



STATE OF ARKANSAS
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PFM Sales Tax Issues

General Overriding Theme is Tax Base Erosion

- **More Sales On-Line**
- **Shift from Goods to Services**
- **Aging Populations Purchase Less**
- **Sales Tax Base as a Percentage of Personal Income**
- **Exemptions**

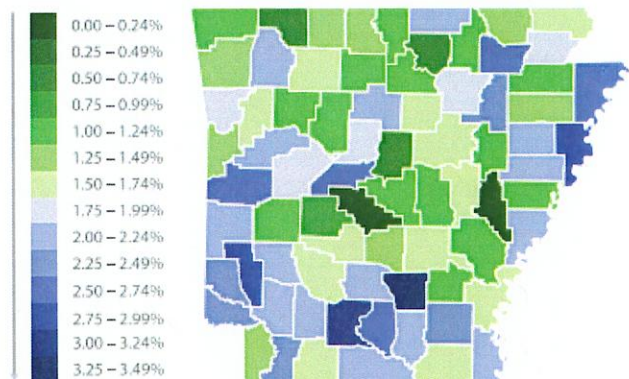


Local Option Sales Taxes in Arkansas

- Arkansas granted local governments the authority to hold local option sales tax elections in 1981.
- Cities and counties can elect to levy a local sales tax of up to 5.5 percent, upon voter approval.
- The State collects the local sales and use tax, and distributes it back to the cities and counties every month.
- Currently, there are more than 300 local taxing jurisdictions in Arkansas (73 of 75 counties, the remainder are cities)

Arkansas County Sales Tax Rates

County sales tax rate is in addition to the statewide 6.5% sales tax and any city sales taxes.





Arkansas - Key Sales Tax Milestones

Year	Milestone	Sales Tax Rate
1935	Act 233 - Temporarily applied a tax to the gross proceeds from all retail sales (May 1, 1935 - July 1, 1937); Exempted "all goods necessary to life."	2.0%
1941	Levied 2% tax on gross proceeds or gross receipts derived from sales of certain tangible personal property.	
1957	Act 19 - Rate increase approved by voter referendum.	3.0%
1983	Act 63 - Rate increase as part of 1st Extraordinary Session of 1983.	4.0%
1983	Computer software and service, repairing and maintaining of computer equipment specifically enumerated (first enumeration).	
1987	Repeal of exemption on cigarettes (first exemption repeal).	
1991	Act 3 - Rate increased by 0.5%.	4.5%
1997	Act 156 - Initiated the Constitutional Amendment (Amendment 75) Conservation Tax of an additional 1/8 cent sales and use tax on all taxable sales of property and services.	4.625%
2001	Act 1492 of 1999 - Increased sales tax by 0.5% upon voter ratification of Constitutional Amendment 79; effective 1/1/2001	5.125%
2001	Act 1279 - Uniform Sales and Use Tax Administration Act; first step towards streamlining.	
2004	Act 107 - Rate increase of 7/8 percent as a special revenue, to be credited to the Educational Adequacy Fund.	6.0%
2011	HJR 1001 (Amendment 91) - Created a temporary 0.5% sales and use tax.	6.5%



State Sales Tax Rates

	State Tax Rate	Average Local Tax Rate	Combined State & Average Local Sales Tax Rate	Max Local Tax Rate
Alabama	4.00%	5.03%	9.03%	7.00%
Missouri	4.225%	3.74%	7.970%	5.00%
Oklahoma	4.50%	4.36%	8.86%	2.25%
Louisiana	5.00%	5.02%	10.02%	7.00%
Nebraska	5.50%	1.40%	6.90%	2.00%
Iowa	6.00%	0.80%	6.80%	1.00%
Texas	6.25%	1.92%	8.17%	2.00%
Kansas	6.50%	2.18%	8.68%	4.00%
Arkansas	6.50%	2.84%	9.34%	5.125%
Mississippi	7.00%	0.07%	7.07%	1.00%
Tennessee	7.00%	2.45%	9.45%	2.75%
Median	4.23%	4.36%	8.86%	5.00%
Average	4.24%	4.38%	8.62%	4.75%
Rank	8 of 11	5 of 11	6 of 11	7 of 11



State Taxation of Services: Arkansas

	Utilities	Personal Services	Business Services	Computer Services	Admissions/Amusements	Professional Services	Fabrication, Repair & Installation	Other Services	Total
Kansas	10	11	9	1	13	0	15	15	74
Mississippi	10	5	8	3	11	0	13	22	72
Arkansas	16	7	12	1	12	0	11	13	72
Tennessee*	11	10	7	3	12	0	13	11	67
Louisiana	10	8	5	3	9	0	13	7	55
Oklahoma	9	3	4	1	10	0	0	5	32
North Carolina	10	4	5	0	9	0	1	1	30
Missouri	8	1	2	2	10	0	0	3	26
Total Number of Services in Category	16	20	34	8	15	9	19	47	168
AK % of Total Services Taxed	100.0%	35.0%	35.3%	12.5%	80.0%	0.0%	57.9%	27.7%	42.9%

Source: Federation of Tax Administrators, 2007 FTA Survey



Scoring Arkansas Sales Tax Exemptions

- In April 2012, the DFA conducted an analysis of revenue estimates of various exemptions to the Arkansas Gross Receipts tax and the Arkansas Compensating Use tax.
- The analysis revealed that in 2011, the State had 101 sales tax exemptions totaling \$1.4 billion.*

Exemption Category	2011 Estimates	
	#	\$
Motor Fuel	4	\$380,197,104
Federal Government	5	\$99,022,461
Media	5	\$22,850,448
Low-Income Households	3	\$24,412,222
Medical	3	\$153,997,461
Agricultural	12	\$241,721,902
Industrial Machinery or Equipment	5	\$122,365,838
Energy	6	\$26,222,230
Local Government Other than School Districts	7	\$9,299,561
Non-Profit, Religious or Charitable Organizations	23	\$107,486,597
Aviation or Aerospace	3	\$25,418,495
School Districts and Other Educational Institutions	8	\$15,743,304
Other	17	\$212,577,035
Total	101	\$1,441,314,658

- Since then, the State has approved 20 new/refined sales tax exemptions with an estimated annual impact of \$102 million.



Arkansas Exemptions that Significantly Erode the State and Local Tax Base

- In 2011, 10 exemptions accounted for 77 percent of the total cost of sales tax exemptions to the State:

FY 2011 Exemptions that Significantly Erode the State and Local Tax Base		
Exemption	FY 2011 Estimate	% of Total FY 2011 Exemptions
1. Gasoline or motor vehicle fuel on which the gasoline or motor vehicle fuel tax has been paid	\$325 million	22.57%
2. Partial sales tax exemption on food and food ingredients	\$176 million	12.21%
3. Prescription drugs	\$143 million	9.89%
4. Sales to any non-profit hospital, sanitarium or nursing homes	\$104 million	7.18%
5. Feedstuffs used in the commercial production of livestock or poultry.	\$99 million	6.84%
6. Sales of machinery and equipment used directly in manufacturing or processing	\$85 million	5.92%
7. Sales of materials used in treating livestock and poultry for commercial production	\$51 million	3.55%
8. Purchases made with food stamps	\$46 million	3.21%
9. Sales to the U.S. government	\$46 million	3.17%
10. Sales of Dyed diesel	\$41 million	2.86%
	\$1.1 billion	77.40%

Source: Arkansas Department of Finance and Administration, Economic Analysis and Tax Research (April 2012)



Summary

- The sales tax (as a broad-based consumption tax) has positive attributes from an economic perspective.
- Economic and demographic changes coupled with consumer behavior and preference are contributing to sales tax base erosion that threaten revenue sufficiency.
- For states with a significant reliance on the sales tax, this has mostly led to rate increases, which creates border effects and spurs additional tax avoidance.
- There are few examples of states that have successfully broadened the sales tax base and reduced the rate.
- Arkansas benefits from the fact that most major population centers are not in close proximity to states with lower sales tax rates.
- Given this, sales tax reduction may not be the best resource investment.



Possible Sales Tax Strategies

- Methods to continue to boost compliance:
 - Changes to state nexus and/or reporting requirements
 - Use tax reporting on individual income tax forms
 - Additional sales tax compliance auditors
- Cost-benefit analysis on sales tax exemptions:
 - Identify exemptions by categories and develop broad-based parameters
 - Develop cost-benefit analytical methods, which may require additional tax data
- Identify specific services areas (based on benchmarking) that are worth considering for base-broadening.