

Department of Finance and Administration

Legislative Impact Statement

Bill: SB467

Bill Subtitle: TO AMEND THE SALES TAX EXEMPTION FOR CERTAIN MACHINERY AND EQUIPMENT; AND TO PROVIDE A SALES TAX EXEMPTION FOR MACHINERY AND EQUIPMENT USED TO PRODUCE OR REPAIR DIES, MOLDS, REPAIR PARTS, OR REPLACEMENT PARTS USED IN MANUFACTURING.

Basic Change :

Sponsor: Sen. B. Johnson

SB467 would provide for a sales and use tax exemption for the purchase of machinery and equipment purchased and used by a manufacturer to produce or repair replacement dies, molds, repair parts, or replacement parts used or consumed in the manufacturer's own manufacturing processes.

Under current law, machinery and equipment purchased by manufacturer's and eligible for exemption must be "used directly" in the manufacturing process to manufacturer articles of commerce that will be sold in the commercial marketplace.

Arkansas law provides that machinery and equipment not used directly and not eligible for exemption specifically includes: hand tools; machinery, equipment, and tools used in maintaining and repairing machinery and equipment; transportation equipment, including conveyors used solely before or after the manufacturing process has been started or completed; office machines and equipment, including computers and related peripheral equipment not directly used in controlling or measuring the manufacturing process; buildings; machinery and equipment used in administrative, accounting, sales, or other such activities of the business; all furniture; machinery and equipment used by a manufacturer to produce or repair replacement dies, molds, repair parts, or replacement parts used or consumed in the manufacturer's own manufacturing process; and all other machinery and equipment not used directly in manufacturing or processing operations.

The bill deletes the provision for taxation of "machinery and equipment used by a manufacturer to produce or repair replacement dies, molds, repair parts, or replacement parts used or consumed in the manufacturer's own manufacturing process" and adds the identical language for purposes of exemption eligibility.

The Act would be effective on the 1st day of the calendar quarter following the effective date of the act.

Revenue Impact :

FY2020

-\$216,667 Total Loss to State Revenues

(8 months reduced tax collections)

- -\$145,350 --- State General Revenue (4.5%)
- -\$28,263 --- Educational Adequacy (.875% tax)
- -\$16,150 --- Property Tax Relief Trust Fund (.5%)
- -\$4,038 --- Conservation Tax (.125%)
- -\$16,150 --- Highway Fund (.5%)
- -\$0 --- Educational Excellence Trust Fund
- -\$0 --- Educational Adequacy (GR transfer)
- -\$4,550 --- State Central Services
- -\$2,167 --- Constitutional Officers

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FY2021

-\$334,750 Total Loss to State Revenues

- -\$202,196 --- State General Revenue (4.5%)
- -\$43,666 --- Educational Adequacy (.875% tax)
- -\$24,952 --- Property Tax Relief Trust Fund (.5%)
- -\$6,238 --- Conservation Tax (.125%)
- -\$24,952 --- Highway Fund (.5%)
- -\$20,552 --- Educational Excellence Trust Fund
- -\$1,817 --- Educational Adequacy (GR transfer)
- -\$7,030 --- State Central Services
- -\$3,346 --- Constitutional Officers

Taxpayer Impact :

The bill would exempt machinery and equipment used to produce or repair dies, molds, repair parts, or replacement parts when purchased by an Arkansas manufacturer.

Resources Required :

None.

Time Required :

Adequate time is provided for implementation.

Procedural Changes :

Updates to the sales tax rules will need to be promulgated.

Other Comments :

None.

Legal Analysis :

SB467 amends §§ 26-52-402(c)(2)(B) and 26-52-402(c)(2)(C) to provide that machinery and equipment used by a manufacturer to produce or repair replacement dies, molds, repair parts, or replacement parts used or consumed in the manufacturer's own manufacturing process is considered used directly for purposes of the manufacturing machinery and equipment sales tax exemption. The title of the bill indicates the bill is intended to exempt machinery and equipment used by a manufacturer to produce or repair replacement dies, molds, repair parts, or replacement parts used or consumed in the manufacturer's own manufacturing process; however, the bill as written does not

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appear to create the desired exemption.

The exemptions found in § 26-52-402 are found in § 26-52-402(a)(1)-(a)(3). The remaining subsections of § 26-52-402 provide examples of operations considered to be manufacturing, a statement of intent, and examples of what the term "used directly" means and does not mean. By amending only § 26-52-402(c), the bill provides that machinery and equipment used by a manufacturer to produce or repair replacement dies, molds, repair parts, or replacement parts is considered used directly for purposes of the exemptions found in § 26-52-402(a). However this is only one of several requirements necessary to qualify for the exemptions found in § 26-52-402(a). Under § 26-52-402(c)(1), the exemptions found in section (a) are limited to machinery and equipment used directly in the actual manufacturing or processing operation at any time from the initial stage when actual manufacturing or processing begins through the completion of the finished article of commerce and the packaging of the finished end product. The exemptions are also limited to only the machinery and equipment used in actual production during processing, fabricating, or assembling raw materials or semi-finished materials into the form in which the personal property is to be sold in the commercial market. Machinery and equipment used to produce or repair replacement dies, molds, repair parts, or replacement parts used or consumed in the manufacturer's own process are not always used in actual production. If the intent of the bill is to exempt machinery and equipment used to produce or repair replacement dies, molds, repair parts, or replacement parts used or consumed outside of actual production (i.e. items purchased to repair machine shop tools, etc.), it is recommended that § 26-52-402(a) be amended to create the necessary exemption and that § 26-52-402(c)(1) and (c)(2) be amended to avoid conflict between the exemption created and the intent identified in the existing law. In addition, and for consistency, the bill should be amended to appropriately amend the companion compensating use tax exemption found in § 26-53-114.

A manufacturer's purchase of machinery and equipment used to modify, replace, or repair machinery and equipment used directly in manufacturing, as well as the purchase of services required to modify, replace, or repair exempt manufacturing machinery and equipment, is entitled to a refund under the provisions of §§ 26-52-447 and 26-53-149. As written, it is unclear if the bill is attempting to create a complete exemption for the purchase of machinery and equipment consumed by a manufacturer outside of actual production, if it is trying to create a complete exemption for the purchase of machinery and equipment used to modify replace, or repair machinery and equipment used directly in manufacturing, or if it is trying to create a complete exemption for the purchase of all machinery and equipment purchased by a manufacturer in Arkansas. Accordingly, this bill has the potential to render the refund found in §§ 26-52-447(a)(1) and 26-53-149(a)(1) obsolete because it could be interpreted by a court to create a complete exemption for all machinery and equipment purchased by a manufacturer in Arkansas.

As the bill is silent about services purchased by a manufacturer to produce or repair replacement dies, molds, repair parts, or replacement parts used or consumed in the manufacturer's own process, a manufacturer purchasing such services in relation to machinery and equipment used outside actual production would still be required to pay tax on such services, while a manufacturer purchasing such services for machinery and equipment used in actual production would still benefit from the refund found in § 26-52-447(a)(2) and 26-53-149(a)(2).

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SB467 will be effective on the first day of the calendar quarter following the effective date of the act, or October 1, 2019.