

Appendix F



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

OFFICE OF THE DIRECTOR
1509 West Seventh Street, Suite 401
Post Office Box 3278
Little Rock, Arkansas 72203-3278
Phone: (501) 682-2242
Fax: (501) 682-1029
<http://dfa.arkansas.gov>

September 4, 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: Revenue Impact of Combination of Adoption of Single Sales Factor and
Throwback Rule Elimination*

Chairmen Hendren and Jean:

The Department is providing a supplemental analysis of the combination of certain Corporate Income Tax proposed changes. The Department previously provided static impacts of the proposed changes, but had not provided an analysis of the two in conjunction. Both the Throwback Rule and the Single Sales Factor for Apportionment affect the sales of a company subject to the Corporate Income Tax and when taken together produce results that are different than just combining the static individual fiscal impacts. As will be discussed in greater detail below, the 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:

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

Single Sales Factor Apportionment

Corporate Income Tax in Arkansas is determined by apportionment of business income by multistate businesses for income tax purposes. Arkansas uses an apportionment formula consisting of property, payroll, and sales factors to apportion income of a multistate business. Currently, Arkansas uses a “double weighted” sales factor to determine the amount of income to be apportioned to Arkansas for the purpose of the Corporate Income Tax. In other states, income may also be apportioned by means of an equally weighted three-factor formula using property, payroll, and sales or by a Single Sales Factor that considers only sales for financial institutions.

The effect on a business will vary based on how much sales, payroll, and property the business has in the state.

For example, Table 1 below compares a high sales factor business within Arkansas for the different methods of determining Corporate Income Tax.

TABLE 1 – BUSINESS WITH 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

Table 2 below demonstrates the same differences for a company that is a low sales factor in Arkansas.

TABLE 2 – BUSINESS WITH 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

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

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

It is important to note that this is not an evenly distributed tax change, as evidenced by the differences in the above tables.

The “Throwback Rule”

The “throwback rule” is part of the calculation used by Arkansas concerning the apportionment of business income by multistate businesses for income tax purposes. Arkansas uses an apportionment formula consisting of property, payroll, and sales factors to apportion income of a multistate business as shown in the tables describing the Single Sales Factor apportionment. 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). Stated differently, 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.”

Repealing the “Throwback rule” would result in an estimated revenue reduction of **\$24,500,000** for Fiscal Year 2018 based on the fiscal impact statement prepared for House Bill 1790 of the 91st General Assembly. The revenue impact of eliminating the Throwback Rule for the prior four years is as follows:

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

Combining Elimination of the Throwback Rule with Single Sales Factor Apportionment

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.

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 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.

Arkansas Tax Reform and Relief Task Force

Re: Revenue Impact of Combination of Adoption of Singles Factor and Throwback Rule

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

The chart above demonstrates the different ways that the combination of single sales factor and elimination of the throwback rule would interact for different exemplar manufacturers in Arkansas. Additionally, the Department has included an analysis for these entities that demonstrates the current formula if throwback was eliminated as well as a single sales only analysis. The enclosed attachment demonstrates the volatility of Corporate Income Tax and how the Department came to the estimate that the two proposals combined would have a revenue impact of **\$57,200,000** when averaged across the 2013-2016 tax years.

The Corporate Income Tax Office took the sample of return information described earlier and determined the impact of a single sales factor and then the impact of a single sale 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's sake. 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. Please see the attached analysis for the 2013-2016 tax years.

Should the Committee have any questions or require any additional information, please do not hesitate to contact me.

Sincerely,



Paul M. Gehring
Assistant Commissioner of Revenue

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STATE OF ARKANSAS
DEPARTMENT OF FINANCE AND ADMINISTRATION
CORPORATION INCOME TAX SECTION

SINGLE SALES W/O THROWBACK
8/21/2018

Year	Summary Description	2016	Tax Impact
2016	Impact - Single Sales Factor		\$ (8,589,624)
2016	Impact - Single Sales Factor for Manufacturing & Wholesale Trade Only		\$ (5,710,289)
	Difference (Removed Manufacturing & Wholesale Impact)		\$ (2,879,335)
2016	Difference (Removed Manufacturing & Wholesale Impact)		\$ (2,879,335)
2016	Estimated Impact - Single Sales Factor w/o Throwback Sales for Manuf. & Wholesale Trade		\$ (46,683,584)
2016	Combined Estimated Impact of Single Sales Factor without Throwback Sales		\$ (49,562,919)

2016 Throwback Impact Current Apportionment \$ (23,710,755)

Year	Summary Description	2015	Tax Impact
2015	Impact - Single Sales Factor		\$ 8,828,403
2015	Impact - Single Sales Factor for Manufacturing & Wholesale Trade Only		\$ 20,062,652
	Difference (Removed Manufacturing & Wholesale Impact)		\$ (11,234,249)
2015	Difference (Removed Manufacturing & Wholesale Impact)		\$ (11,234,249)
2015	Estimated Impact - Single Sales Factor w/o Throwback Sales for Manuf. & Wholesale Trade		\$ (53,799,149)
2015	Combined Estimated Impact of Single Sales Factor without Throwback Sales		\$ (65,033,398)

2015 Throwback Impact Current Apportionment \$ (31,111,787)

Year	Summary Description	2014	Tax Impact
2014	Impact - Single Sales Factor		\$ 8,047,478
2014	Impact - Single Sales Factor for Manufacturing & Wholesale Trade Only		\$ 15,988,011
	Difference (Removed Manufacturing & Wholesale Impact)		\$ (7,940,533)
2014	Difference (Removed Manufacturing & Wholesale Impact)		\$ (7,940,533)
2014	Estimated Impact - Single Sales Factor w/o Throwback Sales for Manuf. & Wholesale Trade		\$ (48,210,500)
2014	Combined Estimated Impact of Single Sales Factor without Throwback Sales		\$ (56,151,033)

2014 Throwback Impact Current Apportionment \$ (24,486,281)

Year	Summary Description	2013	Tax Impact
2013	Impact - Single Sales Factor		\$ (5,429,178)
2013	Impact - Single Sales Factor for Manufacturing & Wholesale Trade Only		\$ 18,699,632
	Difference (Removed Manufacturing & Wholesale Impact)		\$ (24,128,810)
2013	Difference (Removed Manufacturing & Wholesale Impact)		\$ (24,128,810)
2013	Estimated Impact - Single Sales Factor w/o Throwback Sales for Manuf. & Wholesale Trade		\$ (34,009,756)
2013	Combined Estimated Impact of Single Sales Factor without Throwback Sales		\$ (58,138,566)

2013 Throwback Impact Current Apportionment \$ (17,273,674)

AVG Revenue Impact for Single Sales Factor only	\$714,289
AVG Revenue Impact for Eliminating Throwback only	\$24,145,624
AVG Revenue Impact for Combining Single Sales & no Throwback	\$57,221,479