

Department of Finance and Administration

Legislative Impact Statement

Bill: HB1512

Amendment Number: H1

Bill Subtitle: TO REDUCE THE INCOME TAX RATES APPLICABLE TO INDIVIDUALS, TRUSTS, AND ESTATES USING THE REVENUES DERIVED FROM THE COLLECTION OF SALES AND USE TAX FROM SELLERS THAT DO NOT HAVE A PHYSICAL PRESENCE IN THE STATE.

Basic Change :

Sponsor: Representative Davis

Engrossment 02/23/17 --- House Amendment 1 --- The Amendment adds Representatives Ballinger, Boyd, D. Meeks, and Payton as cosponsors of the bill and replaces all language of the original bill after the enacting clause. The bill provides for an income tax rate reduction; removes existing code provisions affecting reduced sales taxes on food if certain conditions are met; and provides for a distribution of sales tax collections received from remote out-of-state sellers having no physical presence in Arkansas.

The bill provides an income tax rate reduction for tax years beginning on and after January 1, 2019. The existing six and nine-tenths percent (6.9%) tax rate would be reduced equally for all taxpayers subject to the 6.9% rate with the rate reduction based on the amount of general revenues that have resulted from the collection of sales and use taxes from out-of-state remote sellers having no physical presence in Arkansas.

The bill provides authority to the Department of Finance and Administration (DFA) to request information from out-of-state sellers registering on and after January 1, 2017 to collect Arkansas taxes as to their physical presence in Arkansas at the time of their initial tax registration. Physical presence in Arkansas exists if the seller has salespersons, solicitors, representatives, consignees, or agents in the state or if the seller owns or rents real or tangible personal property in Arkansas. Any out-of-state sellers not meeting these criteria would be excluded from the calculation used to determine the income tax rate reduction.

To calculate the rate reduction, DFA would determine the amount of general revenues received during the period of July 1, 2017 through June 30, 2018 from remote sellers with no physical presence and certify the amount to the Governor and to the Arkansas Tax Reform and Relief Legislative Task Force. DFA would calculate the reduction to the six and nine-tenths percent (6.9%) income tax rate which would be effective for tax years beginning on and after January 1, 2019.

The bill also deletes § 26-52-317(a), which would levy the state sales tax on food and food ingredients at 0% if certain conditions are met. For the 0% tax rate to be effective, federal law would have to be adopted to authorize the state to collect sales and use tax from sellers having no physical presence in Arkansas.

The bill also creates a definition of "new remote seller". For purposes of this provision, a "new remote seller" means a seller who does not have a physical presence in Arkansas; has made sales of taxable goods or services to Arkansas purchasers; and began collecting and remitting Arkansas sales and use taxes on or after January 1, 2017.

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Beginning in July 2017, and each six months' time period thereafter, DFA would certify to the Governor and the Arkansas Tax Reform and Relief Legislative Task Force the following information:

- (1) The total number of new remote sellers; and
- (2) The total net sales and use tax revenue collected and remitted by the new remote sellers.

DFA would then transfer the amount certified for each six-month time period to the Long Term Reserve Fund. The final transfer would occur during January 2019.

This bill has an emergency clause and would be effective upon approval by the Governor.

Revenue Impact :

The bill will provide for an income tax rate reduction based on the amount of sales and use taxes collected from out-of-state sellers having no physical presence in Arkansas that began collecting and remitting sales and use taxes on and after January 1, 2017 and would establish a fund for monies received from the remote sellers. The amount of sales taxes collected by remote sellers having no physical presence in Arkansas is unknown.

Taxpayer Impact :

Taxpayers who have net taxable income over \$75,000 will have their income tax rate reduced by an undetermined amount if sales and use tax collections from out-of-state sellers with no physical presence in Arkansas begin to collect and remit sales and use tax on and after January 1, 2017.

Resources Required :

In the event the necessary triggers provided for in the bill are met, tax tables and forms would need to be updated and system programming would be required.

Time Required :

A period of six months is estimated by DFA to modify the electronic tax registration system and the tax reporting system to allow for the compiling of the additional taxpayer information and tax reports as required in the bill. DFA would use existing resources to complete the taxpayer communications in order to determine the status of the new out-of-state registrants in the required time frames. Manual record keeping of the amounts of taxes reported by the remote sellers will be required until computer systems can be modified to allow for the compilation of the required reports.

Procedural Changes :

DFA would modify the tax registration system to require out-of-state registrants for collection of sales and use tax to indicate if the company has a physical presence in Arkansas and is registering as the result of state or federal law that requires their registration.

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Other Comments :

DFA has no knowledge as to 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. To acquire the necessary information as required in the bill, DFA would have to contact out-of-state sellers that have registered since January 1, 2017 and request information as to their physical presence status. DFA would continue the communication process in this manner until DFA's online tax registration computer systems can be updated to request the necessary information at the time of initial registration. The accuracy of the physical presence information acquired could not be verified without a field audit and if the out-of-state seller does not provide the information, DFA could not include the seller's data in the calculations. Compiling the necessary tax payment information will be a manual accounting process until DFA computer systems can be modified to add identifying information for registered sellers that are out-of-state remote sellers with no physical presence in the state which would later allow for computer generated reports with the necessary data.

The information acquired by DFA will be provided by the seller at the time of initial registration. The bill does not provide guidance as to sellers initially registering to collect the sales taxes but who subsequently create nexus in Arkansas and no longer meet the criteria of having no physical presence. A business creates nexus in multiple ways including soliciting sales through salespersons, solicitors, representatives or consignees conducting business in Arkansas or purchasing or renting real or tangible personal property in the state.

For purposes of the revenues to be transferred to the Long Term Reserve Fund, the bill requires DFA to certify the amount of "*total*" sales and use tax collected from July 2017 to December 2018 by the new sellers and transfer the collections to the Long Term Reserve Fund in six-month intervals. The bill does not provide the source of revenue for the transfers back to the Long Term Reserve Fund. While not specifically noted, it would be assumed that the transfers would come from the funds that received the original sales tax deposits. Sales tax collections at the full 6.5% tax rate include the constitutional levies of 0.125% for Conservation Tax and 0.5% for Highway Fund.

If the "*total*" of sales and use tax collections as provided in the bill are to be transferred and funds cannot be taken from the constitutional levies, the bill does not identify the funds from which the transfer will be made. If the other statutory funds (general revenue, property tax relief trust fund, educational adequacy fund) have to make up the difference, those funds would transfer more monies to the Long Term Reserve Fund than they collected. It is recommended that the bill be amended to provide which previously-deposited general revenues, property tax relief trust funds, or educational adequacy funds are to be transferred following receipt to the Long Term Reserve Fund.

It is possible that July and January collections will be enough to cover six months' worth of transfers out provided that the new remote seller collections are not significant. The agencies that are beneficiaries of the special revenue sales tax collections would not be able to spend the new revenues as they would be subject to transfers back out in July and January. There would be sufficient state general revenues in July and January to cover the GR transfers. DFA's revenue forecast for those months would require adjustment to reflect the transfers and the bill could result in a cash-flow issue that would impact July's general revenue collections. Since July is the first month of the fiscal year, the need for revenue of state agencies receiving general revenue may be greater since those agencies

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have no prior months' revenues in reserve to fall back on for necessary expenditures.

Depending on the mechanism to move the revenues from the original deposit funds to the Long Term Reserve Fund, there is the potential for general revenues to be shorted in FY2019 and FY2020 as a result of the Educational Excellence Trust Fund calculation. The amount transferred annually to the Educational Excellence Trust Fund from general revenue is determined by multiplying the previous fiscal year's general revenue sales tax collections by 14.14%. If during FY2018 the deposits of the new revenue is recorded as general revenue collections but the six-month transfers are recorded in a manner that does not reflect a reduction against that general revenue collection for purposes of the Educational Excellence calculation, the FY2018 general revenue sales tax collections would be overstated. The collections total would not reflect the netting out of the new revenues and the amount calculated for Educational Excellence in FY2019 would be increased, thereby causing general revenues in FY2019 to be decreased below what there would have been if HB1512 had not been enacted. The bill should be amended to "hold harmless" general revenue for subsequent year Educational Excellence transfers and to allow the same amount of general revenue impact as before the collection of the "new" sales tax revenues from the remote sellers that have no physical presence.

Legal Analysis :

None.