



STATE OF ARKANSAS  
**Department of Finance  
and Administration**

**COMMISSIONER OF REVENUE**

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May 9, 2018

The Honorable Jim Hendren, Co-Chair  
The Honorable Lane Jean, Co-Chair  
Tax Reform and Relief Legislative Task Force  
Multi-Agency Complex – Room A  
1 Capitol Mall  
Little Rock, Arkansas 72201

*Re: Task Force Inquiries from April 25-26, 2018 Meeting*

Chairman Hendren and Chairman Jean:

During the April 25 and 26, 2018, meeting of the Tax Reform and Relief Legislative Task Force, there were several inquiries made for information and clarification. The Department is providing the following answers for the May 10, 2018, meeting to ensure that the Task Force has the best available information for the continuing discussions.

**1. Amount of Sales and Use Tax Farm Exemption Estimate Attributable to ATVs/UTVs**

The total revenue estimate of the farm exemption previously provided (**\$29.9M – GR Portion \$20.7M**) is not based on actual returns filed by taxpayers because it attempts to quantify an amount not reported to the Department. The Department is unable to determine how much of the revenue estimate is attributable to properly-claimed exemptions solely for ATVs and UTVs at this time. The Department did express our intention to work with other stakeholders regarding administration of the farm or agricultural exemption and methods by which it may be able to be improved.

**2. Monthly Sales Tax Revenue Before and After the enactment of the Sales Tax Holiday**

The Arkansas Sales Tax Holiday was enacted by Acts 2011, No. 757 and was effective by August of 2011. As previously described, the Department estimates that this exemption has a revenue impact of **\$2.65M (GR Portion – \$1.8M)**. In providing the comparison of August Sales and Use Tax amounts from before and after the enactment of the Sales Tax Holiday, it is important to note that the revenue estimate is a small fraction of the monthly sales and use tax revenue in August and may be within the margin of error for any estimations. Additionally, in August of 2013, an additional .5% tax was levied for the Arkansas Department of Transportation which may have had an effect on these numbers. The Department has provided an estimated amount of Gross Receipts for your convenience.

Period	Sales Tax	Use Tax	Total		% Change	Estimated Gross Sales
Aug-06	186,679,434	31,720,046	218,399,480			\$3,639,991,333
Aug-07	170,911,110	36,478,017	207,389,127		-5.041%	\$3,456,485,450
Aug-08	163,858,538	33,728,014	197,586,552		-4.727%	\$3,293,109,200
Aug-09	158,727,144	29,498,250	188,225,394		-4.738%	\$3,137,089,900
Aug-10	157,293,556	33,125,445	190,419,001		1.165%	\$3,173,650,017
Aug-11	139,031,334	35,188,940	174,220,274		-8.507%	\$2,903,671,233
Aug-12	129,253,087	29,853,723	159,106,810		-8.675%	\$2,651,780,167
Aug-13	166,044,220	32,294,164	198,338,384	* 0.5% Rate Increase (Highway)	24.657%	\$3,051,359,754
Aug-14	182,273,282	32,863,119	215,136,401	* 0.5% Rate Increase (Highway)	8.469%	\$3,309,790,785
Aug-15	175,957,020	30,845,343	206,802,363	* 0.5% Rate Increase (Highway)	-3.874%	\$3,181,574,815
Aug-16	168,503,998	32,264,051	200,768,049	* 0.5% Rate Increase (Highway)	-2.918%	\$3,088,739,215
Aug-17	167,991,507	27,317,520	195,309,027	* 0.5% Rate Increase (Highway)	-2.719%	\$3,004,754,262

### 3. The Original Enactment Dates of the Income Tax Deductions for Organ Donors and the Special Railroad Retirement Exemption

The Railroad Retirement exclusion in Ark. Code Ann. § 26-51-404(6)(B) was enacted by Acts 1969, No. 462. The Organ Donor Deduction in Ark. Code Ann. § 26-51-2103 was enacted by Acts 2005, No. 668.

### 4. Greater Detail on the Department’s Estimates related to Expensing for accuracy

Since 1982, Internal Revenue Code (IRC) § 179 allows taxpayers to deduct a certain dollar amount of depreciable property in the year purchased rather than capitalizing and depreciating the property. Arkansas Code Annotated § 26-51-428 adopts IRC 179 as in effect on January 1, 2009. Arkansas adopted IRC § 179 beginning in 1990 and had readopted it until 2009. As time has progressed, the types and useful lives of depreciable assets have expanded to the point that virtually all asset purchases except land are now eligible for IRC § 179 expensing. There is a substantial negative revenue impact to Arkansas after adopting an increase in IRC § 179 before revenue losses fall to near zero due to recovery of revenue losses from future depreciation differences. Therefore, the Arkansas § 179 limit has been less than the federal limit for most of the last 20 years. This results in taxpayers keeping two sets of depreciation tables. The Tax Cuts and Jobs Act of 2017 (“TCJA”) increased the federal IRC § 179 limits from \$500,000 to \$1,000,000 with the phaseout limit raised from \$2M to \$2.5M for purchases made in 2018 and after. The Arkansas § 179 limit has been \$25,000 with phase out beginning at \$200,000 since 2011. The federal IRC § 179 deduction and phaseout limits are indexed for inflation, but the Arkansas limit is not.

Since 2001, Federal law has also included first year “bonus” depreciation ranging from 30% to 100%, with most eligible asset purchases at 50% for 2017. The TCJA increases bonus depreciation to 100% for purchases made in 2018 through 2022. The TCJA phases out bonus depreciation by 20% per year until it reaches 20% during 2026 and phases out entirely in 2027 with certain exceptions that are extended until 2028. Bonus depreciation is not allowed for

automobiles, but is allowed for most other business property with a useful life of 20 years or less. In prior years, computer software was not eligible for bonus depreciation, but is under the TCJA. Arkansas has never adopted bonus depreciation because Arkansas revenue loss estimates have ranged from \$30M to over \$50M in the first year of adoption based on 30% to 50% bonus depreciation. Therefore, taxpayers must keep two sets of depreciation tables due to Arkansas never adopting bonus depreciation as well.

The Joint Committee on Taxation (JCT) prepares the revenue impact projections of proposed federal tax legislation. DFA uses a JCT multiplier to scale down federal tax projections for Arkansas tax projection purposes. The JCT multiplier was computed in 2013 by dividing the Census Bureau estimate of Arkansas population of 2,937,979 by the U.S. estimated population of 311,591,917, multiplying that percentage by Arkansas per capita income of \$21,833 divided by the U.S. per capita income of \$27,915 and then dividing by 5 to account for the difference between Arkansas and federal tax rates. This resulted in a JCT multiplier of .001475 for 2013, and .001458 for FY2019. This formula will need to be adjusted in the future because federal corporate tax rates will drop from 35% to 21% beginning in tax year 2019 and after.

In 2012, IRC § 179 was amended to increase the expensing limit from \$125,000 to \$500,000 and phase out was raised from \$500,000 to \$2,000,000 for tax years beginning in 2012 through 2017. The estimated revenue impact of adopting this change was a loss of \$11,929,800 for FY2013 and \$5,961,950 for FY2014. This estimate was derived for FY2013 by multiplying the JCT projection of \$8.088 billion federal loss for federal FY2012 by that year's JCT multiplier of .001475. However, this projection only accounted for the revenue impact of the difference between the \$500,000 federal IRC § 179 limit and the previous \$125,000 limit. Since \$125,000 was the new baseline for federal revenue impacts in 2012, there was no JCT data available to estimate the revenue impact below \$125,000. However, the federal IRC 179 limit was raised from \$100,000 to \$125,000 in 2010. Since the difference between \$100,000 and \$125,000 is one fourth of the difference between the \$125,000 and \$25,000, the Department multiplied the \$3.266 billion JCT estimate for 2010 by four and then by 105% to account for 2011 and 2012 inflation and by our JCT adjustment multiplier of .001475 to arrive at an impact of \$20,232,870 in the first year and \$11,751,915 in the second year for the revenue impact of increasing the Arkansas 179 limit from \$25,000 to \$125,000 and a total impact of **\$32,162,670** for the difference between the Arkansas 179 limit of \$25,000 and the federal limit of \$500,000 for FY2013. The revenue impact of raising the IRC § 179 limit from \$25,000 to \$125,000 was projected to be higher than the projection of raising it from \$125,000 to \$500,000 because as IRC § 179 limits rise, fewer and fewer small businesses can afford to make larger investments.

For the TCJA, federal IRC § 179 limits were increased from \$500,000 to \$1,000,000. The Arkansas revenue impact of adopting just this federal change would be the \$7.4 billion JCT estimate multiplied by the current JCT multiplier of .001458 or **\$10,789,200** for FY2020, and \$5,977,800 for FY2021. This results in a total revenue loss estimate of **\$42,951,870** for FY2020 and \$23,691,665 in FY2021 to increase the limit from \$25,000 to \$1,000,000 for tax years beginning in 2019 and after.

The revenue impact estimates for adopting IRC § 179 have previously not been run past the second fiscal year of potential adoption because the federal IRC § 179 expensing limit was previously scheduled to return to the pre-2003 limit of \$25,000 until it was permanently extended at the \$500,000 limit in 2015. Therefore, adoption of IRC § 179 would have resulted in a revenue gain in the third year after adoption before it was permanently extended in 2015. Therefore, we can only use the revenue estimates from the TCJA from the JCT estimates for IRC § 179 for the third fiscal year following adoption and after. If we assume the JCT estimate for adopting IRC § 179 is \$42,951,870 for FY 2020 based on the \$7.4 billion JCT estimate for federal FY2019, then the Arkansas estimated loss FY2022 would be \$15,091,197 based on the \$2.6 billion JCT estimate for federal FY2021. Using the same method, the estimated revenue loss for Arkansas FY2023 of adopting IRC § 179 would be \$11,608,613, and \$8,706,460 for FY2024.

The federal and Arkansas revenue loss of adopting IRC § 179 never reaches zero or becomes positive, because it is assumed that taxpayers will continue to purchase new assets at or above previous levels, so there exists the revenue loss of new purchases to offset gains from depreciation differences in years after an asset is purchased. The differences between Arkansas and federal depreciation are never fully realized because federal like-kind exchange rules allow business assets that are retired or sold to be replaced with other business assets without recognizing gains on the assets disposed, thus rolling forward the tax benefits of asset expensing indefinitely. However, recent changes in federal like-kind rules ends the practice of indefinitely rolling forward the tax advantages of IRC § 179 and bonus depreciation expensing by limiting like-kind exchange rules to only real property used in production of income beginning in 2018.

In addition to IRC § 179 expensing of assets, IRC § 168(k) and following has allowed bonus depreciation for a wider range of assets and without limitations on the total depreciable assets purchased. Bonus depreciation began after 9/11/2001 at 30% of the purchase price plus normal depreciation deductions on the remaining 70% of the cost of an asset. Bonus depreciation was later increased to 50% and even to 100% for certain types of assets. The TCJA increased all bonus depreciation to 100% for assets purchased after September 27, 2017 and before January 1, 2023.

The current estimate of revenue loss for adopting has been calculated by multiplying the federal estimates of increasing bonus depreciation from 50% to 100% of \$32.5 billion by 2 because Arkansas currently has no bonus depreciation, and then by the current JCT adjustment factor of .001458 to reach an Arkansas estimate of **\$94.77M for FY2020 and \$106.43M for FY2021**, before seeing the revenue losses decrease to \$71.73M for FY2022, \$41.4M for FY2023 and \$33.8M for FY2024.

**The revenue loss of adopting both bonus depreciation and IRC § 179 for tax years beginning in 2019 and after would be \$137.7M for FY2020, \$130.1M for FY2021, \$86.8M for FY2022, \$53M for FY2023 and \$42.5M for FY2024.**

## 5. Options for a Vending Machine Operator to Collect and Remit Tax

A taxpayer is given 3 options to manage their vending operations in Arkansas. All vending machines must display an annually-issued vending device decal, no matter which option is chosen.

- **Option 1** involves the payment of sales tax directly to the supplier of all merchandise that will be sold through the taxpayer's vending machines. Food sold through a vending machine can qualify for taxation at the Reduced Food Tax rate (see Rule 2007-3). **No Sales/Use Tax permit is required if Option 1 is chosen.**

After the opening of a Vending account, fiscal year decals are issued and placed on vending machines by the taxpayer. Prior to the beginning of each new fiscal year, a decal order form is mailed out to all Vending accounts. There are no fees for the annual Option 1 decals.

- **Option 2** involves reporting/paying the 7% Wholesale Vending Tax (see Rule 1995-2) each month on the merchandise to be sold through the taxpayer's vending machines. Merchandise is purchased tax-free under the sale for resale exemption. **A Sales/Use Tax Permit is required.** The taxpayer is required to file a monthly ET-1 Excise Tax Report and pay the appropriate tax.

After the opening of a Vending account, fiscal year decals are requested, issued, and placed on vending machines by the taxpayer. Prior to the beginning of each fiscal year, a decal order form is mailed out to all Vending accounts. There are no fees for the annual Option 2 decals. The distribution of revenue from collection of wholesale vending tax is pursuant to Ark. Code Ann. § 26-57-1002. The 7% is distributed 5.5% to general revenue and 1.5% special revenue to the Educational Adequacy Fund.

- **Option 3** involves exempting vending merchandise purchases from tax under the sale for resale exemption. **A Sales/Use Tax Permit is required.** The taxpayer is required to file a monthly ET-1 Excise Tax Report.

After opening of a Vending account, fiscal year decals are purchased, issued, and placed on vending machines by the taxpayer. The vending machine operator purchases Option 3 decals based on various factors (for example, manual verses electric vending equipment, value of the vended goods, and bulk verses individually vended goods). Prior to the beginning of each new fiscal year, a decal order form is mailed out to all Vending accounts. Option 3 decal costs are shown below:

<b>Type of Vending unit</b>	<b>Dispenser</b>	<b>Value Range</b>	<b>Decal Fee</b>
Individual – Type B Decal	Electric	less than \$0.25	\$15.00
Individual – Type A Decal	Electric	\$0.25 or more	\$93.00
Bulk – Type D Decal	Electric or Manual	\$0.25 or less	\$2.50
Bulk – Type C Decal	Electric or Manual	more than \$0.25	\$7.50
Individual – Type E Decal	Manual	\$0.25 or more	\$30.00

The above option 3 decals are broken down into categories pursuant to Ark. Code Ann. § 26-57-1206.

Type A decals are \$93.00 with the revenue distribution 60% general revenue, 15% special revenue (Cities and Counties Identification Pending Trust Fund, Local Sales and Use Tax), and 25% special revenue (Educational Adequacy Fund).

Type B, C, D, and E vending decals are \$15.00, \$7.50, \$2.50, and \$30.00, respectively. The revenue from Types B, C, D and E decals are distributed 80% to general revenue and 20% to special revenue (Cities and Counties Identification Pending Trust Fund, Local Sales and Use Tax).

## **6. Whether there is a Constitutional Prohibition on Taxing Magazine Subscriptions**

Generally, there is no constitutional prohibition on levying a sales tax on the tangible personal property such as the sale of a magazine under subscription when the tax is applied in a content and viewpoint neutral manner. As discussed at the Task Force meeting, there can be concerns regarding the Freedom of Speech when sales tax is applied to the sale of periodicals.

The analysis provided by the Bureau of Legislative Research in relation to this exemption addressing Arkansas Writers’ Project v. Ragland, 481 U.S 221 (1987), comports with the Department’s analysis of the applicable Constitutional law. Arkansas Writers’ Project makes clear that the previous exemption that was provided only for certain specific types of magazine subscriptions ran afoul of the First Amendment because it was not content and viewpoint neutral. Arkansas Writers’ Project v. Ragland, 481 U.S 221 (1987) (“Such official scrutiny of the content of publications as the basis for imposing a tax is entirely incompatible with the First Amendment’s guarantee of freedom of the press. [citation omitted]”). Because the taxability of the magazine subscription was dependent on the nature of the magazine itself, the Supreme Court of the United States struck down the previous taxing regime. Id. In response, Arkansas

exempted all magazine subscriptions from tax. It is an equally defensible position for the General Assembly to tax all magazine subscriptions under the Arkansas Writers' Project precedent.

## **7. Single Sales Factor Corporate Income Changes**

Please see attached PowerPoint prepared by the Corporate Income Tax Section.

Sincerely,

A handwritten signature in cursive script that reads "Walter Anger".

Walter Anger  
Commissioner of Revenue

Enc.