

Department of Finance and Administration

Legislative Impact Statement

Bill: SB332 Amendment Number: S1 (2/17/15 Engrossment)
Bill Subtitle: TO REDUCE THE SALES AND USE TAX ON THE PARTIAL REPLACEMENT AND REPAIR OF CERTAIN MACHINERY AND EQUIPMENT USED IN MANUFACTURING; AND TO DECLARE AN EMERGENCY.

Basic Change : Sponsor: Senator Files

Senate Amendment 1 --- Adds Representative Jett as a cosponsor of the bill.

Original Bill --- The proposal would amend Ark. Code Ann. §§ 26-52-447 and 26-53-149 to add new language for a further reduction in the state sales and use tax rate for partial replacement and repair parts and labor used in repairs of manufacturing machinery and equipment. The manufacturer would pay the full state tax rate of 6.5% to the seller and subsequently file a refund request with DFA for the portion eligible for the refund. Services relating to the initial installation, alteration, addition, cleaning, refinishing, replacement and repair of manufacturing machinery or equipment would also be eligible for the refund.

The proposal also removes the requirement in existing law that requires manufacturers to be eligible for the reduced taxation benefit; they must first obtain a direct payment permit from DFA.

When purchasing the repair and replacement parts and services, manufacturers without direct payment authority with DFA would pay the full 6.5% state sales and use tax to the seller and subsequently file a refund request with DFA for the portion of the tax eligible for the refund. Manufacturers with direct pay authority would report taxes due on all purchases on their monthly tax return and claim the refund amount against any sales and use tax due at the time of filing.

The Constitutional levies of 0.125% for Conservation and 0.5% for Highways would not be eligible for the refund. Also, local city and county sales and use taxes would not be eligible.

The portion of the 6.5% state sales and use tax that is subject to the refund is as follows:

Effective July 1, 2015: 3.375% portion eligible for refund --- 3.125% net tax rate
Effective July 1, 2016: 5.875% portion eligible for refund --- 0.625% net tax rate

The proposal contains an emergency clause for an effective date of the date of approval by the Governor.

Revenue Impact :

FY16 Tax Decrease

Total Impact to State Revenues	- \$18.54 million
-\$13.75 million ---State General Revenue (4.5%)	
-\$ 2.67 million ---Educational Adequacy (.875% tax)	
-\$ 1.53 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)	
-\$.41 million ---State Central Services	
-\$.19 million ---Constitutional Officers	

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FY17 Tax Decrease

Total Impact to State Revenues - \$39.73 million
-\$27.34 million ---State General Revenue (4.5%)
-\$ 5.73 million ---Educational Adequacy (.875% tax)
-\$ 3.27 million ---Property Tax Relief Trust Fund (.5%)
-\$ 0 million ---Conservation Tax (.125%)
-\$ 0 million ---Highway Fund (.5%)
-\$ 1.94 million ---Educational Excellence Trust Fund
-\$.17 million ---Educational Adequacy (GR transfer)
-\$.87 million ---State Central Services
-\$.40 million ---Constitutional Officers

Taxpayer Impact :

Purchasers with direct pay authority would continue to claim the refund on monthly excise tax returns filed with DFA. Purchasers who have not registered for direct pay authority would be required to submit claims for refunds with supporting purchase invoices and documentation to substantiate their claim for the refund benefits.

Resources Required :

Personnel will need to be hired to review and audit the refund claim forms, purchase invoices, and other supporting documentation submitted by manufacturing companies that submit refund requests to DFA's Sales and Use Tax Section. Based on DFA experience with auditing documents for local tax rebates and rebates for reduced manufacturing utilities, it is anticipated that 6 additional auditing positions will be needed to process refund claims.

Sales and Use Tax Section

1 Tax Auditor Supervisor C123 --- \$ 69,734
5 Tax Auditor II C120 --- \$375,696

Field Audit

10 Tax Auditor II C120 --- \$750,792
10 Motor Vehicles --- \$200,000
Travel Expenses --- \$50,000
Computer Equipment --- \$30,000

Time Required :

The proposal has an emergency clause which would remove the direct payment requirement effective the date of the approval by the Governor with the next rate reduction to be effective July 1, 2015. This does not provide adequate time to modify DFA's computer systems to accept the new reduced rates and establish refund claim procedures and processing procedures for this new type of paper refund claims. The monthly tax return will have to be modified to add an additional net tax rates for direct pay taxpayers and forms will need to be developed for the refund claims. Emergency rules may be necessary to implement the refund claim process required for those taxpayers who do not have direct pay authority. It is recommended that the proposal be effective on the first day of a calendar month as

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tax reports are filed for calendar months and not partial months.

Procedural Changes :

Modifications to DFA's computer system to accept monthly tax returns from manufacturers with direct pay authority will be required. Modification of existing forms; development of new forms for processing refund claims; drafting new tax form instructions; development of procedures for processing refund claims; and drafting of emergency rules.

Other Comments :

There are approximately 3500 to 4000 manufacturers that may be eligible to claim the reduced tax rate benefits with most filing paper refund claim documentation.

The proposal should be amended to clearly provide from which funds the refunds are to be granted. The current 6.5% state sales tax rate is levied at: 4.5% for state General Revenues; .5% for Property Tax Relief; .875% for Education Adequacy; plus the Constitutional levies of .5% for Highways and .125% for Conservation. When the 2.5% tax rate for the statutory levies begins on July 1, 2015, from which of the three statutory funds are the refunds to be granted? Are the refunds to be proportionally taken from the deposits to the three funds or are they to be issued from the General Revenue portion only?

The proposal should clearly provide that no interest is due the claimant of the tax refund claimed. Most refund claims will take several weeks or several months to audit and verify the claim. Since no tax has been overpaid, payment of interest by the state should not be required.

Ark. Code Ann. § 26-18-401 requires amendment to provide authority to DFA to assess taxpayers for improper refunds issued. Unless all refund claims are audited by DFA field tax auditors, any refunds granted by desk audit must allow for subsequent assessment if issued in error.

The DFA Revenue Division budget appropriation used for issuing state sales and use tax refunds, MTA0301, as provided in Ark. Code Ann. § 19-5-1009, may need an increase in authorization in order to make payments of the increased tax refunds that will be granted.

Additional resources are required to process refund claims when administering reduced rates for state sales and use tax where the constitutional levies remain in effect. The proposal leaves the constitutional levies in place. The Conservation Tax rate of 0.125% is a permanent tax while the 0.5% tax for Highways is limited to a ten year tax which became effective July 1, 2013 and will expire on June 30, 2023. Continuing these tax levies in conjunction with removing the existing requirements for direct pay reporting only, substantially increase the administrative impact of the proposal requiring additional desk audit and field audit staff to audit the refund claims.

Purchases of repair parts and services will be eligible for local tax rebates if the purchase invoices exceed \$2,500. To claim the local tax rebates and the refunds of state sales and use tax on the same purchase transaction, two separate rebate/refund claims with each having photocopies of purchase invoices, purchase orders and other documentation will be prepared and submitted by taxpayers to receive these tax benefits. Taxpayer costs to photocopy and deliver the documents to DFA may be

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significant. Business records would have to be maintained separately by the taxpayer for each refund request submitted and be available for auditors to review each purchase transaction.

Timeliness of issuance of refunds to taxpayers will have significant delay. From the time of tax is paid to the seller, subsequent preparing documentation to send to DFA to request refund, receipt by DFA with desk review and subsequent field audit to determine compliance and eligibility for the parts and services purchased, issuance of refund payment would be several months.

The proposal does not provide for the frequency the taxpayers are to follow when filing refund claims. If taxpayers file claims monthly and submit the proper documentation for subsequent audit, continuous auditing of taxpayer records for refund claims may occur for those taxpayers having hundreds or thousands of documents to review for each month. Invoices in most cases have model numbers, parts numbers and specific information as provided by the seller but the information shown does not necessarily reflect which manufacturing machine for which the products and services are purchased. Examining the invoice without having further explanation by the taxpayer regarding how the purchase is used to repair a manufacturing machine, will be time consuming for the taxpayer and for DFA.

Legal Analysis :

Amendment S1 adds Representative Jett as a cosponsor to SB332