

Department of Finance and Administration

Legislative Impact Statement

Bill: HB1007

Bill Subtitle: TO OFFSET THE REVENUES GENERATED BY SALES TAX COLLECTED FROM OUT-OF-STATE SELLERS BY REDUCING THE INCOME TAX RATES APPLICABLE TO INDIVIDUALS, TRUSTS, AND ESTATES.

Basic Change : Sponsor: Rep. Linck

The bill reduces State income taxes for individuals, trusts and estates by reducing the income tax rates and offsetting the reduced income tax revenue with the increased state sales and use tax revenue that will be collected from remote sellers having no physical presence in Arkansas. Federal law authorizing the collection of the sales and use taxes from these sellers will be required prior to the income tax reductions as proposed in this bill becoming effective.

The process to implement the income tax rate reductions would begin after twelve (12) months of DFA collecting sales and use taxes from the remote sellers subject to the federal law. DFA would certify to the Governor and to the Office of Economic and Tax Policy the amount of the net general revenues attributable to taxes remitted by these remote sellers during their first 12 months of tax reporting. DFA would also determine the reduced state income tax rates to offset the amount certified.

The reduced rates would be incorporated into the income tax tables for the tax year following the first twelve months of sales and use collections by DFA from the remote sellers. Example: If remote collection authority were granted effective January 1, 2016. DFA begins collecting from the remote sellers in February, 2016 with the first twelve months of collecting ending with the collections received by DFA in January, 2017. The proposed income tax rate reductions would become effective January 1, 2018. The bill provides that the effective date of the act would be January 1, 2015.

Revenue Impact :

Income tax rate reductions will occur after increased sales taxes have been received from remote sellers having no physical presence in our state. Federal legislation must first be adopted to grant the sales tax collection authority.

Impact to state General Revenues as the result of increased sales tax collections being used to offset reduced income tax collections will result in a net negative impact. The general revenue loss from the income tax reduction would equal the general revenue collection gain from the new sales tax. The required deductions from sales tax general revenue for Educational Excellence and Educational Adequacy would automatically increase, leaving the remaining net available general revenues from the new sales tax insufficient to replace the income tax reductions. For example, a gain of \$50 million in sales tax general revenue collections plus a loss of \$50 million in income tax reductions would result in an approximate loss of \$7 million to general revenues as the result of the automatic deductions from the new sales tax general revenue for Educational Excellence and Adequacy.

Passage of federal law authorizing the collection of sales tax on out-of-state sellers may trigger an existing sales tax rate reduction on food and food ingredients that already exists in Arkansas law, Ark. Code Ann. §26-52-317(a)(1). It is possible that the income tax rate reductions as outlined in HB1007 and the sales tax rate reduction on food and food ingredients could both be triggered from the sales tax collections received the result of the new federal law. This would result in a net loss to state general revenues for the combined impact from both the food tax rate reduction and the income tax rate reduction.

Taxpayer Impact :

Arkansas individual income taxpayers will be subject to reduced tax rates.

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Resources Required :

None.

Time Required :

Adequate time is allowed for implementation.

Procedural Changes :

Revised employer's income tax withholding formulas and withholding tax tables will be required. Income tax tables used when filing Arkansas income tax returns will also be modified.

Other Comments :

As a member of the Streamlined Sales Tax Agreement, approximately 2,300 out-of-state sellers with no physical presence in Arkansas have voluntarily registered to collect Arkansas state and local sales taxes. The tax receipts from these sellers currently provide approximately \$10M annually in state sales and use tax revenue. The proposal does not provide guidance as to including the revenue from these sellers when deterring the amount of sales tax collections received when determining the income tax rate reductions.

Arkansas law provides for the state sales and use tax on food to be reduced to 0% once tax collections begin for remote sellers. Under this provision, after six months of new tax collections at 150% of the existing tax collections on food, the sales tax rate on food would be reduced to 0%. Even without the sales tax cut on food being triggered, the effect of the HB1007 would not be revenue neutral for General Revenues. The general revenue loss from the income tax cut would equal the general revenue *collection* gain from the new sales tax, but the required deductions from sales tax general revenue for Educational Excellence and Educational Adequacy would automatically increase, leaving total net available general revenues lower. For example, a gain of \$50M in sales tax general revenue collections plus a loss of \$50M in income tax cuts would create an increase in automatic deductions from general revenue of about \$7M for Educational Excellence and Adequacy. It would require out-of-state new remote seller sales tax collections of approximately \$150 million annually for both triggers to be met.

Legal Analysis :

HB1007 likely results in an unlawful delegation of authority to DFA to determine the income tax rates of the state. The bill provides that the tax rates are to be reduced "equally". The term "equally" is not defined leaving DFA to determine how the reduction should occur. The term "equally" could be interpreted various ways. This provision vests the legislative power to determine the tax rates in DFA which is contrary to the separation of powers doctrine. See Ark. Const. Art. 4, § 2 and Art. 2§23. Because HB1007 does not merely set a condition on which a specific circumstance will occur to administer an activity, but instead requires that the Executive branch reconfigure the rates of tax in the absence of a specific Legislative action to set the rates of tax, HB1007 is potentially unconstitutional.