Department of Finance and Administration

Legislative Impact Statement

Bill: SB571 Amendment Number: H3
Bill Subtitle: TO PROVIDE FOR AN INDIVIDUAL INCOME TAX REDUCTION; TO PROVIDE FUNDING FOR THE INCOME TAX REDUCTION THROUGH A TAX ON E-CIGARETTES; AND TO CREATE THE CIGARETTE TAX AND INCOME TAX REFORM STUDY.

Basic Change :

Sponsors: Senator J. Hendren; Representative L. Johnson

House Amendment 3 --- Amends the bill to reduce the tax rate provided in the low-income tax table on taxable income of $4,500 to $8,899 to 1½% from the current tax rate of 2%. The reduced tax rate would be effective for tax years beginning on and after January 1, 2020.

The amendment also provides that the definition of "vapor product" and "e-liquid product" for purposes of the E-Cigarette Privilege Tax would have the same meaning as those terms are currently defined in § 26-57-203. The amendment levies the privilege tax at the tax rate of thirty percent (30%) of the manufacturers invoice price to the wholesaler or retailer. The privilege tax is also levied on a vapor product when sold as part of a system with an e-liquid product or as part of a bundled transaction with an e-liquid product. The privilege tax would be applicable to e-liquid products and vapor products purchased by a wholesaler or retailer on or after the effective date of the act (anticipated to be October 1, 2019).

Engrossed 03/29/19 --- House Amendment 2 --- Deletes cosponsors and amends the bill to provide for a change to the Arkansas low-income tax table to lower the 2% bracket to 1% on taxable income of $4,500 to $8,899. The original bill would have lowered the rate to 0%. The amendment would also delete the provisions of the original bill to create the Earned Income Tax Credit Trust Fund; delete the provisions for an increased standard deduction; delete the provisions creating an earned income tax credit; and the provisions that would have created a Special Excise Tax on Cigarettes that would be levied at the retail level.

The draft amendment continues the provisions for the levy of an E-Cigarette Privilege Tax at the tax rate of 68% of the selling price from the manufacturer or wholesaler to the retailer of e-cigarettes sold in this state. The privilege tax would be imposed, reported, remitted and administered in the same manner and at the same time as taxes on tobacco products under the Arkansas Tobacco Products Tax Act. The amendment removes the provision that would have required the "E-cigarette Privilege Tax" to apply to the inventory and stocks of e-cigarettes held by a wholesaler or a retailer on the effective date of the act. The amendment provides that the tax levy would be effective on and after the first day of the second calendar month following the effective date of the act (September 1, 2019).

The amendment also provides for the Cigarette Tax and Income Tax Reform Study to be conducted by the House Committee on Revenue and Taxation, the Senate Committee on Revenue and Taxation, the House Committee on Public Health, Welfare, and Labor, and the Senate Committee on Public Health, Labor, and Welfare. The study would develop recommendations to the General Assembly regarding additional taxes on cigarettes and the reduction of the income tax burden on individuals, particularly low-income and middle-income individuals. The study would also determine how much the cigarette tax should be increased or the rate at which a new tax on cigarettes should be levied to help offset the costs to the state of covering the treatment of tobacco-related illnesses; study the feasibility of enacting an earned income tax credit to reduce the tax burden on low-and middle-income Arkansans; and to study the possibilities for reducing the income tax burden on individuals, including without limitation an increase in the standard deduction amount.

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Engrossed 03/27/19 --- **House Amendment 1** --- Deletes Representatives Breaux, Hawks, Lundstrum, and Petty as cosponsors of the bill.

Engrossed 03/19/19 --- **Senate Amendment 1** --- Amends the bill to provide that the Earned Income Tax Credits would become effective for tax years beginning on and after January 1, 2021. In the original bill, the tax credits would be effective for tax year 2020. The amendment also provides that if sufficient funds are not available in the Earned Income Tax Credit Trust Fund, the earned income tax credits would be at the maximum amount the fund will support.

The provisions regarding the revenue to be distributed from the special excise tax on cigarettes is also amended to provide that during FY2020, the first $55 million in revenue from the 20% retail tax on cigarettes is deposited to General Revenue. For FY2021 and subsequent fiscal years, the first $83,700,000 would be deposited as General Revenues with the remainder of the tax collections being deposited to the Earned Income Tax Credit Trust Fund.

Original Bill --- SB571 would amend Arkansas Code provisions regarding state taxation to reduce individual income tax rates, increase the standard deduction, create an earned income tax credit, levy new retail taxes on cigarettes, and levy a new excise tax on e-cigarettes.

The bill would amend the Arkansas low-income tax table to eliminate the 2% bracket (taxable income of $4,500 to $8,899) and increase the standard deduction from $2,200 to $3,300. The reduced tax rates and increased standard deduction would be effective for tax years beginning on and after January 1, 2020.

The bill would establish a refundable earned income tax credit in the Arkansas income tax code beginning for tax year 2020. The credit would be in the amount of at least five percent (5%) of the credit allowed under federal law if there are sufficient funds in the Earned Income Tax Credit Trust Fund to provide the necessary funding. The bill establishes the "Earned Income Tax Credit Trust Fund" to receive deposits from a portion of the new 20% retail tax on cigarettes. The Earned Income Tax Credit Trust Fund would be used to offset the cost of the earned income tax credit allowed. The refundable earned income tax credit would be effective for tax years beginning on and after January 1, 2020 with the fiscal impact being reflected in FY2021 state income tax collections and refundable income tax credits being issued.

Beginning on January 1, 2022, and on January 1 of each following year, DFA would certify the total amount of the earned income tax credits claimed during the previous year and transfer the amount certified from the Earned Income Tax Credit Trust Fund to the General Revenue Fund. The first transfer of funds would occur in FY2022 for the earned income tax credits allowed in FY2021. No funds would be transferred in FY2021 for the FY2021 earned income tax credits allowed.

The bill establishes the "Earned Income Tax Credit Trust Fund" to receive deposits from a portion of the new retail tax on cigarettes. After the first $55 million in revenue from the 20% retail tax on cigarettes is deposited to General Revenue, the remainder of the tax collections would be deposited to the Earned Income Tax Credit Trust Fund. The Earned Income Tax Credit Trust Fund would be used to offset the cost of the earned income tax credits allowed as provided in the bill. Beginning on January

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1, 2022, and on January 1 of each following year, DFA would certify the total amount of the income tax credits claimed during the previous year and transfer the amount certified from the Earned Income Tax Credit Trust Fund to the General Revenue Fund.

The bill also creates and levies a new special excise tax on cigarettes sold in Arkansas. The tax would be levied at the tax rate of 20% of the retail price and collected by the retailer at the time of sale to the consumer. The tax would be in addition to all other taxes and cumulative to the state and local sales tax. Retailers would file and remit the tax at the same time and in the same manner as filing their state sales tax. The tax returns would be filed electronically and failure to file a return and remittance will result in an assessment of penalty in the amount of 10% of the tax due. The first $55 million in revenue would be deposited to General Revenue Fund with the remainder deposited to the Earned Income Tax Credit Trust Fund.

This proposal also levies a new "E-Cigarette Privilege Tax" at the tax rate of 68% of the selling price from the manufacturer or wholesaler to the retailer on e-cigarettes sold in this state. "E-cigarette" is defined to mean a vapor product or an e-liquid product as those terms are defined by current Arkansas law. The privilege tax would be imposed, reported, remitted and administered in the same manner and at the same time as taxes on tobacco products under the Arkansas Tobacco Products Tax Act. The proposal requires the privilege tax to be separately stated and identified on each invoice or statement as the "E-cigarette Privilege Tax." The privilege tax levied under this section applies to the inventory and stocks of e-cigarettes held by a wholesaler or a retailer on the effective date of the act. The revenue generated would be deposited as state General Revenue.

The provisions of the bill providing the increased standard deduction, reduced tax rate, and the earned income tax credit would be effective for income tax years beginning on and after January 1, 2020. The provisions of the bill levying the special 20% retail tax on cigarettes and the e-cigarette privilege tax would be effective on the first day of the second calendar month following the effective date of this act, which is anticipated to be September 1, 2019.

Revenue Impact :

FY2020

1. Privilege Tax on E-Cigarettes
(8 Months of New Tax Collections)
+$2.18 Million Gain to State General Revenue

2. Rate Reduction in Low-Income Tax Table
- $2.1 Million Reduction in General Revenue

FY2021

1. Privilege Tax on E-Cigarettes
+$3.27 Million Gain to State General Revenue

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2. Rate Reduction in Low-Income Tax Table
- $4.18 Million Reduction in General Revenue

FY2022

1. Privilege Tax on E-Cigarettes
+$3.27 Million Gain to State General Revenue

2. Rate Reduction in Low-Income Tax Table
- $4.18 Million Reduction in General Revenue

[E-Cigarettes --- Revenue Estimate based on sales volumes of same products in Pennsylvania which levied special excise taxes in 2016. Sales per capita calculated and applied to Arkansas population and proposed 30% excise tax rate.]

Taxpayer Impact :

Manufacturers/wholesalers/retailers of e-cigarettes would be subject to remittance of new privilege taxes. Certain individual income tax payers would benefit from a reduced tax rate.

Resources Required :

Computer programs, tax forms and instructions will need to be updated

Time Required :

Adequate time is provided for implementation

Procedural Changes :

The proposal will require modifications to the state's tax system to allow for the new tax on e-cigarettes

Other Comments :

E-Cigarette Taxation --- Tobacco excise tax is levied at the wholesale level and remitted to DFA by the wholesaler at the time of sale to the retailer based on the manufacturer's selling price to the wholesaler. Arkansas law specifically defines wholesaler to mean a person that purchases vapor products, alternative nicotine products, or e-liquid products from any source and distributes or sells the vapor products, alternative nicotine products, or e-liquid products to other wholesalers, vendors, or retailers and does not sell to consumers. Manufacturers specifically include persons that mix, compound, repackage, or resize e-liquids or vapor products. There are many retailers for e-cigarettes and vapor products that also meet the definition of a manufacturer as the result of their own manufacture of products that do not sell to wholesalers but sell their manufactured products in their retail stores. If the intent of the bill is to levy the new privilege tax on all e-cigarette products, the bill would require amendment to provide that the tax will be due from retailers that also manufacture their own products. If amended, the monetary value upon which the tax is to be levied and calculated by the retailers should be included.

Legal Analysis :

SB571-H3 is an amendment to SB571 as previously engrossed.

SB571-H3 maintains the elimination of the two percent (2%) tax rate for the lowest income tax table, but amends the tax rate for incomes from $4,500 through $8,899 to one and one half percent (1.5%) for the same table.

SB571-H3 amends the levy of the tax on e-cigarettes tax as originally levied in SB571. SB571-H3 levies a tax of thirty percent (30%) on the invoice price of e-liquid products and vapor products, as those terms are defined in § 26-57-203. A vapor product would be taxable only when it was sold as part of a system with an e-liquid product or as part of a bundled transaction with an e-liquid product. The tax would apply to all stocks of wholesalers or retailers that were purchased on or after the effective date of SB571.

The provisions adjusting the tax tables become effective for tax years beginning on or after January 1, 2020. The provisions establishing a tax on vapor products and e-liquid products become effective on the first day of the second calendar month following the effective date of the act.