

# Department of Finance and Administration

## Legislative Impact Statement

**Bill: HB1218**

**Bill Subtitle: TO REDUCE THE SALES AND USE TAX ON NATURAL GAS AND ELECTRICITY USED BY MANUFACTURERS AND TO DECLARE AN EMERGENCY.**

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### Basic Change :

Representative Jean

Senator B. Sample

The proposal would reduce the state sales and use tax rate on natural gas and electricity used in manufacturing by manufacturers classified in section 31 through 33 of the North American Industry Classification system (NAICS) and for certain high efficiency generators of electric power.

The proposal would reduce the current statutory tax rate of two and five-eighths percent (2.625%) to the rate of one percent (1.0%) effective July 1, 2013 for manufacturing companies classified in NAICS 31 through 33.. When combined with the 0.125% Conservation Tax and the new 0.5% Highway Tax, the total state tax rate would be 1.625%. Currently, the total state sales and use tax rate for these manufacturers is 2.75%.

Beginning July 1, 2014, the sale of natural gas and electricity used in the manufacturing process by eligible manufacturers would become exempt from state, city and county sales taxes. The bill provides that although the utilities would be exempt from tax, the bill states that the 0.125% Conservation Tax and the 0.5% for Highways would continue.

### Tax Rates for Manufacturers in NAICS 31 through 33

Through June 30, 2013	2.75% (current law)
July 1, 2013 through June 30, 2014	1.625%
July 1, 2014	0.625%

The bill also removes the provision of current law that caps the total tax savings at fro the eligible manufacturers at twenty seven million dollars (\$27,000,000) per fiscal year. The cap level has not been met in previous years.

For natural gas and electricity used by a generator of electric power classified within Sector 22 of the North American Industry Classification System to operate a new or existing facility that uses combined cycle gas turbine technology, the state sales and use tax rate would be further reduced to one percent (1%) beginning on January 1, 2015. When combined with the 0.125% Conservation Tax and the 0.5% Highway Tax, the total state rate would be 1.625% beginning July 1, 2015.

Effective January 1, 2016, the natural gas and electricity used by eligible generators of electric power would be exempt from state and local sales and use tax. The bill provides that although the utilities would be exempt from tax, the 0.125% Conservation Tax and the 0.5% for Highways would continue.

### Tax Rates for Eligible Electricity Manufacturers

January 1, 2013 through June 30, 2013	4.25% (current law)
July 1, 2013 through December 31, 2013	4.75% (current law)
January 1, 2014 through December 31, 2014	3.25% (current law)
January 1, 2015 through December 31, 2015	1.625%
January 1, 2016	0.625%

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Although stated in the bill that the sales and use tax constitutional levies would remain in effect when the tax law is amended to state that they are exempt from tax, the constitutional amendments contain language that the sales and use taxes levied for Conservation and for Highways are levied on all taxable sales of property and services subject to the tax levied by the Arkansas Gross Receipts Tax Act and the Arkansas Compensating Tax Act, it appears these taxes could not continue to be collected on the sales of these utilities since the tax levy would be removed by the proposal. Clarifying language is recommended. The proposal would be effective July 1, 2013

### **Revenue Impact :**

#### **FY14 Tax Decrease**

**Total Impact to State Revenues - \$13.1 million**

-\$ 9.7 million --- State General Revenue (4.5%)  
-\$ 1.9 million --- Educational Adequacy (.875% tax)  
-\$ 1.1 million --- Property Tax Relief Trust Fund (.5%)  
-\$ 0 million --- Conservation Tax (.125%)  
-\$ 0 million --- Highway Fund (.5%)  
-\$ 0 million --- Educational Excellence Trust Fund  
-\$ 0 million --- Educational Adequacy (GR transfer)  
-\$ .3 million --- State Central Services  
-\$ .1 million --- Constitutional Officers

#### **FY15 Tax Decrease**

**Total Impact to State Revenues - \$25.4 million**

-\$17.3 million --- State General Revenue (4.5%)  
-\$ 3.7 million --- Educational Adequacy (.875% tax)  
-\$ 2.1 million --- Property Tax Relief Trust Fund (.5%)  
-\$ 0 million --- Conservation Tax (.125%)  
-\$ 0 million --- Highway Fund (.5%)  
-\$ 1.4 million --- Educational Excellence Trust Fund  
-\$ .1 million --- Educational Adequacy (GR transfer)  
-\$ .6 million --- State Central Services  
-\$ .3 million --- Constitutional Officers  
Total Impact to City and County Sales Tax -\$1,600,000

#### **FY16 Tax Decrease**

**Total Impact to State Revenues - \$28.9 million**

-\$18.5 million --- State General Revenue (4.5%)  
-\$ 4.2 million --- Educational Adequacy (.875% tax)  
-\$ 2.4 million --- Property Tax Relief Trust Fund (.5%)  
-\$ 0 million --- Conservation Tax (.125%)  
-\$ 0 million --- Highway Fund (.5%)  
-\$ 2.7 million --- Educational Excellence Trust Fund  
-\$ .2 million --- Educational Adequacy (GR transfer)

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- \$ .7 million --- State Central Services  
- \$ .3 million --- Constitutional Officers  
Total Impact to City and County Sales Tax - \$1,600,000

### **FY17 Tax Decrease**

**Total Impact to State Revenues - \$30.6 million**

-\$19.4 million --- State General Revenue (4.5%)  
- \$ 4.4 million --- Educational Adequacy (.875% tax)  
- \$ 2.5 million --- Property Tax Relief Trust Fund (.5%)  
- \$ 0 million --- Conservation Tax (.125%)  
- \$ 0 million --- Highway Fund (.5%)  
- \$ 3.0 million --- Educational Excellence Trust Fund  
- \$ .3 million --- Educational Adequacy (GR transfer)  
- \$ .7 million --- State Central Services  
- \$ .3 million --- Constitutional Officers  
Total Impact to City and County Sales Tax - \$1,600,000

### **Taxpayer Impact :**

Taxpayers would be required to change accounting and computer systems to allow for the rate changes and make the necessary changes for the exemption when it becomes effective.

### **Resources Required :**

None

### **Time Required :**

Adequate time is allowed in the proposal

### **Procedural Changes :**

Education of staff in the changes and a revision of the rules.

### **Other Comments :**

None

### **Legal Analysis :**

Currently, the sale of natural gas and electricity to manufacturers in NAICS sectors 31-33 for use directly in the actual manufacturing process is subject to a total state sales and use tax rate of 2.75%. This rate consists of a statutorily imposed rate of 2.625% and a rate of .125% imposed by Amendment 75 to the Arkansas Constitution. Any refund claims related to a rate reduction is limited to \$27 million during a fiscal year.

This bill reduces the statutorily imposed state tax rate on qualifying utilities as follows and does not place any limit on the amount of refunds that may issued during a fiscal year:

- Reduces the statutorily imposed rate to 1% beginning July 1, 2013
- Provides an exemption from state tax beginning July 1, 2014.

Currently, the sale of natural gas to a generator of electricity is subject to a state sales and use tax rate of 4.25%. This rate consists of a statutorily imposed rate of 4.125% and a rate of .125% imposed by

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Amendment 75 to the Arkansas Constitution. The statutorily imposed rate will be reduced to 2.625% on January 1, 2014. No limitation was imposed on the amount of refunds issued to generators of electricity.

This bill reduces the statutorily imposed rate on generators of electricity as follows:

- Reduces the statutorily imposed rate to 1% beginning January 1, 2015
- Provides an exemption from state tax beginning January 1, 2016.

At the time the utilities become exempt from state tax, they will also be exempt from local tax. Cities and counties are only able to adopt local taxes on sales that are subject to the state sales/use tax. Ark. Code Ann. §§ 26-75-502(a), 26-74-212, and 26-74-407. The bill provides that the utilities will continue to be subject to the constitutional levies of 1/8% [Am. 75] and 1/2% [Am. 91].

Although stated in the bill that the sales and use taxes levied by the Arkansas Constitution would remain in effect when the tax law is amended, the constitutional sales tax levies contain language that the sales and use tax levied for Conservation and for Highways are levied on all taxable sales of property and services subject to the tax levied by the Arkansas Gross Receipts Tax and the Arkansas Compensating Use Tax Act. It appears that these constitutional taxes could not continue to be collected on the sales of these utilities since the underlying sales and use tax levies would be removed by the proposal. Clarifying language is needed.

This bill contains an emergency clause and will be effective July 1, 2013. Additional code sections will have to be amended to incorporate the numbering changes created as a result of this bill. Particularly, Ark. Code Ann. §§ 19-5-1103(b) (Property Tax Relief Fund funding), 19-5-1227(b)(3) (Education Adequacy Fund funding), and 19-6-201(59) and (61) (general revenue listings) will have to be corrected.