 million --- Educational Excellence Trust Fund
-\$ 0 million --- Educational Adequacy (GR transfer)
-\$.15 million --- State Central Services
-\$.07 million --- Constitutional Officers

FY15 Tax Decrease

Total Impact to State Revenues - \$13.85 million
-\$ 9.52 million --- State General Revenue (4.5%)
-\$ 2.00 million --- Educational Adequacy (.875% tax)
-\$ 1.14 million --- Property Tax Relief Trust Fund (.5%)
-\$ 0 million --- Conservation Tax (.125%)
-\$ 0 million --- Highway Fund (.5%)
-\$.68 million --- Educational Excellence Trust Fund
-\$.06 million --- Educational Adequacy (GR transfer)
-\$.32 million --- State Central Services
-\$.14 million --- Constitutional Officers

FY16 Tax Decrease

Total Impact to State Revenues - \$21.87 million
-\$14.62 million --- State General Revenue (4.5%)
-\$ 3.15 million --- Educational Adequacy (.875% tax)
-\$ 1.80 million --- Property Tax Relief Trust Fund (.5%)
-\$ 0 million --- Conservation Tax (.125%)
-\$ 0 million --- Highway Fund (.5%)
-\$ 1.45 million --- Educational Excellence Trust Fund
-\$.13 million --- Educational Adequacy (GR transfer)
-\$.50 million --- State Central Services
-\$.22 million --- Constitutional Officers

FY17 Tax Decrease

Total Impact to State Revenues - \$30.27 million
-\$19.93 million --- State General Revenue (4.5%)
-\$ 4.36 million --- Educational Adequacy (.875% tax)
-\$ 2.49 million --- Property Tax Relief Trust Fund (.5%)
-\$ 0 million --- Conservation Tax (.125%)

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-\$ 0 million --- Highway Fund (.5%)
-\$ 2.29 million --- Educational Excellence Trust Fund
-\$.20 million --- Educational Adequacy (GR transfer)
-\$.70 million --- State Central Services
-\$.30 million --- Constitutional Officers

FY18 Tax Decrease

Total Impact to State Revenues - \$39.09 million

-\$25.51 million --- State General Revenue (4.5%)
-\$ 5.63 million --- Educational Adequacy (.875% tax)
-\$ 3.22 million --- Property Tax Relief Trust Fund (.5%)
-\$ 0 million --- Conservation Tax (.125%)
-\$ 0 million --- Highway Fund (.5%)
-\$ 3.17 million --- Educational Excellence Trust Fund
-\$.28 million --- Educational Adequacy (GR transfer)
-\$.90 million --- State Central Services
-\$.39 million --- Constitutional Officers

FY19 Tax Decrease

Total Impact to State Revenues - \$47.55 million

-\$30.76 million --- State General Revenue (4.5%)
-\$ 6.85 million --- Educational Adequacy (.875% tax)
-\$ 3.91 million --- Property Tax Relief Trust Fund (.5%)
-\$ 0 million --- Conservation Tax (.125%)
-\$ 0 million --- Highway Fund (.5%)
-\$ 4.09 million --- Educational Excellence Trust Fund
-\$.36 million --- Educational Adequacy (GR transfer)
-\$ 1.09 million --- State Central Services
-\$.48 million --- Constitutional Officers

Taxpayer Impact :

Purchasers of eligible repair and replacement parts and services would be required to submit claims for refund with supporting documentation to receive a refund of the tax previously paid to sellers or to claim eligible refunds on their monthly tax reports.

Resources Required :

Personnel will need to be hired to review and audit the refund claim forms, purchase invoices and other supporting documentation submitted by manufacturing companies that submit direct refund requests to DFA's Sales and Use Tax Section. Based on DFA experience with auditing documents for local tax rebates and rebates for the reduced tax rates on manufacturer's utilities, it is anticipated that 4 additional auditing positions will be required to audit and process the refund claims.

Time Required :

The proposal would have the first rate reduction beginning July 1, 2013. This does not allow adequate

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time to alter the DFA computer system to accept tax returns claiming refunds; redesign the monthly reporting forms which are sent to printing contractors in April; create new instructions, forms and procedures for filing direct refund claims with DFA; and draft emergency rules to implement the refund process. It is recommended the first rate reduction be effective January 1, 2014 to allow adequate time for implementation.

Procedural Changes :

Modifications to DFA's computer system to accept tax returns claiming refunds will be required in addition to a redesign the monthly sales tax reporting form, drafting new tax form instructions, and developing new forms, procedures and rules for filing direct refund claims to DFA. Staff personnel that would receive and audit refund claims will need to be educated in the provisions of the law.

Other Comments :

Section 1 -- Page 3 -- Line 21 -- The bill language references a taxpayer, seller, or vendor of property that is required to collect or remit taxes levied under §§ 26-52-401 and 26-52-402. These two statutes are sales tax exemption provisions. The correct references are §§ 26-52-301 and 26-52-302.

The proposal provides for the portion of the total state sales tax that is to be refunded. The bill does not contain any provision to provide from which funds the refund is to be paid. The current 6.5% sales tax levy (July 1, 2013) is deposited as: 4.5% to General Revenues; .5% to Property Tax Relief; .875% to Education Adequacy; .125% to Conservation; and .5% to Highways. The refunds to be granted will not impact the Conservation and Highways levies. The proposal requires amendment to state the portion of the refund that is to apply to General Revenues, Property Tax Relief and Education Adequacy. Other legislation has contained a formula with a percentage to be allocated to these taxes and it is recommended this formula be inserted into the bill.

Section 1 -- Page 3 -- Lines 20 through 24 -- The proposal contains language which provides that upon audit, a seller or vendor who has failed to collect and remit the state sales tax on sales that may be eligible for subsequent partial refund, to only be assessed by DFA on the calculated tax rate after giving consideration of the refund component that the purchaser may be eligible to claim. This provision would allow the seller to be assessed a reduced tax rate while subsequently billing the purchaser for the full sales tax rate. The purchaser could then request a refund of the portion eligible for refund resulting in a refund on tax monies that DFA did not receive thus enriching the seller for their failure to collect the proper tax. This provision should be removed from the bill. This type of situation should be handled by the seller and the purchaser in the same manner as other sales transactions eligible for the refund.

Legal Analysis :

This bill allows a refund of a portion of the state sales and use taxes that are paid on:

- The purchase of replacement and repair parts for machinery and equipment that is used directly in manufacturing by a manufacturer that manufactures articles of commerce; and

- Labor performed in connection with the replacement and repair parts, including initial

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installation, alteration, addition, cleaning, refinishing, replacement, or repair.

The refund is available only for tax paid at the 5.875% state tax rate and not the 0.125% constitutional levy or the .5% levy for highways. No local taxes are subject to refund.

The bill does not address whether interest is to be paid on a refund under this bill. Arguably, the refund under this section is an "overpayment" of tax that is subject to the payment of interest when refunded, because the tax is not exempted but is made subject to refund. The refund method is presumably a way to gradually reduce the tax rate in compliance with Streamline. Regardless, the bill could specifically provide that no interest will be paid on refunds, if that is the intent.

Page 3, line 22 and page 5, line 16, "founds" should be "found."