

SUMMARY OF PROPOSAL #13
for consideration by the
ARKANSAS TAX REFORM AND RELIEF LEGISLATIVE TASK FORCE

TOPIC: Fuel Taxes; Indexed Retail Sales Tax

Summary of Proposal for Consideration

To create an indexed retail sales tax on motor fuel and distillate special fuel that adjusts based on Arkansas highway construction costs and to set a minimum tax rate equal to the previous year's retail sales tax rate on motor fuel and distillate special fuel and a maximum tax rate of two cents (2¢) above the previous year's retail sales tax rate on motor fuel and distillate special fuel. This proposal would create a percentage tax on the retail selling price per gallon of motor fuel and distillate special fuel based on the average retail selling price of motor fuel and distillate special fuel over a twelve-month period. The sales tax would be converted to a cents-per-gallon tax and would be collected, reported, and paid in the same manner as the excise taxes on motor fuel and distillate special fuel. The revenues derived from the proposed retail sales tax on motor fuel and distillate special fuel would be special revenues to be distributed under the Arkansas Highway Revenue Distribution Law.¹

Fiscal Analysis

According to the Department of Finance and Administration (DFA), based on the amount of motor fuel revenue in Fiscal Year 2017 (\$476,507,000), a one percent (1%) inflationary measure has an estimated the fiscal impact of four million seven hundred sixty-five thousand dollars (\$4,765,000); at two percent (2%) it is estimated to be nine million five hundred thirty thousand dollars (\$9,530,000), and at three percent (3%) it is estimated to be fourteen million two hundred ninety-five thousand dollars (\$14,295,000). This amount would be subject to compounding inflation year over year.

Arkansas is a party to the International Fuel Tax Agreement (IFTA) which provides a method by which commercial interstate motor carriers are able to allocate motor fuel tax based on the miles driven within each jurisdiction. IFTA requires that the tax on motor fuel be a definite amount per gallon rather than a sales tax percentage of the receipts, be levied at the wholesale level, and that the tax rate only be changed on a set time table, such as quarterly. Any adjustments to be made based on these variables would need to be made in compliance with IFTA. DFA could publish on a quarterly, biannual, or annual basis, the amount of the adjustment

¹ Under Arkansas Code § 27-70-206, the funds would be distributed as follows:

- First, three percent (3%) would be credited to the Constitutional Officers Fund and the State Central Services Fund;
- Second, up to two million five hundred thousand dollars (\$2,500,000) may be credited to the Gasoline Tax Refund Fund, if certified by the Director of the Department of Finance and Administration as necessary to pay approved gasoline tax refund claims; and
- Third, the remainder would be distributed as follows: seventy percent (70%) to the State Highway and Transportation Department Fund, fifteen percent (15%) to the County Aid Fund, and fifteen percent (15%) to the Municipal Aid Fund.

to the motor fuel, special motor fuel, and other related taxes based on a defined formula provided by legislation.

Legal Analysis

Current Law

Arkansas imposes excise taxes on motor fuel at a rate of twenty-one and one-half cents (21.5¢) per gallon and on distillate special fuel at a rate of twenty-two and one-half cents (22.5¢) per gallon.² Arkansas does not currently have a retail sales tax on motor fuel or distillate special fuel, and state law does not provide a mechanism for the motor fuel or distillate special fuel tax rates to automatically adjust based on one (1) or more economic indicators, including construction costs.

Under Arkansas Code § 26-52-401(11), motor fuel and distillate special fuel are exempt from the sales tax.

Most of the revenues generated by the taxes on motor fuel and distillate special fuel are special revenues distributed under the Arkansas Highway Revenue Distribution Law. However, the additional tax of one cent (1¢) on motor fuel and distillate special fuel levied by Act 445 of 1973 is credited to the State Highway Special Construction Account, which is transferred to the State Aid Road Fund, and Arkansas Constitution, Amendment 91, distributes one cent (1¢) per gallon from motor fuel and distillate special fuel to the State Aid Street Fund.

History

Act 606 of 1921 enacted a tax on motor fuel and distillate special fuel at a rate of one cent (1¢) per gallon. The rate was increased twice in 1923, first to three cents (3¢) and then to four cents (4¢) per gallon. In 1927, the rate increased to five cents (5¢) per gallon, and it was increased again in 1931 to six cents (6¢) per gallon.

Act 383 of 1941 separated the tax on motor fuel and the tax on distillate special fuel and levied a tax on each of six and one-half cents (6.5¢) per gallon.

Acts 40 and 41 of 1965 (1st Ex. Sess.) increased the tax rate for motor fuel to seven and one-half cents (7.5¢) per gallon and increased the tax on distillate special fuel to eight and one-half cents (8.5¢) per gallon.

Act 445 of 1973 levied an additional tax of one cent (1¢) per gallon on motor fuel and distillate special fuel.

² The motor fuel taxes may be found in Arkansas Code §§ 26-55-205, 26-55-1002, 26-55-1006, 26-55-1201, and 26-56-601. The distillate special fuel taxes may be found in Arkansas Code §§ 26-56-201, 26-56-502, 26-56-601, and 26-56-802.

Act 437 of 1979 increased the motor fuel tax and the distillate special fuel tax by another one cent (1¢) per gallon, bringing the total tax rate to nine and one-half cents (9.5¢) per gallon for motor fuel and ten and one-half cents (10.5¢) per gallon for distillate special fuel.

Act 456 of 1985 added a tax of four cents (4¢) per gallon on motor fuel and two cents (2¢) per gallon on distillate special fuel.

Act 219 of 1991 levied an additional tax of four cents (4¢) per gallon on distillate special fuel.

Acts 364 and 382 of 1991 levied an additional tax of five cents (5¢) per gallon on motor fuel and two cents (2¢) per gallon on distillate special fuel, bringing the tax to a total of eighteen and one-half cents (18.5¢) per gallon on both motor fuel and distillate special fuel.

Act 1028 of 1999 phased in an additional tax of three cents (3¢) per gallon on motor fuel over three (3) years and an additional tax of four cents (4¢) per gallon on distillate special fuel, which resulted in the current total tax rates for motor fuel and distillate special fuel.

Potential Legal Issues

Amendment 19 to the Arkansas Constitution (incorporated at Article 5, § 38) requires an emergency clause and a ¾-vote of the legislature to increase the rate of certain taxes.³ The motor fuel and distillate special fuel taxes are generally considered to fall under the Amendment 19 requirements. However, Amendment 19 applies only if the specific rates of tax are being increased; if a new tax is created, it is not subject to Amendment 19. To determine whether a tax is a new tax or an increase of an existing tax, courts consider how similar the two taxes are in terms of what is being taxed, who bears the burden of paying the tax, how the tax is structured, and what the funds generated by the tax are used for. The Attorney General has stated that the courts have made it clear that the party responsible for paying the tax is an important consideration in determining whether the tax is subject to Amendment 19.

This proposal is intended to create a separate sales tax on motor fuel and distillate special fuel that would be structured as a new sales tax rather than as an increase of the existing excise taxes. However, the proposed new tax would be similar to the existing taxes in that it would be levied on the same products; the wholesalers would bear the burden of paying the taxes because it would be collected, reported, and paid in the same manner as the excise taxes; the revenues would be used for the same purpose as the revenue from the excise taxes; and the rate would ultimately be levied in cents-per-gallon. It would be different from the existing excise taxes because it would be structured as a retail sales tax equal to a percentage of the retail price of the motor fuel and distillate special fuel, which is then converted to a cents-per-gallon tax for ease of administration. It is unclear whether a court would determine that this proposal would be subject to the requirements of Amendment 19.

³ Amendment 19 also allows for the General Assembly to refer such tax rate increases to the voters for their approval, in which case the bill would require only a majority vote of each house.