

Department of Finance and Administration

Legislative Impact Statement

Bill: SB576

As Engrossed: 3/20/2019

Bill Subtitle: TO REFORM THE TAX LAWS CONCERNING THE LEVY AND COLLECTION OF SALES AND USE TAX, THE APPORTIONMENT AND ALLOCATION OF INCOME FOR TAX PURPOSES, CORPORATE INCOME TAX RATES, AND NET OPERATING LOSSES; AND TO DECLARE AN EMERGENCY.

Basic Change :

Sponsors: Senators Hester, J. Hendren, J. Dismang, B. Ballinger, A. Clark, L. Eads, J. English, Irvin, B. Johnson, M. Pitsch, D. Wallace; Representative D. Douglas

Engrossed 03/20/19 --- Senate Amendment 1 --- Amends the bill to add additional language regarding marketplace facilitators to provide that DFA shall audit a facilitator solely for sales made by marketplace sellers and facilitated by the facilitator. The amendment also provides that DFA shall not audit a marketplace seller for sales facilitated by the marketplace facilitator except if the facilitator seeks relief from liability as a result of the seller providing incorrect or insufficient information.

Corporation Income Tax --- Throwback Rule --- SB576, as amended, retains the Throwback Rule for corporation income tax filing. SB576, as originally introduced, would have repealed the Throwback Rule over a two-year period beginning with the 2021 tax year.

Corporation Income Tax --- Top Rate Reduction --- SB576 reduces the maximum corporation income tax rate for income exceeding \$100,000 for tax years beginning on or after January 1, 2021 to 6.2% and reduces the maximum corporation income tax rate to 5.9% for income exceeding \$25,000 for tax years beginning on or after January 1, 2022.

Corporation Income Tax --- Net Operating Losses --- SB576 revises the extension of the net operating loss carryforward from 5 years to 8 for losses occurring in tax years beginning on or after January 1, 2020 and to ten years for losses occurring in tax years beginning on or after January 1, 2021.

Original Bill --- SB576 would amend Arkansas tax laws regarding various provisions for the filing on income taxes by corporations; state and local sales and use taxes on remote seller tax collection requirements; and sales tax requirements on car washes. The bill provides specific amending provisions for the following:

- Amends the provisions of the Multistate Tax Compact and the Uniform Division of Income for Tax Purposes Act;
- Repeals the Throwback Rule for corporation income tax filing;
- Provides for a single sales factor for the Apportionment Formula used by corporations for income tax filing;
- Amends the apportionment and allocation of Income of financial institutions;
- Phase in an extension of net operating loss carry-forward periods;
- Requires the collection of sales and use tax by remote sellers and marketplace facilitators;
- Provide a sales tax exemption for certain providers of car wash services;
- Exempts from sales tax all purchases by car wash operators; and
- Levies new annual fees on certain car wash operators and monthly water usage fees on operators of car wash tunnels.

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Remote Sellers and Marketplace Facilitators --- The bill would amend the Arkansas Gross Receipts Tax Act of 1941, § 26-52-101 et seq., to require out-of-state remote sellers having no physical presence in Arkansas to collect Arkansas sales and use tax on sales to Arkansas purchasers. Out-of-state or "remote" sellers subject to the provisions of the bill would include those sellers meeting either of the following criteria in the previous calendar year or the current calendar year: (1) A seller having gross revenue from annual sales of products and services delivered into Arkansas that exceeds one hundred thousand dollars (\$100,000); or (2) A seller who has sold products and services for delivery into Arkansas in at least two hundred (200) separate sales transactions. These thresholds are identical to those imposed by South Dakota which were recently upheld by the United States Supreme Court in *South Dakota v. Wayfair, Inc.* 585 U.S. ____, 138 S.Ct. 2080 (2018). The bill provides that the tax collection responsibility would not be applied retroactively, and businesses would be subject to the provisions only upon the effective date of the act.

The bill would also require "marketplace facilitators" that sell or facilitate sales of products and services for their marketplace participating sellers to collect and remit the applicable Arkansas taxes on all sales conducted through the marketplace. The facilitator would collect and remit the sales and use taxes for their participating sellers eliminating the need for the sellers to register directly with DFA unless the seller's direct sales to consumers conducted outside the marketplace exceed the established threshold levels.

The bill also repeals § 26-52-110, which established sales tax collection by businesses that have a connection to the state through affiliated companies. With the adoption of the requirement for remote sellers and marketplace facilitators to collect the tax, these affiliate nexus provisions are likely no longer needed.

Sales Tax on Car Washes --- The proposal would amend existing law to provide that sales tax does not apply to sales to a "car wash" operator or on sales by a "car wash" including ancillary services provided by a carwash in conjunction with the sale of a car washing service.

Currently, sales tax code provisions provide that the service of cleaning a motor vehicle is subject to tax. Excluded from taxation are services performed by a "coin-operated car wash" in which the car washing equipment is activated by the insertion of the payment into a receptacle and the labor of washing the exterior of the car or motor vehicle is performed solely by the customer. Also excluded from sales tax are car washes performed by "automatic car washes" and "car wash tunnels" if all of the cleaning services are performed by the mechanical equipment. Current Arkansas sales tax law only levies sales tax on car wash services performed by mechanical equipment when used in conjunction with a portion of the motor vehicle cleaning service being performed manually by an attendant. All car washes and car cleaning services performed manually are also subject to sales tax and will continue to be taxed under the provisions of the bill.

The bill also exempts the sale of ancillary services sold in conjunction with a car wash. These services would include: hand prepping any portion of a motor vehicle; vacuuming; hand drying any portion of a motor vehicle; waxing any portion of a motor vehicle; hand cleaning any portion of a motor vehicle; and applying a protective or shine coat to any portion of a motor vehicle.

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The bill also provides a sales tax exemption for purchases by a car wash operator of products and services for use in the car wash operations. The exemption would include purchases of water, cleaners, waxes, electricity to operate the washing and other equipment, repairs to equipment, vacuuming equipment, towels, protective and shine products, etc. The sales tax exemption on purchases would not apply to car wash cleaning service providers that perform car washes manually. These businesses would continue to pay tax on purchases and collect sales taxes on their sales.

Car Washes --- Water Usage and Annual Fees --- The bill levies new monthly water usage fees or annual fees on car wash operators who operate either an "Automatic Car Wash", a "Car Wash Tunnel" or a car washing "Self-Service Bay" for public use. "Car Wash Tunnel" operators would remit the monthly fees which would be calculated and based on the amount of water consumed. "Automatic Car Washes" and "Self-service Car Washes" are not subject to monthly fees but would be subject to annual fees.

For purposes of the fee calculation, an "automatic car wash" is defined as a car wash bay that provides an exterior car wash using mechanical equipment that cleans the motor vehicle while the vehicle remains stationary. A "car wash tunnel" is defined as a car wash bay that provides a fully automated exterior car wash in which the motor vehicle is moved through a tunnel by a conveyor system. A "self-service bay" is defined as a car wash bay that allows a person to manually wash the exterior of their motor vehicle using equipment and supplies provided by the car wash operator.

Fees would be due and calculated on the amount of water consumed by the operator's "Car Wash Tunnels". No water usage monthly fees would be levied on water used in "automatic car washes" or "self-service bays". For operators using water in an "automatic car washes" or "self-service bays", annual fees would be paid based on the number of "automatic car wash" bays or the number of "self-service bays" in operation.

Fee structure:

- Operator with "Car Wash Tunnels" only -- Monthly reporting of water usage fees at full rate on water used in tunnels.
- Operator with "Car Wash Tunnels" and either "automatic car washes" or "self-service bays" or both -- Monthly reporting of water usage fee is due at reduced rate on water used in tunnels only -- No annual fee on "automatic car washes" or "self-service bays".
- Operator with "self-service bays" only -- \$100 per year per bay.
- Operator with "automatic car washes" only -- \$500 per year for each automatic car wash.
- Operator with both "automatic car washes" and "self-service bays" at the same location -- \$500 per year for each automatic car wash with no annual fees due on the "self-service bays".

Water usage fees for "Car Wash Tunnels" for an operator would be calculated as follows:

- Operator with one or more car wash tunnels --- Multiply the total number of gallons used the previous month by nine-tenths (0.9). This product is then multiplied by seventy-five hundredths of a cent (.0075) to determine the amount of monthly fee due.

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- Operator with one or more car wash tunnels and one or more self service bays or automatic car washes or both --- The total number of self-service bays and automatic car washes is multiplied by one-tenth (0.1). Subtract the lesser of this product or five-tenths (0.5) from nine-tenths (0.9), and then multiply this difference by the total aggregate number of gallons used during the preceding month at all of the operator's car wash tunnels only. Multiply this total by the .0075 cents to determine the monthly fee due. The fee is not due on the water used in the operator's self-service bays or automatic car washes.

The due date for remittance of the monthly return on water fees is by the twentieth day of each month and must be paid electronically on forms prescribed by the Department. The language of the bill requires DFA to collect and administer the fee in accordance with Arkansas Tax Procedure Act, § 26-18-101 et. seq. All revenue collected under this provision would be deposited as State General Revenue.

The bill would require at the end of each fiscal year, for DFA to determine the total state revenue generated by the fees remitted and the loss resulting from the sales tax exemption provided under § 26-52-401(40) on sales of car washes at tunnel car washes that are currently subject to tax and purchases by operators of "car wash tunnels", "self-service bays" and "automatic car washes" exempted by the bill. If DFA determines that the total state revenue loss resulting from the exemptions provided in § 26-52-26 401(40) is greater than the total state revenue generated by the fees under the provisions of this bill, the provisions of the bill would expire on and after the first day of the calendar quarter following the determination.

Corporation Income Tax --- Net Operating Losses --- The bill extends the number of years that net operating losses may carry forward from ten years to 20 years for steel manufacturers, from 15 years to 20 years for qualified medical companies and from five years to 20 years for all other taxpayers in increments over a five year period beginning with tax years beginning on or after January 1, 2020.

Corporation Income Tax --- Single Sales Factor Apportionment --- The bill changes the apportionment formula for multi-state corporations from three factors to a single factor apportionment formula based only on sales or receipts for tax years beginning on or after January 1, 2021.

Corporation Income Tax --- Repeal of Throwback Rule --- Phases out the throwback rule for sales shipped from Arkansas for tax years beginning on or after January 1, 2021.

Revenue Impact :

FY2020 --- Remote Sellers and Marketplace Facilitator Tax Remittances

11 months of FY 2020 Deposits Only

\$32,439,833 Million Total Gain to State Sales Tax Revenue

- +\$ 21,762,137 --- General Revenue
- +\$ 4,231,527 --- Educational Adequacy (7/8% tax)
- +\$ 2,418,015 --- Property Tax Relief Trust Fund

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- +\$ 604,504 --- Conservation Tax
- +\$ 2,418,015 --- Highway Fund
- +\$ 681,236 --- State Central Services
- +\$ 324,398 --- Constitutional Officers

Gain to City and County Sales Tax Revenue: +\$10,800,000

Full Year FY 2021 --- Remote Sellers and Marketplace Facilitator Tax Remittances

\$35,388,909 Million Total Gain to State Sales Tax Revenue

- +\$ 20,391,321 --- General Revenue
- +\$ 3,077,166 --- Educational Excellence Trust Fund
- +\$ 272,027 --- Educational Adequacy (GR transfer)
- +\$ 4,616,211 --- Educational Adequacy (7/8% tax)
- +\$ 2,637,635 --- Property Tax Relief Trust Fund
- +\$ 659,459 --- Conservation Tax
- +\$ 2,637,835 --- Highway Fund
- +\$ 743,167 --- State Central Services
- +\$ 353,889 --- Constitutional Officers

Gain to City and County Sales Tax Revenue: +\$11,800,000

Annual Car Wash Impact to State Revenues

-\$800,000 to \$1,200,000 Estimated Net Annual Loss to State Revenues - Car Wash Tunnel Loss, Annual Fee Gains, Existing Sales Tax Loss plus additional loss on purchases by automatic car washes and self-service bays.

-\$ Unknown Additional Loss from Sales Tax Exemption on Purchases by "Automatic Car Washes" and "Self-Service Bay" Car Washes

Net Loss Distribution Calculation

-\$2.1 Million Loss to State Sales Tax Revenue --- Loss of Existing Sales Tax Collections on Car Washes

- \$1,191,967 --- General Revenue
- \$ 199,201 --- Educational Excellence Trust Fund
- \$ 17,610 --- Educational Adequacy (GR transfer)
- \$ 273,929 --- Educational Adequacy (7/8% tax)
- \$ 156,531 --- Property Tax Relief Trust Fund
- \$ 39,133 --- Conservation Tax
- \$ 156,531 --- Highway Fund
- \$ 44,100 --- State Central Services
- \$ 21,000 --- Constitutional Officers
- \$ 700,000 Loss to City and County Sales Tax Revenue

-\$210,000 to - \$630,000 Loss from Sales Tax Exemption on Purchases by Car Wash Tunnels

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-\$ Unknown Loss from Sales Tax Exemption on Purchases by Automatic Car Washes and Self-Service Bays.

+\$1.1 Million Gain from Car Wash Water Usage Fees from Car Wash Tunnels

+\$423,360 Gain from Annual Fees Levied on Automatic Car Washes and Self-Service Bays

The unknown amount of additional loss of sales tax on purchases of water, soap cleaners, electricity, repair services and other products and services used to operate "Automatic Car Washes" and "Self-Service Bays". Industry supplied data reflects 1,814 Self-Service Bays and 484 Automatic Car Washes are located in Arkansas. Additional losses from the sales tax exemption of purchases would occur.

[Car Wash Information --- Estimate based on data supplied by industry representatives that state that there are 672 car wash businesses in Arkansas with 67 Car Wash Tunnels, 1,814 Self-Service Bays, and 484 Automatic Car Washes. DFA has no additional knowledge regarding the number of "car wash tunnels" that would be subject to the water usage fees and if the operators of the tunnels also have other "car wash bays" or "automatic car washes" which would determine eligibility for the reduced tax rate of fee payment. DFA also has no knowledge regarding the number of Automatic Car Washes and Self-Service Bays operating in Arkansas that would be eligible for a sales tax exemption on purchases. In a report published in 2018 by Chris Brown Consulting for the International Carwash Association the average tunnel car wash uses 38 gallons of water per vehicle wash. Water usage fees per wash as provide in the bill at this rate of consumption would result in a maximum fee per wash of \$0.285, with a reduced fee amount due if the operator also operates other car wash bays or automatic car washes. Under current sales tax law, no sales tax is due on a car wash performed by a car wash tunnel if the total washing service is performed by the mechanical equipment only with no portion of the motor vehicle cleaning service being performed by an attendant.]

[The bill provides that the water usage fees would be in lieu of the operator collecting and remitting state and local sales taxes although under current sales tax law, no sales taxes are collected if the exterior car washing is being performed only by the "Car Wash Tunnel", the "Automatic Car Wash" or by the consumer at a "Self-Service Bay". Sales taxes are due at these facilities only if a portion of the cleaning services are being performed by attendants in conjunction with the mechanical equipment.]

Single Sales Factor Apportionment

FY2021 - Revenue Loss of \$357,000

FY2022 - Revenue Loss of \$714,270

FY2023 and following - Revenue Loss of \$714,270

Increase Net Operating Loss Carry Forward to 10 Years

FY2026 - Revenue Loss of \$7.8 million.

FY2027 - Revenue Loss of \$23.0 million.

FY2028 - Revenue Loss of \$37.4 million.

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FY2029 - Revenue Loss of \$44.4 million.

FY2030 - Revenue Loss of \$51.0 million.

FY2031 - Revenue Loss of \$63.7 million.

FY2032 - Revenue Loss of \$70.0 million.

Reduced Corporate Tax Rates in Tax Years 2021 and 2022

FY2021 - Revenue Loss of \$9.8 million.

FY2022 - Revenue Loss of \$29.5 million

FY2023 and following - Revenue Loss of \$39.4 million

Taxpayer Impact :

An out-of-state seller having no physical presence in Arkansas would be required to collect and remit Arkansas sales and use tax if their sales volume meet or exceed the threshold levels as established in the bill. Marketplace facilitators would collect and remit the sales and use taxes for all of their participating marketplace business clients.

Car wash businesses, other than car wash locations performing manual washing, would register with DFA and be subject to annual fees or monthly water usage fees. Existing taxable purchases by car washes would be eligible for tax exemption.

Taxpayers will have longer net operating loss carry forward for tax years beginning on or after January 1, 2020. Taxpayers operating in more than one state will apportion income using a single factor based on sales or receipts. Corporations will have a maximum income tax rate of 6.2% for tax years beginning on or after January 1, 2021 and 5.9% for tax years beginning on or after January 1, 2022.

Resources Required :

Computer programming costs will be incurred for fiscal years 2020 through 2024 as laws will change each year during that period. Forms and instructions and processing and training procedure manuals will need to be updated each year for five straight years.

Time Required :

Adequate time is provided for implementation.

Procedural Changes :

Computer programs, forms and instructions will need to be updated. Computer system development will be required to administer the new car wash annual and monthly fees. Updates to the Gross Receipts Tax Rules will be necessary. Department employees will need to be educated as well as the tax community.

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Other Comments :

Car Washes

Operators of "automatic car washes" and "self-service bays" would register with DFA and report annual fees based on the number of facilities owned.

Operators of "car wash tunnels" that currently collect sales tax from their customers would register for a new tax type and report monthly water usage fees based on gallons of water used in exterior car washing. Operators of car wash tunnels would no longer collect sales tax from their customers. Operators of manual car washing businesses would continue to collect sales tax on their car washing services and continue to pay sales tax on purchases of the products used to perform the services. Operators of "automatic car washes", "car wash tunnels" and car washing "self-service bays" would claim exemption from sales tax on all purchases of water, products and services for use in their car wash operations.

Sunset Provision --- The bill provides that at the end of each fiscal year, DFA would determine the revenues received from the fees on car wash operators, the amount of loss of sales tax resulting from the tax exemption of car wash sales, and the amount of loss on purchases by car wash operators and calculate if a loss to state revenues has occurred. DFA cannot perform this analysis without performing a field tax audit of the books and records of all car wash operators each year to determine the amount of tax savings each received purchases of car wash products and services and the amount of sales tax that would have been collected by car wash tunnel operators from their customers on their formerly taxable sales. With approximately 672 car wash operators in Arkansas, additional tax auditors would be required to audit all of the locations in Arkansas each year.

Remote Sellers and Marketplace Facilitators

An out-of-state remote seller having no physical presence in Arkansas or a marketplace facilitator meeting the sales transactions or sales volume criteria as provided in the bill would register with DFA to collect and remit Arkansas state and local sales and use tax and begin collecting the tax on July 1, 2019.

The bill mirrors that previously adopted by the State of South Dakota and upheld by the U.S. Supreme Court in its decision of *South Dakota v. Wayfair*. As of January 2019, of the 45 states that levy sales taxes, 32 have implemented or adopted state laws requiring remote sellers to collect sales tax on products and services sold for delivery into their states following the South Dakota model of establishing thresholds levels.

Marketplace facilitators and the states recently worked with the Multistate Tax Commission to create provisions and standardized procedures for marketplace facilitator tax collections. The final report included the procedures as requested by the marketplace facilitators for their collection of the state and local sales taxes on behalf of their participating marketplace sellers.

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Section 5 of the bill is effective for tax years beginning on or after January 1, 2020. Sections 2-4 and 6-16 are effective for tax years beginning on or after January 1, 2021. Sections 17-19 would be effective on July 1, 2019 provided that the bill's emergency clause is adopted. If the emergency clause is not adopted, the bill would be effective on the first day of the calendar quarter following the effective date of the bill.

Legal Analysis :

SB576, as engrossed, makes numerous changes to several different taxes and tax provisions discussed below:

Corporation Income Tax Rate - This bill reduces the rate of the top corporation income tax bracket from 6.5% to 6.2% in tax year 2021 and from 6.2% to 5.9% for tax year 2022 and all years after.

Net Operating Losses (NOL) - This bill extends the ability to carry a net operating loss deduction forward. Previously, these deductions could be carried forward for five (5) years. The bill gradually increases how long net operating losses can be carried forward each year until it ultimately allows for net operating losses to be carried forward ten (10) years.

Corporate Income Tax Apportionment - Previously, corporations would calculate their apportionment factor by using a three-factor formula (sales, property, and payroll). The sales factor is double-weighted under Arkansas law. This bill would change the apportionment formula to only consider sales in Arkansas compared to sales everywhere else.

Remote Sellers Sales Tax - This bill empowers DFA to impose collection of sales tax on remote sellers who deliver taxable goods or services into the state if the seller receives gross revenue of \$100,000 or conducts at least 200 transactions into the state. These thresholds are identical to those imposed by South Dakota which were recently upheld by the United States Supreme Court in *South Dakota v. Wayfair, Inc.*, 585 U.S. ____, 138 S.Ct. 2080 (2018). This bill also requires marketplace facilitators to collect and remit sales tax on sales it facilitates, provided the marketplace facilitator meets the same thresholds as remote sellers.

Car Washes - The bill modifies the taxation of car washes and ancillary services. The bill provides a specific exemption to gross receipts tax of tangible personal property, specified digital products, or digital code by or to a car wash operator for use in a car wash. The bill exempts the services ancillary to a car wash, including, for example, hand prepping the motor vehicle before entry into the car wash. The bill then creates a fee and registration requirement for car wash operators if they operate a self-service bay, automatic car wash, or car wash tunnel for commercial use. The fees are distinguished between the use of public and nonpublic water:

- Car wash operators operating more than one car wash tunnel using a public water system will pay a monthly fee at the rate of 0.9 the total number of gallons of water the car wash operator used in the previous month and multiply that number times 0.75¢. In addition, the car wash operator will multiply the number of self-service bays and automatic car washes by 0.1, then subtract from that number either 0.5 or the number previously calculated times 0.9, then multiply the total number of gallons of water used by

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the car operator by the result of the previous calculation, and then multiply that number by 0.75¢.

- Additionally, car wash operators operating one or more self-service bays or automatic car washes on a public or non-public water system is required to pay an annual fee of \$100.00 per self-service bay and \$500.00 per automatic car wash. The law provides that if a car wash operator has one or more self service bays and one or more automatic car washes at the same location, it does not have to pay the \$100.00 annual fee on the self-service bays. The bill also allows for a one-half abatement on an automatic car wash only operated during the last six months of a fiscal year.
- All revenue collected would be designated as general revenues.
- The new fee on car washes has a sunset clause that will allow the director to determine whether the total state revenue lost from the exemption for car washes created by the bill exceeds the revenue generated from the water usage fees. The provisions of the bill regarding car washes will expire upon a determination that there is a revenue loss.

The rules deadline presents a substantial issue for the promulgating agency. Most of the provisions of the bill that require rule promulgation will not be effective until after the rules deadline. The remaining provision would go into effect shortly before the rule promulgation deadline. It is unclear whether the agencies would have authority to promulgate and publish notice for rules that are required by a statute which is not yet effective. Moreover, the accelerated timeline to promulgate rules would create a significant administrative burden on the promulgating agency requiring promulgation efforts to begin in earnest before adjournment of the General Assembly. To meet the required deadline of September 1, the Rules would need to be approved by ALC in August requiring submission for the agenda in July, assuming that ALC even chooses to meet in August. To submit the Rules and comments in July will require that they be approved for publication and public comment by the beginning of June at the latest to have the 30 days of publication and time to collate any public comments received. To have the rules prepared would likely require that drafters begin work in March at the latest.