

Department of Finance and Administration

Legislative Impact Statement

Bill: HB1693

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

Basic Change :

Sponsor: Representative Rye

The bill provides for a distribution of sales and use tax revenues that are received from sellers having no physical presence in Arkansas. The bill also provides for the distribution of sales and use taxes subsequent to the passage of federal law that would provide authority for the remittance of sales and use taxes by sellers having no physical presence in the state.

The provisions of the bill would be effective on the first day of the calendar quarter following the effective date of the act. Beginning on the effective date, DFA would begin determining the amount of sales and use taxes that are collected from sellers that have no physical presence in Arkansas. The sales and use taxes collected from these sellers would be deposited with the first fifteen million dollars (\$15,000,000) being deposited as state general revenues with amounts received after meeting the fifteen million dollar (\$15,000,000) threshold being deposited to the State Highway and Transportation Department Fund.

The bill also includes provisions regarding the distribution of sales and use tax revenues that would be received from sellers having no physical presence in Arkansas from the date federal law is adopted authorizing the collection of state and local sales taxes. Beginning on that date, the sales and use taxes that are collected from sellers that have no physical presence in Arkansas would be distributed with the first fifteen million dollars (\$15,000,000) being deposited as state general revenues with fifty percent (50%) of the remainder deposited to the State Highway and Transportation Department Fund and fifty percent (50%) used to reduce the six and nine-tenths percent (6.9%) income tax rate.

Revenue Impact :

FY2018 --- Sales and use tax general revenues collected from out-of-state sellers having no physical presence in Arkansas would be changed beginning on the effective date of the act, which is estimated to be October 1, 2017, with the first fifteen million dollars (\$15,000,000) continuing to be deposited to State General Revenues with all monies received after meeting the threshold being deposited to the State Highway and Transportation Department Fund. If revenues exceed the \$15,000,000 threshold amount during FY2018, the revenues would then be deposited for Highways which may result in reduced State General Revenues during FY2018 compared to the previous fiscal year. The revenues from out-of-state sellers having no physical presence in Arkansas who have been collecting and remitting the Arkansas sales taxes during previous years which would have been deposited to General Revenues would change during FY2018 after meeting the \$15,000,000 threshold amount and would then be deposited for Highways. The amount of General Revenue reduction in FY2018 is not known. When federal law is adopted requiring sales tax collections by out-of-state sellers having no physical presence, the distribution would change with the first fifteen million dollars (\$15,000,000) being deposited to State General Revenue and the remainder being divided between the State Highway and Transportation Department Fund and presumably State General Revenues to support income tax reductions.

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Taxpayer Impact :

Revenues being received from out-of-state sellers having no physical presence in Arkansas will be distributed in the manner as outlined in the bill. Consumers purchasing products from out-of-state sellers that are collecting Arkansas sales taxes will have no change. Taxpayers who have 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 is passed provided that federal law imposes the requirement to collect sales tax.

Resources Required :

Modifications to DFA's cash receipts and accounting systems will require modification. Resource costs associated with the changes have not been determined. Resources will be expended to contact the more than 16,000 existing out-of-state sellers requesting information regarding their status of having physical presence in Arkansas and updating DFA's tax registration information to reflect their response in order to have information for future depositing of their remitted sales tax revenues.

Time Required :

A period of six months is estimated by DFA to modify the cash and accounting systems and the DFA tax registration and tax reporting system to allow for the compiling of the additional taxpayer information related to their status of not having physical presence in Arkansas in order to account for the revenues in the manner required. Requesting and receiving responses from the existing 16,000 out-of-state sellers regarding their physical presence status in Arkansas may not be complete during the six-month time frame.

Procedural Changes :

DFA would have to contact all currently registered out-of-state sellers collecting sales and use taxes and request information as to their status as being required to collect and report or if the company deems themselves as not having a physical presence and their tax reporting is on a volunteer basis. 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 :

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. 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 having 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

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to Arkansas consumers through the terms and requirements of the Streamlined Agreement. At the time of their Streamlined 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. DFA has approximately 75,000 registered businesses that collect and remit Arkansas state and local sales and use taxes. Of the total registrants, more than 16,000 are out-of-state sellers collecting and reporting in the same manner as the in-state sellers. To acquire the necessary information to implement the bill, DFA would have to contact all of the out-of-state sellers and request information as to their physical presence status. The accuracy of the "no 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 regardless of their status.

The bill does not exclude existing tax collections from currently registered out-of-state sellers having no physical presence in Arkansas from the distribution change. Transfers to the State Highway and Transportation Department Fund will occur if the existing general revenue collections from these sellers exceed the fifteen million dollar (\$15,000,000) threshold. If they do exceed \$15,000,000 as of the effective date of the act, a loss to state general revenues will occur.

The bill is not clear as to the distribution change occurring on the effective date of the act. After the first fifteen million dollars (\$15,000,000) is deposited to state general revenues, it is unclear whether the remaining revenues deposited to State Highway and Transportation Department Fund are to be future collections for an indefinite period of time or whether it is the intent for the fifteen million dollar (\$15,000,000) threshold to be a threshold met each fiscal year with the remainder collected during the year to go to highways. It is recommended that the bill be amended to provide clarity for the deposits across multiple years.

The bill provides that if federal law is adopted giving Arkansas collection authority over remote sellers, monies collected would be used to reduce the 6.9% income tax rate. Income taxes are reported on a calendar year basis by individual income tax filers. The bill should be amended to provide that guidance as to when the income tax rates would change.

If federal law is adopted giving Arkansas collection authority over remote sellers, monies collected would be deposited for highways and for income tax reductions. Fifty percent (50%) of revenue over the established threshold would be deposited to the State Highway and Transportation Department Fund. The bill does not provide guidance as to where the remaining fifty percent (50%) would be deposited. Specific instruction should be added to the bill.

Sales and Use tax revenues received by DFA are deposited to general revenues upon receipt. A transfer to the State Highway and Transportation Department Fund could only occur after the tax returns from the out-of-state sellers are processed with error corrections completed each month. The Education Excellence Trust Fund receives an amount equal to 14.14% of the prior year's sales tax general revenues. If sales taxes are deposited to general revenues and subsequently transferred to the State Highway and Transportation Department Fund, it is not clear if the initial general revenues deposits from the out-of-state sellers with no physical presence that are subsequently transferred to Highways are to be excluded from the calculation. If not excluded, during the fiscal year following the transfer to Highways, the Educational Excellence Trust Fund would receive 14.14% of the amount before the transfer and general revenues would be shorted.

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Legal Analysis :

HB1693 proposes to deposit sales and use tax collections from sales by sellers that do not have a physical presence in the state for distribution to the State Apportionment Fund (SAF) and the State Highway and Transportation Department Fund (SHTD). If federal law authorizes the state to collect sales and use tax on sales by sellers that do not have a physical presence in the state, then those collections are to be distributed to the SAF, SHTD, and additionally towards an income tax rate reduction.

The bill does not define the term "physical presence." Existing Arkansas law providing for federal authorization would likely adopt the federal definition of physical presence if and when remote collection authority passes Congress. Without a clear definition of physical presence, DFA cannot determine which sales will be included in the calculation of the amount to deposit for distribution to the SAF and SHTD. Thus, any amounts derived by DFA to apply to these distributions will be estimates at best. Executive agencies cannot constitutionally exercise that type of discretion. Instead, the legislature must provide clear direction. As the bill proposes to begin distributions to SAF and SHTD upon the first day of the calendar quarter following the bill's effective date, it is crucial to have this clear definition and direction.

After federal law passes, then the director is required to certify how much of the collections of sales and use tax from sellers without a physical presence will be distributed for purposes of an income tax rate reduction. This provision of the bill creates the potential for an unlawful delegation of legislative authority because the Director of DFA will still have discretion to determine the amount of the rate decrease based upon the amount certified.

DFA currently has over 76,000 registered sellers, of which approximately 3,200 are registered under the Streamlined Sales and Use Tax Agreement to voluntarily collect Arkansas sales and use tax. Whether a seller has physical presence can change from time to time as sellers establish brick and mortar locations, warehouses, and other forms of physical presence as well as when sellers may withdraw physical presence.

In addition, existing Arkansas law provides that when federal law authorizes collections of sales and use tax from sellers without physical presence that the food and food ingredients tax rate provided for in 26-52-317 and 26-53-145 will be reduced.

An incorrect Arkansas Code reference exists in the bill on Page 2, Line 3. A reference is made to Ark. Code Ann. § 26-52-107(b)(2)(iii)(b). That code cite does not currently exist and is not created in the bill. It is recommended that this error be corrected by deleting "§ 26-52-107(b)(2)(B)(iii)(b)" and replacing with "§ 26-52-107(b)(2)(B)(ii)(b)".