



# Revenue Impact of Adoption of Single Sales Factor and Elimination of Throwback Rule

Arkansas Tax Reform and Relief Legislative Task Force

September 26, 2018

Arkansas Department of Finance and Administration



## Apportionment of Business Income

- Arkansas requires that all business income be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus double the sales factor, and the denominator of which is 4.

Most state apportionment formulas fall within one of three categories:

- Equally weighted three-factor formulas;
- Three-factor formulas with enhanced sales factors; or
- Single sales factor formulas.

# Apportionment of Business Income

Equally Weighted	Enhanced Sales Factor	Single Sales Factor
Alaska, Hawaii, Kansas, Mississippi, Missouri, Montana, North Dakota, Oklahoma, Utah	Alabama, Arkansas, Delaware, Florida, Idaho, Kentucky, Maryland, Massachusetts, New Hampshire, New Mexico, North Carolina, Tennessee, Vermont, Virginia, West Virginia	Arizona, California, Colorado, Connecticut, Georgia, Illinois, Indiana, Iowa, Louisiana, Maine, Michigan, Minnesota, Nebraska, New Jersey, New York, Oregon, Pennsylvania, South Carolina, Texas, Wisconsin
9	15	20
	(Enhanced = Double or greater weighted)	

## Apportionment Comparison – High Sales Factor

	3 Factor - Equally Weighted	3 Factor with Double Sales	Single Sales Factor
Apportionable Income	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000
Arkansas Property	\$ 100,000	\$ 100,000	
Everywhere Property	\$ 10,000,000	\$ 10,000,000	
Property %	1%	1%	
Arkansas Payroll	\$ 100,000	\$ 100,000	
Everywhere Payroll	\$ 10,000,000	\$ 10,000,000	
Payroll %	1%	1%	
Arkansas Sales	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000
Everywhere Sales	\$ 10,000,000	\$ 10,000,000	\$ 10,000,000
Sales %	10%	10%	10%
Double Weights Sales %	0%	10%	
SUM of Percentages	12%	22%	10%
Number of Factors	3	4	1
Arkansas Percentage	4.00%	5.50%	10.00%
Arkansas Net Taxable Income	\$ 40,000	\$ 55,000	\$ 100,000

## Apportionment Comparison – Low Sales Factor

	3 Factor - Equally Weighted	3 Factor with Double Sales	Single Sales Factor
Apportionable Income	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000
Arkansas Property	\$ 1,000,000	\$ 1,000,000	
Everywhere Property	\$ 10,000,000	\$ 10,000,000	
Property %	10%	10%	
Arkansas Payroll	\$ 1,000,000	\$ 1,000,000	
Everywhere Payroll	\$ 10,000,000	\$ 10,000,000	
Payroll %	10%	10%	
Arkansas Sales	\$ 100,000	\$ 100,000	\$ 100,000
Everywhere Sales	\$ 10,000,000	\$ 10,000,000	\$ 10,000,000
Sales %	1%	1%	1%
Double Weights Sales %	0%	1%	
SUM of Percentages	21%	22%	1%
Number of Factors	3	4	1
Arkansas Percentage	7.00%	5.50%	1.00%
Arkansas Net Taxable Income	\$ 70,000	\$ 55,000	\$ 10,000

## Revenue Impact – Adoption of Single Sales Factor

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- Corporate Income Tax is an unpredictable source of revenue and can change significantly year over year. In a review of the previous four years of returns, the Department estimates that the overall revenue impact of changing the statutory apportionment formula to a single sales factor, without any other changes in corporate income tax, would result in an average overall revenue gain of **\$714,289**.

# Revenue Impact – Adoption of Single Sales Factor

- The revenue impact of adopting the Single Sales Factor for the prior four years is as follows:

<b>Tax Year</b>	<b>Revenue Impact</b>
2016	(\$8,589,624)
2015	\$8,828,403
2014	\$8,047,478
2013	(\$5,429,178)
<b>Average</b>	<b>\$714,289</b>

# The Throwback Rule

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- The “throwback rule” is part of the calculation used by Arkansas concerning the apportionment of business income by multistate businesses for income tax purposes.
- The throwback rule is part of Arkansas law that determines what are considered Arkansas sales for the Arkansas Sales Percentage in determining apportionment. Under existing law, a multistate business is required to include “unreported” out of state sales in its sales factor under § 26-51-715 (Repl. 1997).
- All sales must be reported somewhere otherwise a taxpayer will have untaxed “nowhere” income. “Nowhere” sales are recaptured and placed in the Arkansas sales factor under § 26-51-716 which is referred to as the “throwback rule.”



# Revenue Impact – Repeal of Throwback Rule

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- DFA provided Fiscal Impact for HB 1790 for repeal of the throwback rule during 91st General Assembly of **\$24,500,000** for Fiscal Year 2018.

# Revenue Impact – Repeal of Throwback Rule

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- The revenue impact of eliminating the Throwback Rule for the prior four years is as follows:

<b>Tax Year</b>	<b>Revenue Impact</b>
2016	(\$23,710,755)
2015	(\$31,111,787)
2014	(\$24,486,281)
2013	(\$17,273,674)
<b>Average</b>	<b>(\$24,145,624)</b>

# Combined Revenue Impact – Single Sales and Throwback Rule Repeal

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- If the Throwback Rule is eliminated, companies subject to Corporate Income Tax in Arkansas will no longer be required to include the “nowhere sales” in their Arkansas Sales Factor which would be combined with a Single Sales Factor to remove from the Corporate Tax Base property, payroll, and a significant percentage of sales.
- The Department has completed an analysis of four years of samples from Corporate Income Tax returns to provide an estimate of the combination of the adoption of a single sales factor apportionment that also repeals the throwback rule.

# Combined Revenue Impact – Single Sales and Throwback Rule Repeal

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- Nearly all of the impact on Corporate Income Tax for elimination of the throwback rule is in the manufacturing and wholesale industries.
- A sample of taxpayers who have identified as either manufacturing or wholesale in their NAICS (North American Industry Classification System) codes were used to evaluate the overall impact of the combination of the single sales factor and the elimination of the throwback rule, as well as other similar analyses such as sales factor only.

# Comparison – Single Sales Factor and Throwback Rule Repeal for Different Manufacturers

	PROPERTY	PAYROLL	SALES	SALES FACTOR	ARKANSAS	ARKANSAS	INCOMETO	ARKTAXABLE	ARKANSAS
	FACTOR	FACTOR	FACTOR	NO THROWBACK	FACTOR	PERCENT	APPORTION	INCOME	TAX AT 6.5%
<b>TYPICAL MANUFACTURER IN ARKANSAS</b>									
CURRENT FORMULA	12%	8%	5%	2%	$(12+8+5+5)/4$	7.50%	\$2,000,000,000	\$150,000,000	<b>\$9,750,000</b>
CURRENT FORMULA NO THROWBACK	12%	8%	5%	2%	$(12+8+2+2)/4$	6%	\$2,000,000,000	\$120,000,000	<b>\$7,800,000</b>
SINGLE SALES WITH THROWBACK RULE	12%	8%	5%	2%	5%	5%	\$2,000,000,000	\$100,000,000	<b>\$6,500,000</b>
SINGLE SALES NO THROWBACK RULE	12%	8%	5%	2%	2%	2%	\$2,000,000,000	\$40,000,000	<b>\$2,600,000</b>
<b>MANUFACTURER THAT LOSES WITH SINGLE SALES FACTOR BUT WINS WITH SINGLE SALES AND NO THROWBACK RULE</b>									
CURRENT FORMULA	4%	2%	10%	1%	$(4+2+10+10)/4$	6.5%	\$1,000,000,000	\$65,000,000	<b>\$4,225,000</b>
CURRENT FORMULA NO THROWBACK	4%	2%	10%	1%	$(4+2+1+1)/4$	2%	\$1,000,000,000	\$20,000,000	<b>\$1,300,000</b>
SINGLE SALES WITH THROWBACK RULE	4%	2%	10%	1%	10%	10%	\$1,000,000,000	\$100,000,000	<b>\$6,500,000</b>
SINGLE SALES NO THROWBACK RULE	4%	2%	10%	1%	1%	1%	\$1,000,000,000	\$10,000,000	<b>\$650,000</b>
<b>MANUFACTURER THAT LOSES WITH SINGLE SALES FACTOR AND WITH SINGLE SALES AND NO THROWBACK RULE</b>									
CURRENT FORMULA	4%	2%	10%	9%	$(4+2+10+10)/4$	6.5%	\$1,000,000,000	\$65,000,000	<b>\$4,225,000</b>
CURRENT FORMULA NO THROWBACK	4%	2%	10%	9%	$(4+2+9+9)/4$	6%	\$1,000,000,000	\$60,000,000	<b>\$3,900,000</b>
SINGLE SALES WITH THROWBACK RULE	4%	2%	10%	9%	10%	10%	\$1,000,000,000	\$100,000,000	<b>\$6,500,000</b>
SINGLE SALES NO THROWBACK RULE	4%	2%	10%	9%	9%	9%	\$1,000,000,000	\$90,000,000	<b>\$5,850,000</b>

# Combined Revenue Impact – Single Sales and Throwback Rule Repeal

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- DFA's Corporate Income Tax Section took a sample of return information and determined the impact of a single sales factor and then the impact of a single sales factor for just manufacturing and wholesale industries. The difference between these is then added to the amount from the sample for wholesale and manufacturing industries impact of single sales factor plus the elimination of the throwback rule to have a combined estimate. This also shows the amount of estimate for the elimination of the throwback rule without the single sales factor for comparison.
- The estimate for Throwback elimination for 2016 is a revenue loss of \$23,700,000 and the estimate for Single Sales Factor in 2016 is a \$8,600,000 revenue loss, but when both changes are applied together the estimate is a \$49,600,000 fiscal impact rather than a \$32,300,000 impact (when both static impacts are added together).

# Combined Revenue Impact – Single Sales and Throwback Rule Repeal

- Combined revenue impact of adopting the Single Sales Factor and a repeal of the Throwback rule has been calculated for the past four filing years as follows:

<b>Tax Year</b>	<b>Combined Revenue Impact</b>
2016	(\$49,562,919)
2015	(\$65,033,398)
2014	(\$56,151,033)
2013	(\$58,138,566)
<b>Average</b>	<b>(\$57,221,479)</b>

# Conclusion

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- Questions?