

EXHIBIT D



# State of Arkansas Tax Relief and Reform Legislative Task Force

## Issues Related to Sales and Use Tax

November 7, 2017

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## Discussion Topics

- State Taxes in Theory and Practice
- Sales and Use Tax Overview
- Arkansas Sales Taxes in Comparison to Other States
- Online Sales and Economic Nexus
- Sales Tax Exemptions
- Sales Tax Major Actions in Other States
- Summary



# State Taxes in Theory and Practice



# Sales Taxes and the Traditional ‘Three-Legged Stool’

- Individual income tax, sales and use tax, corporate income tax:
  - Each differs in what it taxes and how it impacts economic activity
  - Paid by both businesses and consumers
  - Helps balance the advantages and disadvantages of each type of tax
  - Sales and use tax is the largest of the three, corporate income tax is the smallest (and declining)
  - Share by state varies considerably (especially sales/individual income tax)
  - State and local combined – property tax replaces corporate income tax as the ‘Big Three’ revenue sources
  
- Key Issues:
  - Mix of consumption/income taxes
  - Erosion of the sales tax base
  - Volatility of the individual income tax
  - Decline of the corporate income tax as a share of total state tax revenue
  - Federal tax changes’ impact on major state taxes

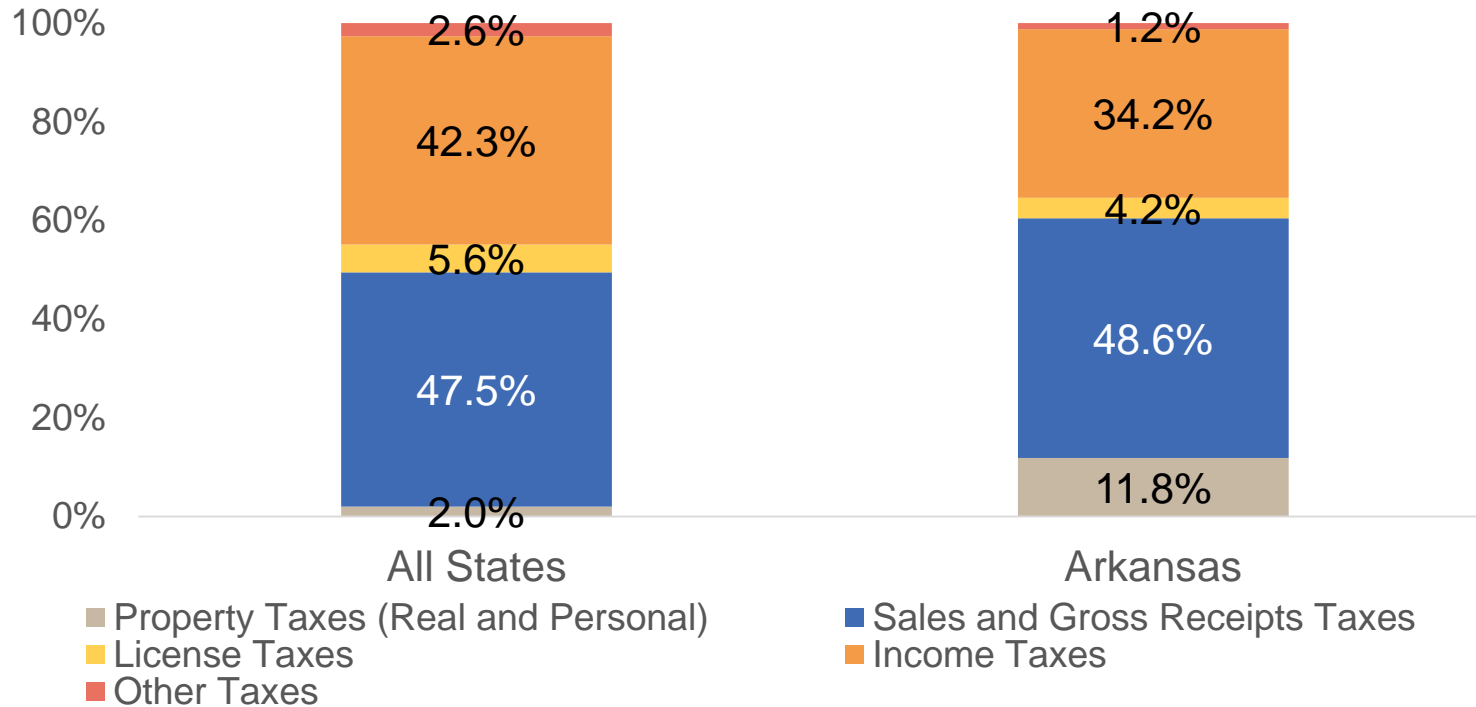


# Consumption versus Income-based Taxes

- In theory, consumption taxes are more economically efficient:
  - Nearly all will pay some tax
  - Avoids taxing savings and capital investment necessary for economic growth
  - No disincentive to work/earn more
- In practice, consumption taxes have some downside:
  - Depending on the base, can be regressive
  - Erosion of the sales tax base – creates horizontal equity and revenue sufficiency issues
- Income tax more likely to solve for sufficiency concerns:
  - Performs very well during economic expansions
  - However, has proven very volatile during economic downturns
  - Some timing issues (such as realized capital gains) make it hard to estimate
- Combining the two is the typical state approach:
  - Both have negative border effects
  - Broad sales tax can mitigate some of the income tax volatility
  - Progressive income tax/refundable credits can mitigate some of the sales tax regressivity



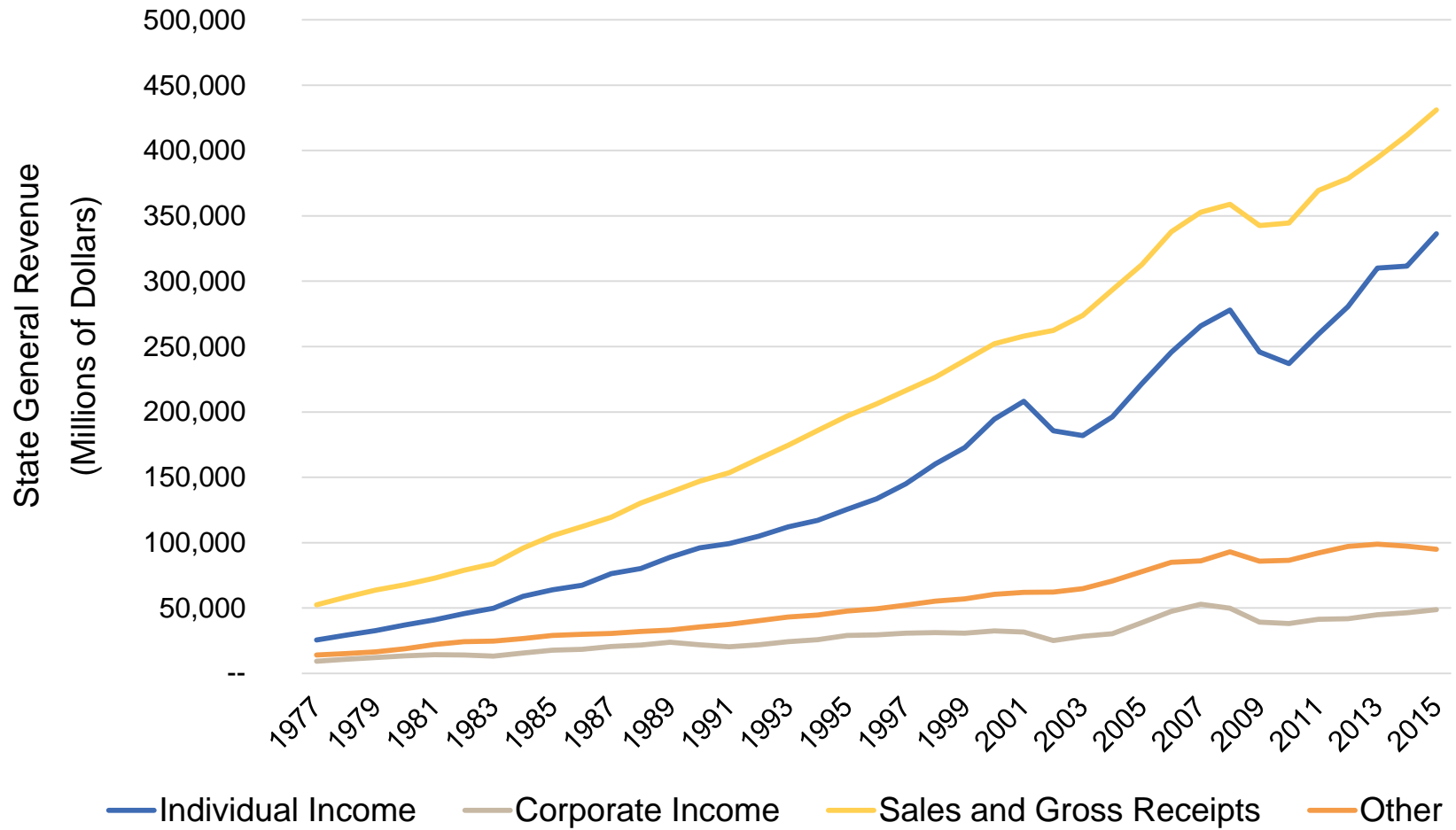
# State Tax Revenues by Tax Category, 2016



- **“Other Taxes”** include death and gift, severance, documentary and stock transfer, and other taxes not elsewhere classified.
- **“License Taxes”** include alcoholic beverages, public utilities, motor vehicles, motor vehicle operators, corporations in general, hunting and fishing, amusements, occupation and businesses, and other license taxes.



# State Tax Revenues by Tax Category, Historic (1977-2015)





# **Sales and Use Tax Overview**



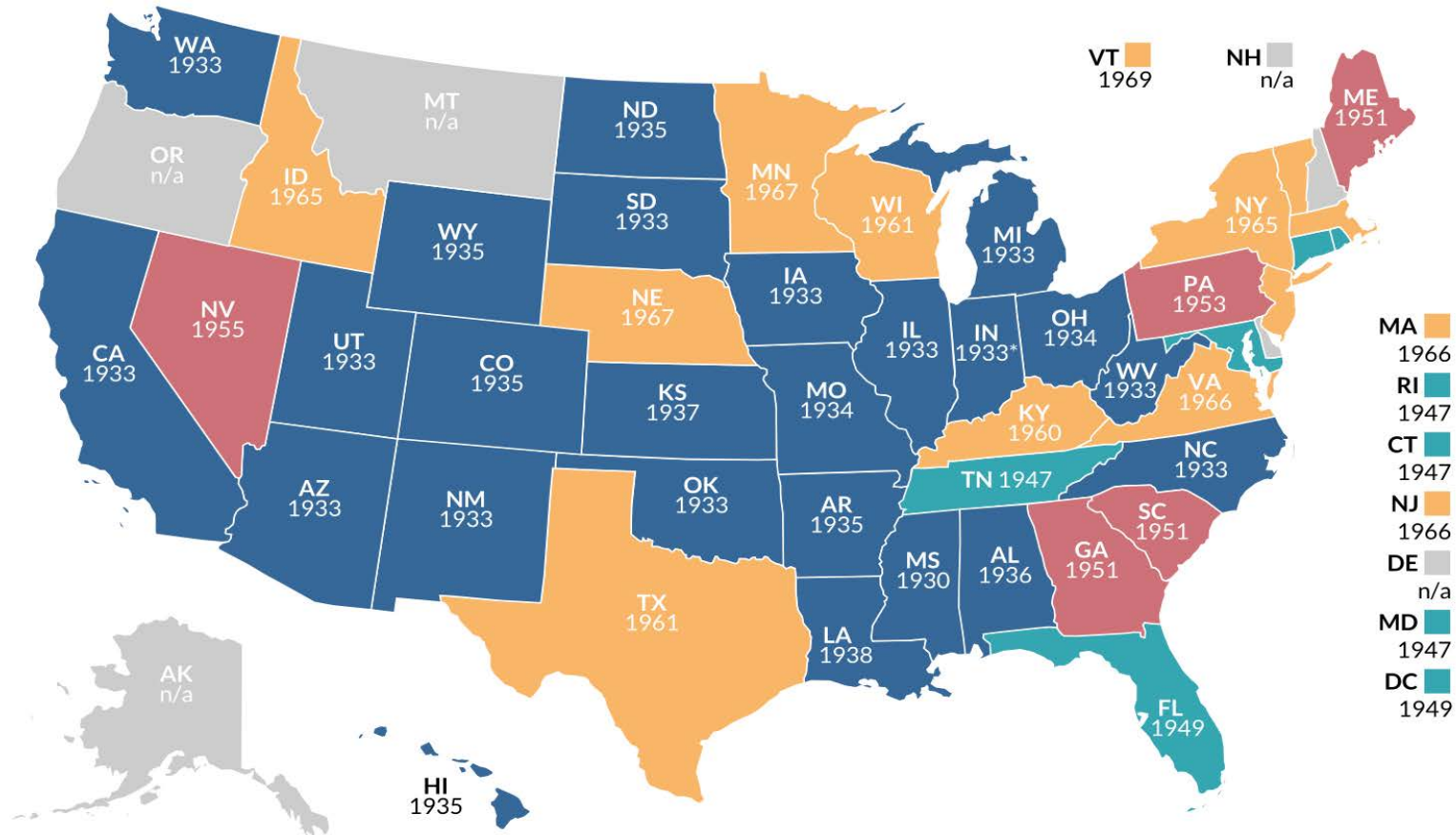


## Sales and Use Tax Overview

- **Sales taxes** are general taxes, levied with a (mostly) uniform rate when a qualifying good or service is purchased or sold to its final consumer within a state's borders.
- Sales taxes are typically accompanied by a **use tax** that applies to the use, storage or other consumption of qualifying goods or services consumed within the state but purchased out of state.
- Sales taxes can be structured differently – some states impose a business privilege tax (under various names), which has different characteristics and impacts.
  - These are often applied more broadly and have a different impact on nexus (since no compulsion to collect from the customer – the Quill standard.)
  - Arizona transaction privilege tax
  - Hawaii general excise tax
  - Pennsylvania business privilege tax



# State Sales Taxes: Year of Adoption by State



State Sales Taxes: Year of Adoption by State





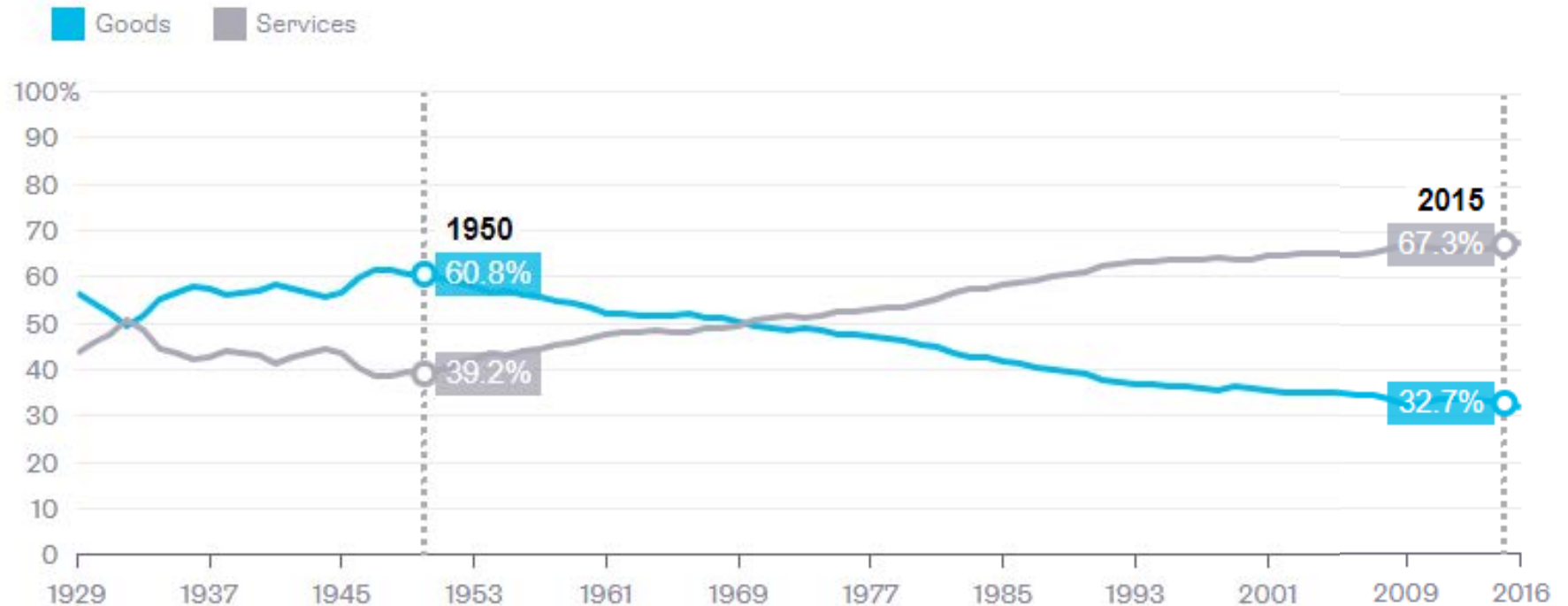
# Trends in Broad-Based Consumption Taxes

- Changes in **what** we consume:
  - When sales taxes were created, consumption was mostly tangible goods
  - Now, consumption has shifted to mostly intangible goods and services
- Changes in **how much** we consume:
  - The general population is aging
  - An older population consumes less
- Changes in **how we purchase** what we consume:
  - Late last century saw rise of catalogue and phone purchases
  - During this century, electronic commerce has grown
- Sales as a percent of personal income is generally declining:
  - Base as a percent of personal income declining for decades
  - Legislatively exempted goods are another reason
  - Some services have been added to sales tax bases, but not in a broad-based fashion



# Changes in What We Consume: Tangible Goods Versus Intangible Goods and Services

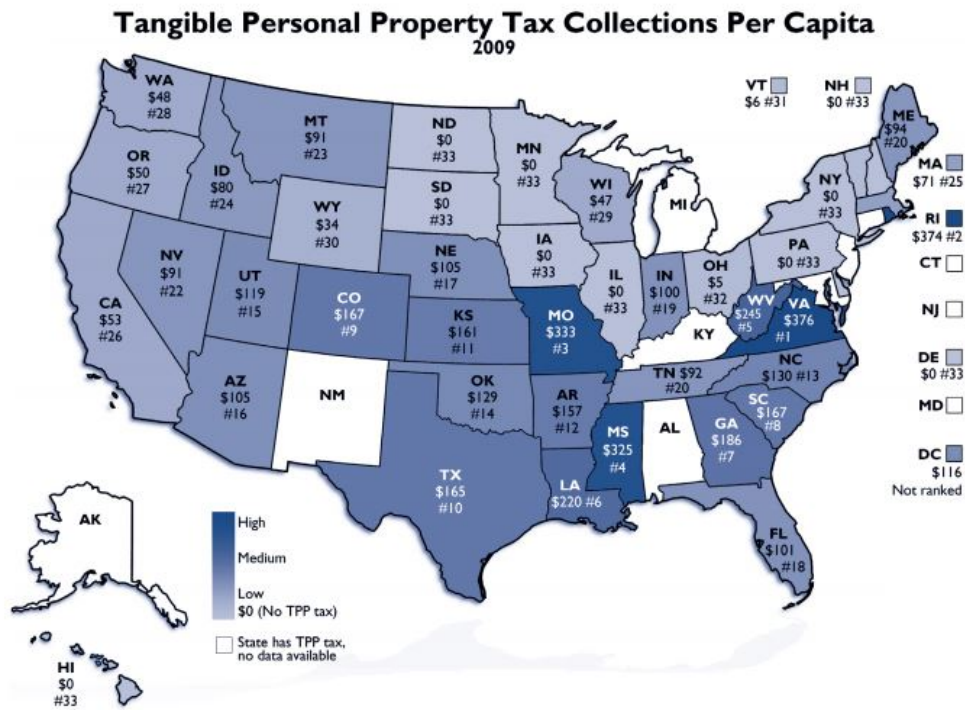
Spending as a percentage of total personal consumption





# Changes in What We Consume: Tangible Goods Versus Intangible Goods and Services

- **Tangible goods** (tangible personal property; TPP) – property that can be touched and moved
  - Ex: equipment, furniture



Source: Tax Foundation, *States Moving Away from Taxes on Tangible Personal Property*, October 2012)



## Changes in What We Consume: Tangible Goods Versus Intangible Goods and Services

- **Intangible goods** – do not have a physical substance
  - Ex: Digital products, e-books, online subscriptions, “virtual goods”
  - Digital products come in a variety of formats (audio, video, e-books delivered electronically without physical media)
- As the percentage of purchases made on the Internet increase, states are looking for new ways to collect taxes on online sales (“Amazon tax laws” and nexus)
- “Digital products” are not explicitly defined by each state
- Streamlined Sales Tax definition of “specified digital products”:  
“Electronically transferred digital audio-visual works, digital audio works and digital books.”
  - This definition is used by 12 states (IN, KY, NJ, NE, NV, ND, RI, TN, VT, WA, WI, WY)



## State Definitions of “Digital Goods”

State	Definition of "Digital Goods"
Alabama	Does not specifically define digital goods; tangible property is described as "personal property which... is in any manner perceptible to the senses."
Arkansas	SST member; only defines "digital audio-visual works" and "digital audio works."
Iowa	Defines digital goods in regulations: “Sales of items < delivered digitally or electronically include> artwork, drawings, photographs, music, electronic greeting cards, “canned” software ... , entertainment properties (e.g., films, concerts, books, and television and radio programs), and all other digitized products.”
Kansas	Defines digital goods within its telecommunication services law: “Digital products delivered electronically, including, but not limited to, software, music, video, reading materials or ring tones.”
Louisiana	Includes “digital or electronic products such as “canned” computer software, electronic files, and “on demand” audio and video downloads within the category of taxable tangible property.
Mississippi	Not a SST member, but uses a similar definition: ““Specified digital products” means electronically transferred digital audio-visual works, digital audio works and digital books.”
Missouri	Does not specifically define digital goods for sales tax purposes
Nebraska	Uses SST definition.
Oklahoma	Defines digital products as those "delivered electronically include music, video, ringtones, and books.”
Tennessee	Uses SST definition.
Texas	Defines digital goods as tangible property. “Digital products, such as photographs and music are tangible personal property as defined in Section 151.009 of the Texas Tax Code.”



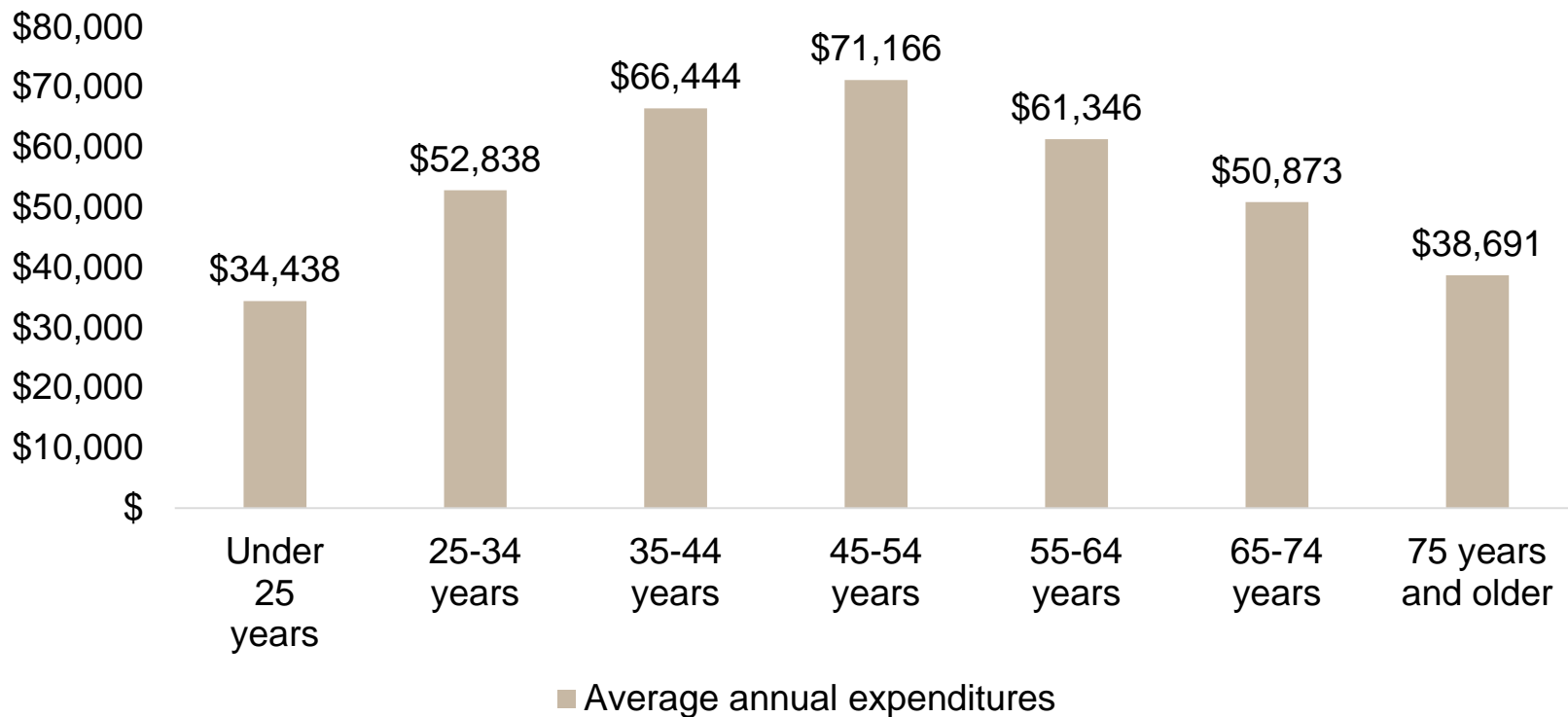
## Changes in What We Consume: Tangible Goods Versus Intangible Goods and Services

- “Americans spent almost \$400 billion online in 2016, approximately 8 percent of all retail sales.”
- Retailers are only required to collect sales taxes in states in which they have a physical presence of property or employees. Limits the scope of state taxing power.
- “Because the use tax requires self-reporting and payment by the consumer instead of collection at the point-of-sale by the retailer, use tax compliance is very low except for large purchases or business purchases susceptible to a state audit.”
- Consumers do not tend to report many of their Internet purchases in order to avoid paying use tax on them.
- “As more individuals purchase items via online retailers, state sales tax collections have fallen as many retailers do not have sufficient nexus in a state to require the retailer to collect and remit sales taxes. Many online retailers fail to meet this standard, putting strain on state sales taxes.”





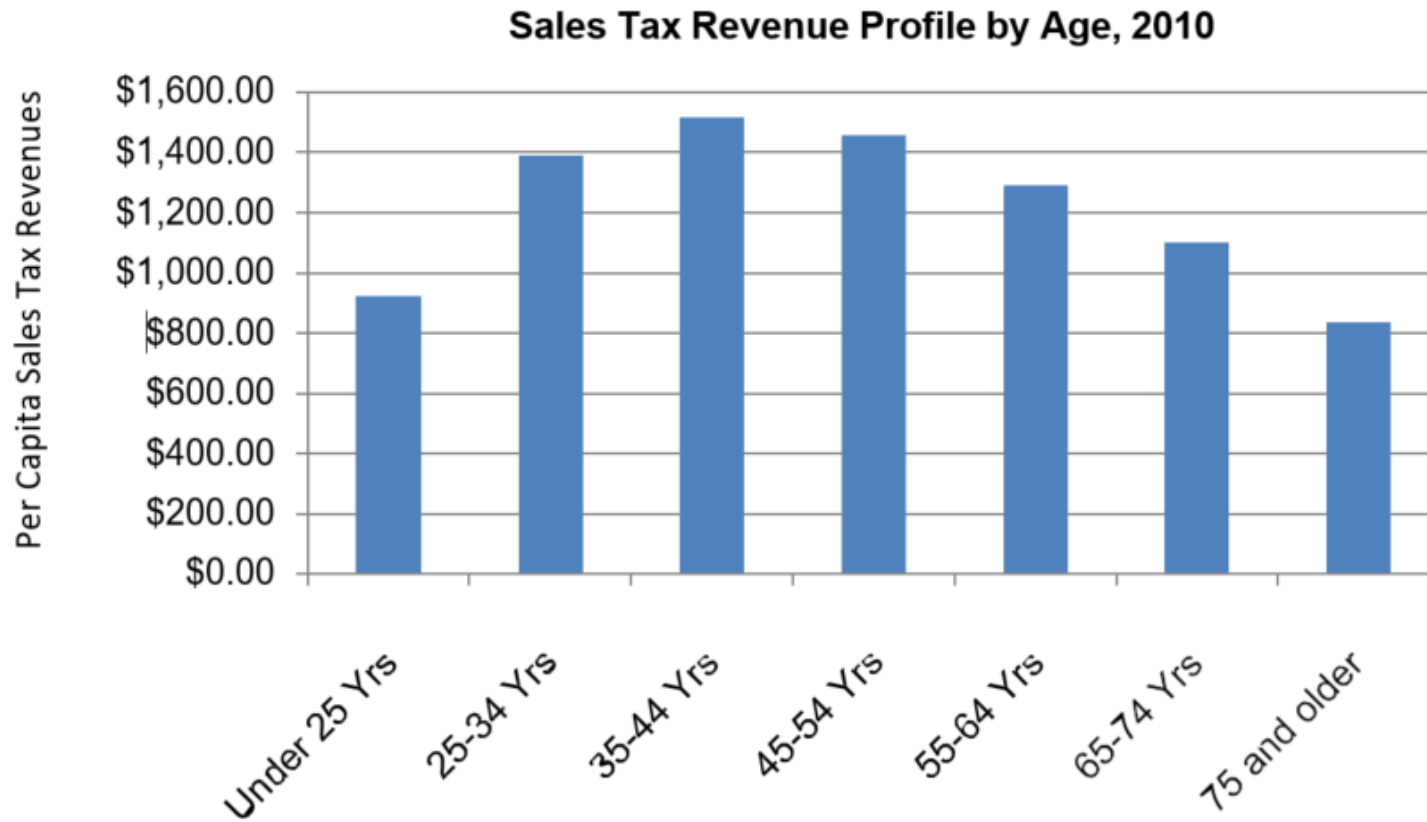
## Changes in How Much We Consume: Older Population Consumes Less



Source: U.S. Bureau of Labor Statistics Consumer Expenditure Survey, 2016



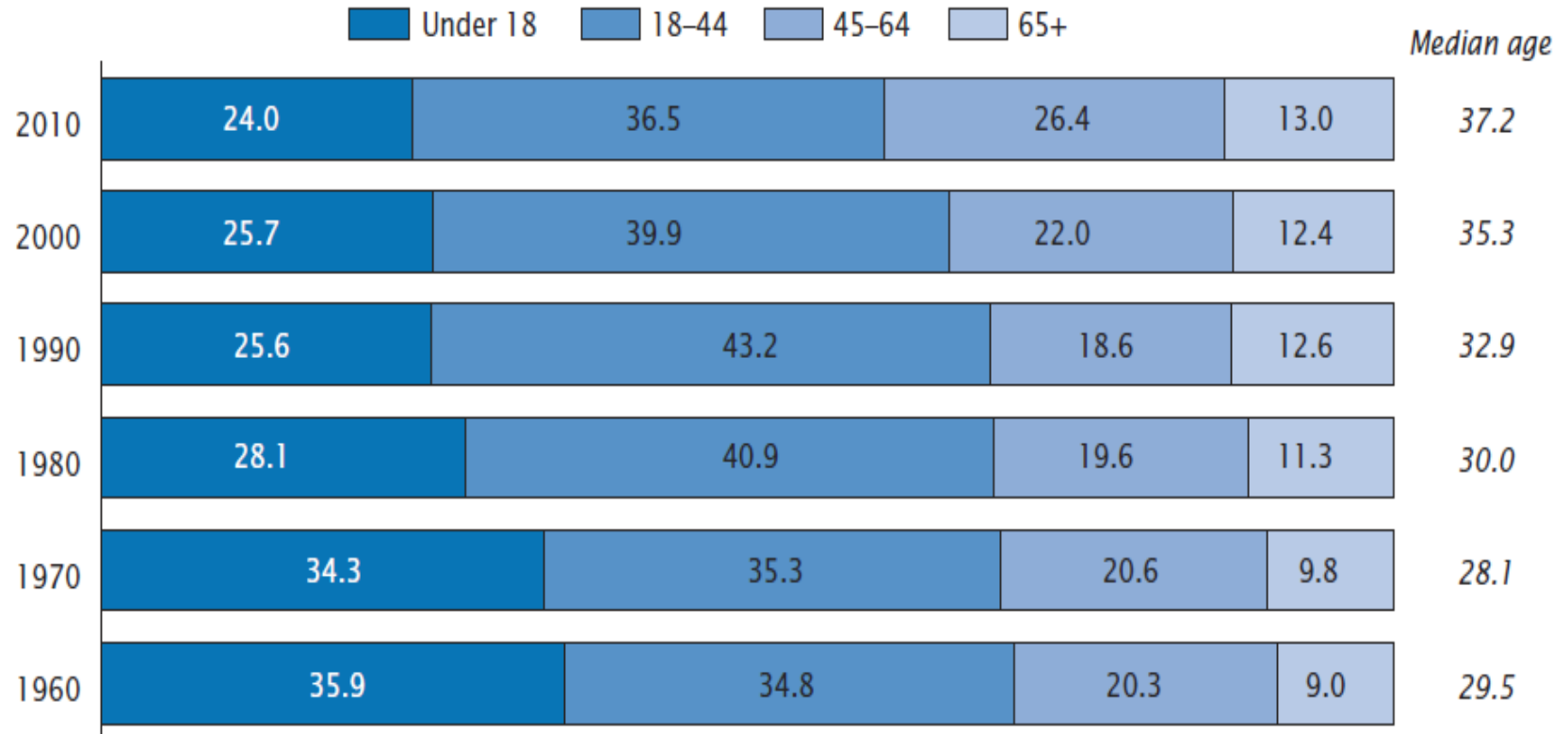
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Source: U.S. Bureau of Labor Statistics Consumer Expenditure Survey, 2016



# Demographic Shifts – U.S.

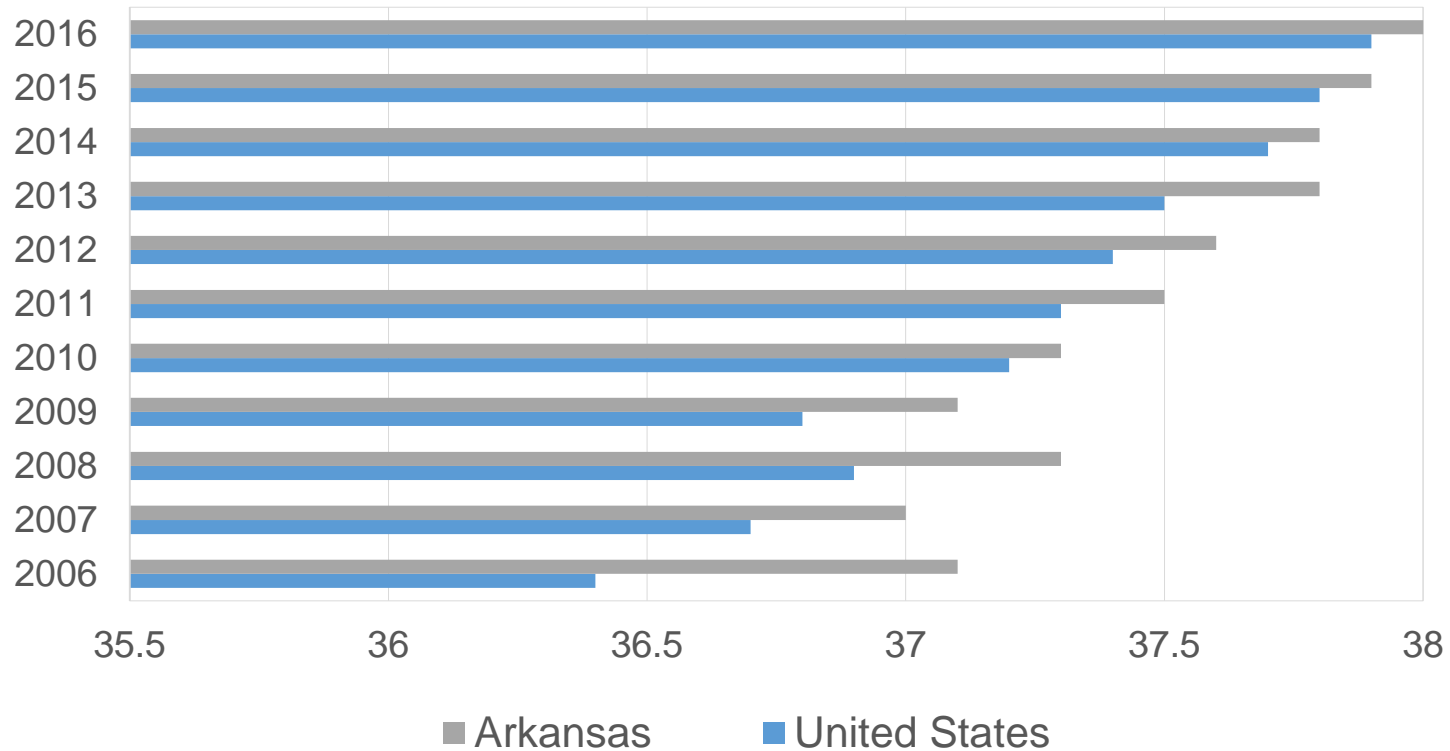


Source: U.S. Census Bureau, Age and Sex Composition, (May 2011)



## Demographic Shifts – Arkansas

- The 2016 median age in Arkansas is 38 years of age, which is slightly above the United States median age of 37.9 years.

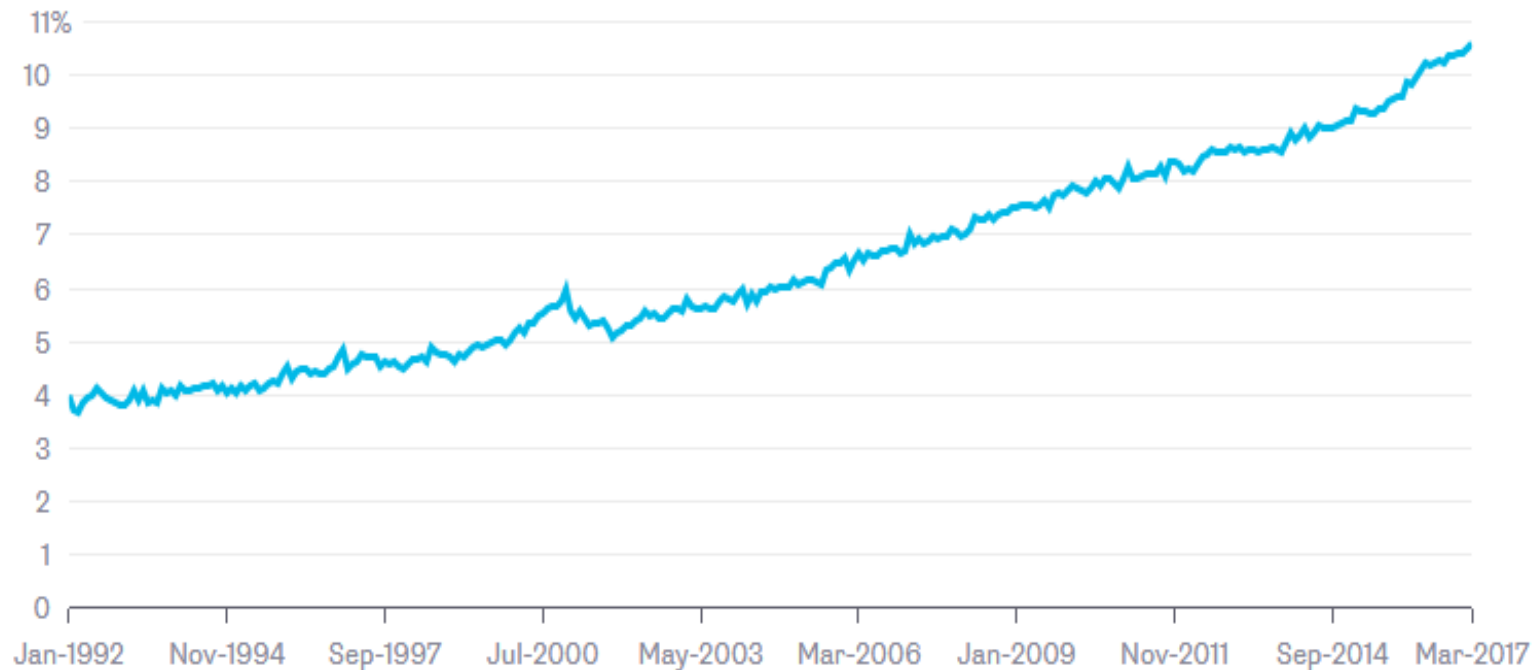


Source: U.S. Census Bureau



# Changes in How We Purchase What We Consume: Electronic Commerce

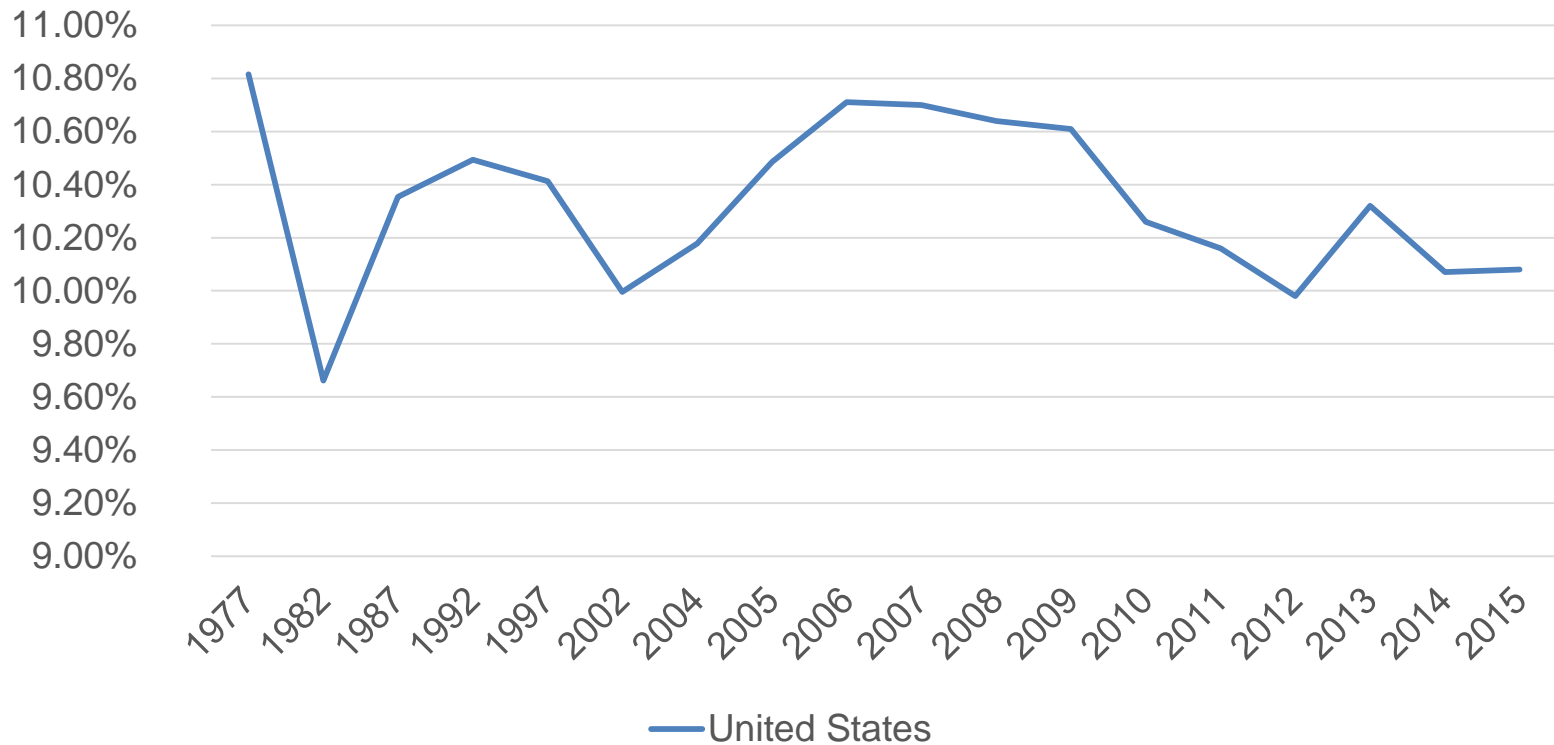
Nonstore sales as a percentage of total retail sales





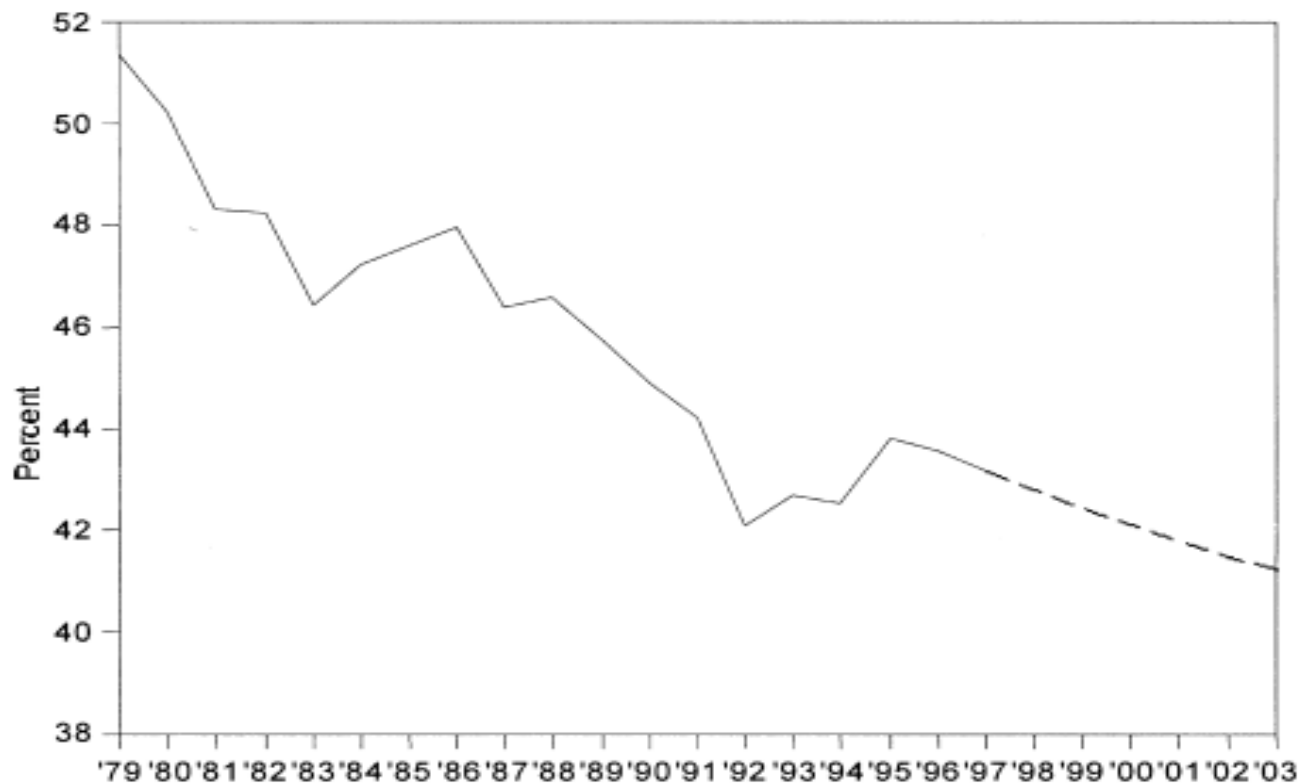
# Sales Tax Base as a Percent of Personal Income: Generally Declining

State and Local Tax Revenue as a Percentage of Personal Income (1977 – 2015)





## Sales Tax Base as a Percent of Personal Income: Generally Declining (Erosion of the Base, and, as a Trade-off, Raising of the Rate)





## Expanding the Base: Local Option Sales Taxes

- Many states permit local governments (primarily cities and counties) to levy local option sales taxes.
- This tax is levied in addition to the State's current tax rate; the sales tax base is the sum of all taxable sales.
- Currently, 38 states collect sales tax at both the state and local levels.
- Generally, the state collects both, and then remits the local portion.
- Since the state collects, this reduces the local government administrative costs (relative to the property tax, which is administered locally)



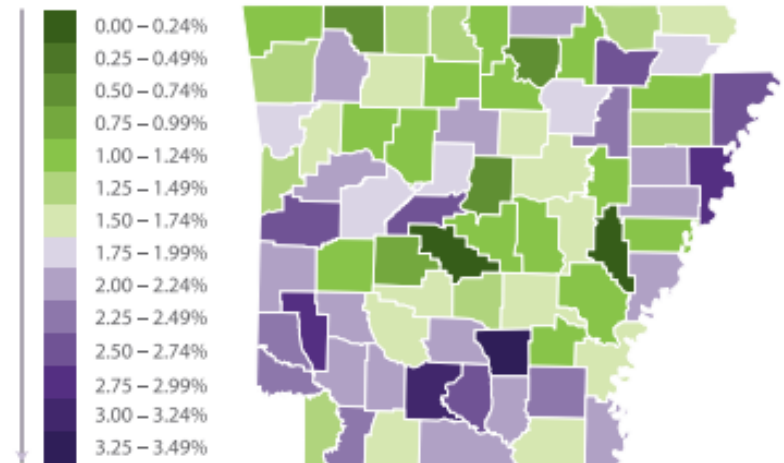


# Local Option Sales Taxes in Arkansas

- 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.





# Local Option Sales Taxes in Arkansas

Local Tax Rates – <b>City</b>		
	<b>Rate</b>	<b>City</b>
Highest	3.50%	DeWitt
Lowest	0.50%	Rudy, Beedeville, Pyatt, Marshall
Median	1.00%	
Mode	1.00%	155 cities

Local Tax Rates – <b>County</b>		
	<b>Rate</b>	<b>County</b>
Highest	3.25%	Cleveland County
Lowest	0.50%	Carroll, Faulkner, Izard
Median	1.63%	
Mode	2.00%	14 counties

Source: Arkansas Department of Finance and Administration, City & County Tax Rates, 2017



# Local Option Sales Taxes in Arkansas

- Rates vary by city and county, and can change on a quarterly basis.

July 2017				
City or County Name	Date	Rate	County	Recent Action
Damascus	7/1/2017	1.00%	Faulkner	Annexation
Dyer	7/1/2017	1.00%	Crawford	Annexation
Eureka Springs	7/1/2017	2.25%	Carroll	Decreased
Lamar	7/1/2017	2.00%	Johnson	Increased
Lonoke	7/1/2017	1.50%	Lonoke	Decreased
Pleasant Plains	7/1/2017	2.00%	Independence	Annexation

October 2017				
City or County Name	Date	Rate	County	Recent Action
Siloam Springs	10/1/2017	2.00%	Benton	Annexation
Bentonville	10/1/2017	2.00%	Benton	Annexation
Eureka Springs	10/1/2017	2.38%	Carroll	Increased
Plumerville	10/1/2017	2.00%	Conway	Increased
Mountainburg	10/1/2017	2.50%	Crawford	Annexation



# Arkansas Sales Taxes and Comparison to Other States



## Arkansas - Key Sales Tax Milestones

Year	Milestone	Sales Tax Rate
1935	<b>Act 233</b> - 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	<b>Act 19</b> - Rate increase approved by voter referendum.	3.0%
1983	<b>Act 63</b> - 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	<b>Act 3</b> - Rate increased by 0.5%.	4.5%
1997	<b>Act 156</b> - 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	<b>Act 1492 of 1999</b> - Increased sales tax by 0.5% upon voter ratification of Constitutional Amendment 79; effective 1/1/2001	5.125%
2001	<b>Act 1279</b> - Uniform Sales and Use Tax Administration Act; first step towards streamlining.	
2004	<b>Act 107</b> - Rate increase of 7/8 percent as a special revenue, to be credited to the Educational Adequacy Fund.	6.0%
2011	<b>HJR 1001</b> (Amendment 91) - Created a temporary 0.5% sales and use tax.	6.5%



## Current Sales Tax Law in Arkansas

- A 6.5% sales or gross receipts tax is levied on the sale of all tangible personal property at retail, unless there is a specific exemption listed in statute.
  - The majority of these exemptions are found in Arkansas Code § 26-52.
- Customer pays tax → Retailer remits taxes → State
  - The retailer retains 2 percent of tax due up to \$1,000 per month as a collection fee if remittance is on or before the dates due.
- Services are taxable only if the service is specifically enumerated in statute.
- This is the typical state construction – sales taxes were generally passed at a time when services were not a major part of consumption.



## 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%
<b>Arkansas</b>	<b>6.50%</b>	<b>2.84%</b>	<b>9.34%</b>	<b>5.125%</b>
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: What is a taxable service?

- **Services to tangible personal property**
  - Carpentry; car repairs.
- **Services to real property**
  - Improvements to buildings and land; janitorial services
- **Business services**
  - Telephone answering services; credit reporting agencies and credit bureaus; extermination services.
- **Professional services**
  - Attorneys; physicians; accountants; other licensed professionals.
- **Amusement and Recreation**
  - Park admission; sporting and entertainment events.





# State Taxation of Services





# 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
<b>Arkansas</b>	<b>16</b>	<b>7</b>	<b>12</b>	<b>1</b>	<b>12</b>	<b>0</b>	<b>11</b>	<b>13</b>	<b>72</b>
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
<b>Total Number of Services in Category</b>	<b>16</b>	<b>20</b>	<b>34</b>	<b>8</b>	<b>15</b>	<b>9</b>	<b>19</b>	<b>47</b>	<b>168</b>
<b>AK % of Total Services Taxed</b>	<b>100.0%</b>	<b>35.0%</b>	<b>35.3%</b>	<b>12.5%</b>	<b>80.0%</b>	<b>0.0%</b>	<b>57.9%</b>	<b>27.7%</b>	<b>42.9%</b>

Source: Federation of Tax Administrators, 2007 FTA Survey



# Online Sales & Economic Nexus



## Other States' Tax Reform: E-commerce

- States Passing Economic Nexus Standards:
  - Wyoming, North Dakota, Indiana and Maine (March-April-May-June) \$100,000 sales or over 200 separate transactions
  - Ohio (June) using in-state software, gross receipts of \$500,000 for sales into Ohio
  - Rhode Island (August) in-state software nexus, over \$100,000 in sales
  - Tennessee administrative action for remote sellers 'who regularly and systematically solicit business in the state'
- States Passing Marketplace Sellers Standards:
  - Minnesota (June) marketplace providers with sales of over \$10,000 into state
  - Washington (July) agents with sales of \$10,000, referrers sales of \$267,000 into state
- Colorado-type Reporting Standards:
  - All effective 7/1/17
  - Alabama notify customers and Department of Revenue
  - Louisiana notification if sales of over \$50,000 into the state
  - Rhode Island allows either/or of reporting or collection (see above)

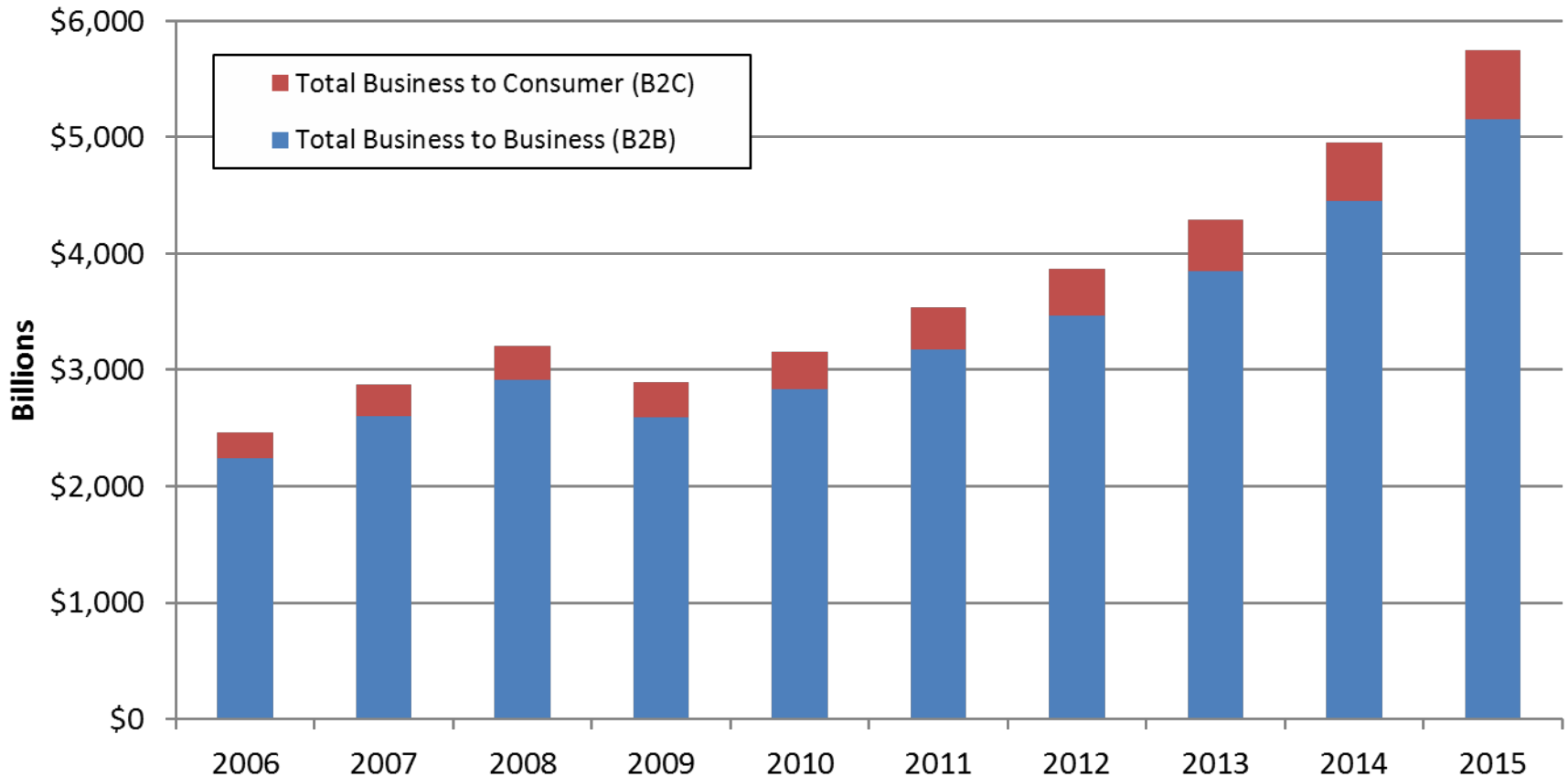


## Revenue Estimates from e-commerce

- Considerable disagreement:
  - Primary source (William Fox and Donald Bruce in 2009) estimated state and local lost revenue of \$11.4 billion by 2012
  - A later analysis (NCSL and ICSC) added non-e-commerce sales and calculated the loss at nearly \$25 billion for 2015
  - Earlier analysis of losses (based on the original Fox/Bruce calculations) put the lost revenue at about 1/10<sup>th</sup> of their calculation
  - In practice, state laws to enforce nexus are not collecting revenue near 'their share' of the loss figures
- Mitigating factors:
  - Amazon is now collecting sales tax in all 50 states (began April 1, 2017)
  - Amazon's share of e-commerce retail sales is estimated at 43 percent (and growing)
  - Other voluntary collections (such as vendors complying with the Streamlined Sales Tax Initiative (SSTI))
  - DFA estimates that SSTI collections in Arkansas have totaled \$107.5 million (since 2005)
  - Most e-commerce sales are business-to-business, and much is reflected in use tax



# Estimated Total E-Commerce Sales



Source: Dr. William Fox, Presentation to the NCSL Fiscal Leaders meeting, October 5, 2017



## Additional Developments

- South Dakota economic nexus case:
  - South Dakota Supreme Court invalidated state law based on Quill
  - State appealed to the U.S. Supreme Court to resolve conflicting state decisions (North Dakota Supreme Court ruled in state's favor on similar case)
  - General expectation that the U.S. Supreme Court will grant certiorari
- Result will likely shape future state strategies (Colorado or South Dakota approaches).
- A third approach is to 'require' purchaser reporting:
  - Use tax reporting on State income tax forms
  - 25 states provide the opportunity for taxpayers to declare use tax owed on the individual income tax form
  - Unclear whether states are obtaining significant revenue from this approach (but probably not)



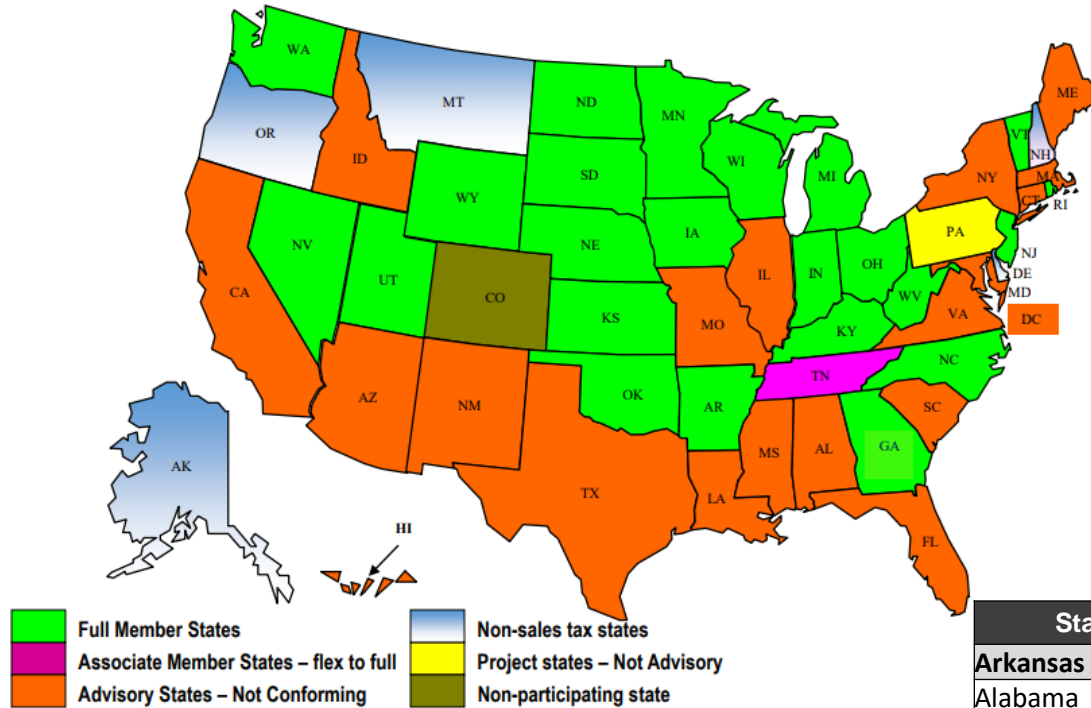
## Streamlined Sales Tax Agreement

- Initiated by the National Governors Association and National Conference of State Legislatures (NCSL) in 1999 in response to two Supreme Court decisions:
  - *Bellas Hess v. Illinois*
  - *Quill Corp v. North Dakota*
- As of 2017, 24 states participate in the program.
- The goal was to increase uniformity that would either lead to greater vendor voluntary collection or reconsideration of Hess/Quill.
- While there are a significant number of states participating, several major states do not, which limits its impact.





# SSTA – State Participation Status as of 1/1/17



State	Participation Status	Join Date
Arkansas	Full Member State	1/1/2008
Alabama	No	N/A
Iowa	Full Member State	10/1/2005
Kansas	Full Member State	10/1/2005
Louisiana	No	N/A
Mississippi	No	N/A
Missouri	No	N/A
Nebraska	Full Member State	10/1/2005
Oklahoma	Full Member State	10/1/2005
Tennessee	Yes; Associate Member State	10/1/2005
Texas	No	N/A



## Arkansas Involvement in Streamlined Sales Tax Agreement

- Act 1279 of 2001 adopted the Uniform Sales and Use Tax Administration Act, which authorized the DFA to enter into agreements with other states in order to provide a mechanism with which to maintain a cooperative, simplified system for the application and administration of sales and use taxes.
- AR became a full member of the program on January 1, 2008.
- Is it beneficial for AR?
  - Minimizes costs and administrative burdens on retailers that collect sales tax, particularly retailers operating in multiple states
  - State has collected approximately \$107 million via the SSTA
  - Limits some State flexibility related to definitions and how it can treat sales taxes
  - Collects additional revenue (some consider it a 'back door' tax increase)



# Drop Shipments are an example of the “The Bermuda Triangle” of Sales and Use Tax





# Sales Tax Exemptions



## Sales Tax Exemptions – One Perspective

- “Tax experts generally recommend that sales taxes apply to all final retail sales of goods and services but not intermediate business-to-business transactions in the production chain.
- These recommendations would result in a tax system that is not only broad-based but also ‘right-sized,’ applying once and only once to each product the market produces.
- Despite agreement in theory, the application of most state sales taxes is far from this ideal.”
- There are some complications to this formulation – EX: How should you treat inputs into a finished product (usually a service) that is not subject to sales tax?
- This suggests that unless you have an extremely broad-based consumption tax, you’re going to have horizontal equity winners and losers.



## Sales Tax Exemptions Overview

- Over the years, state legislatures have enacted a variety of tax exemptions designed to stimulate certain types of economic activity or to achieve other public purposes.
- Commonly-exempted goods (among the 45 states with a sales tax):
  - **Prescription Medications:** 44 states exempt; 1 state imposes alternate rate
  - **Gasoline:** 40 states exempt; 2 states impose alternate rates
  - **Groceries:** 32 states exempt; 6 states impose alternate rates
  - **Non-Prescription Medications:** 9 states exempt; 1 state imposes alternate rate
  - **Clothing:** 7 states exempt
- Required exemptions:
  - States are prohibited by the Constitutional Commerce Clause and the federal law from taxing the federal government
- Although exemptions may be well-intentioned, they shrink the sales tax base.
  - Groceries and clothing alone made up 10 percent of personal consumption expenditures in 2016.

*Source: Tax Foundation, Three Big Problems with Sales Taxes Today – and How to Fix Them (February 10, 2017);  
BEA, GDP & Personal Income (2016)*



# Comparable State Treatment of Common Exemptions

State	State Sales Tax Rate	Groceries	Clothing	Prescription Medication	Non-Prescription Medication	Gasoline
Arkansas	6.5%	1.5%*	Taxable	Exempt	Taxable	Exempt
Alabama	4.0%	Taxable	Taxable	Exempt	Taxable	Exempt
Iowa	6.0%	Exempt	Taxable	Exempt	Taxable	Exempt
Kansas	6.5%	Taxable	Taxable	Exempt	Taxable	Exempt
Louisiana	5%**	Exempt	Taxable	Exempt	Taxable	Exempt
Mississippi	7.0%	Taxable	Taxable	Exempt	Taxable	Exempt
Missouri	4.225%	1.225%*	Taxable	Exempt	Taxable	Exempt
Nebraska	5.5%	Exempt	Taxable	Exempt	Taxable	Exempt
Oklahoma	4.5%	Taxable	Taxable	Exempt	Taxable	Exempt
Tennessee	7.0%	5.0%*	Taxable	Exempt	Taxable	Exempt
Texas	6.25%	Exempt	Taxable	Exempt	Exempt	Exempt

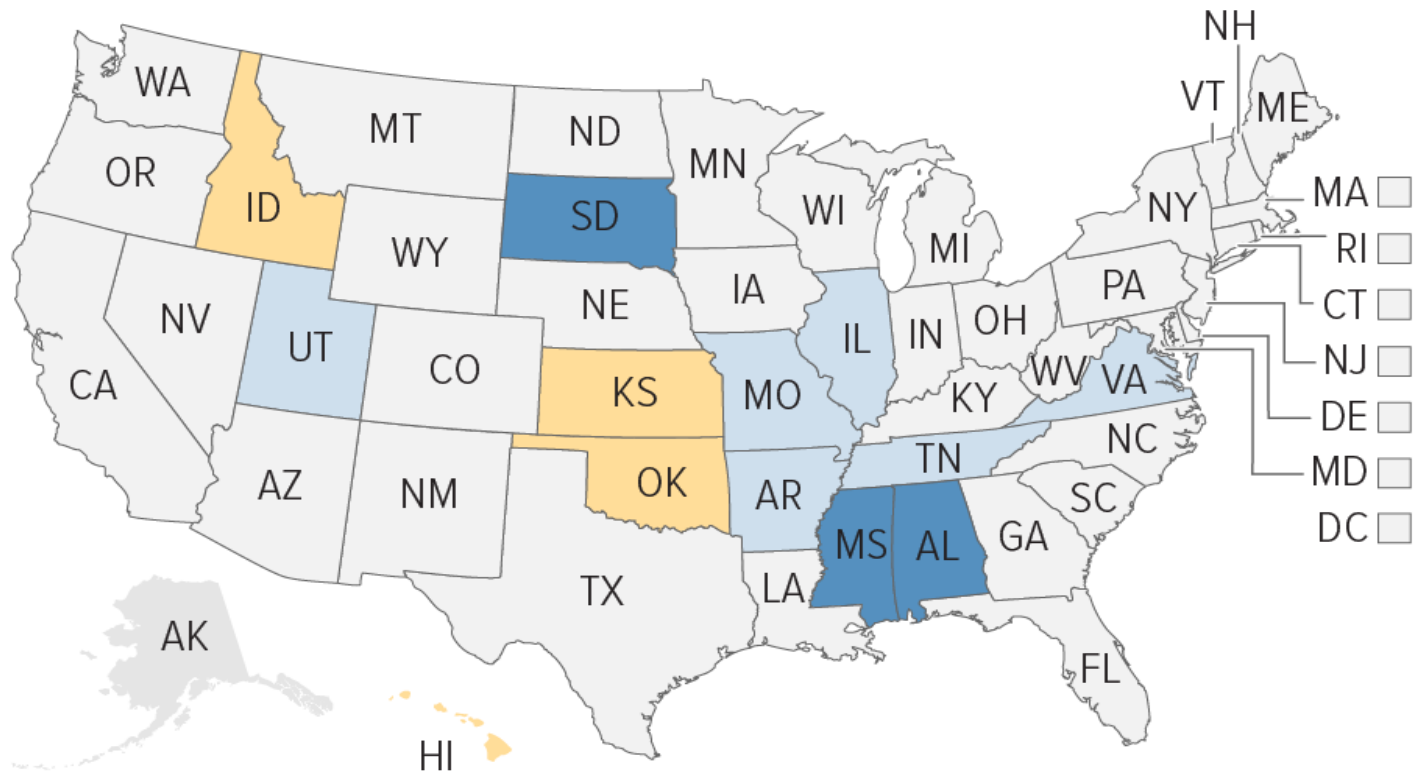
\* Food sales subject to local taxes.

\*\* Louisiana sales tax rate will decrease to 4% effective 7/1/18.



# State Taxation of Groceries

■ States taxing groceries at regular sales tax rate    
 ■ States providing offsetting credit    
 ■ States taxing groceries at lower rate



Source: CBPP analysis, as of March 1, 2017





## Arkansas Sales Tax Exemptions

- Largest sales tax exemption: **gasoline or motor vehicle fuel** on which the gasoline or motor vehicle fuel tax has been paid (\$325 million)
  - Seven states make motor fuels subject to the statewide general sales tax (CA, FL, GA, HI, IL, IN, MI).\*
- Partial sales tax exemption on **food and food ingredients** (\$176 million)
- Exemption of sales and purchases of **prescription drugs** by licensed pharmacists, hospitals or physicians, and oxygen prescribed by a licensed physician for human use (\$143 million)
- Exemption of sales to any **hospital, sanitarium or not-for-profit nursing homes** operated for charitable and non-profit purposes (\$104 million)

\* Source: National Conference of State Legislatures, *Motor Fuel Sales Tax and Other Taxes on Fuel Distributors or Suppliers* (June 2012)



# 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
<b>Total</b>	<b>101</b>	<b>\$1,441,314,658</b>

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

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



## Case Study: Kansas Review of Sales Tax Exemption

- In 2010, Kansas conducted a performance audit report to determine if the State has sales or property tax exemptions that should be considered for elimination.
- “A number of legitimate reasons exist for allowing certain entities or transactions not to be taxed.”
- Legitimate reasons generally fell into three categories:
  - Exemptions **required** by federal law or state constitution.
  - Exemptions that **tax policies** suggest need to be exempt from taxation.
  - Exemptions enacted as a matter of **public policy**.



## Arkansas Sales Tax Exemptions Reasonably Excluded from the 2012 Review:

- Exemptions **required** by federal law or state constitution.
  - Arkansas exempts purchases legally made with food stamps or the Special Supplemental Food Program for Women, Infants and Children (WIC) (\$46 million).
- Exemptions that **tax policies** suggest need to be exempt from taxation.
  - Arkansas exempts gasoline or motor vehicle fuel on which the gasoline or motor fuel tax has been paid to avoid double taxation (\$325 million).
- Exemptions enacted as a matter of **public policy**.
  - Arkansas exempts the sale of the first 500 kilowatt hours of electricity per month to each residential customer whose household income does not exceed \$12,000 per year (\$3 million)



## Case Study: Kansas Exemptions Targeted for Review

- Exemptions that **provide unequal treatment** for similar types of taxpayers or services:
  - Exemptions for individually named organizations or very narrowly defined activities.
  - Exemptions made for some non-profit organizations, but not all of them.
  - Exemptions for non-profit entities, but not their for-profit counterparts.
- Exemptions that significantly **erode the State and local tax base.**
- Exemptions for “**purchases made on behalf of**” and “**sales by.**”



# 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%
	<b>\$1.1 billion</b>	<b>77.40%</b>

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



## Other Arkansas Exemptions

FY 2011 Exemptions that <b>Provide Unequal Treatment for Similar Types of Taxpayers or Services</b>	
<b>Exemption</b>	<b>FY 2011 Estimate</b>
Exemption of 15 individually named non-profit or charitable organizations	\$640,000
Exemption of sales to any hospital, sanitarium, or not-for-profit nursing home operated for charitable and non-profit purposes	\$104 million

FY 2011 Exemptions for <b>“Purchases Made on Behalf of”</b> or <b>“Sales by”</b>	
<b>Exemption</b>	<b>FY 2011 Estimate</b>
Exemption of churches and charitable organizations not engaged in business for profit	\$600,000



# Major Sales Tax Actions in Other States





## State Sales Tax Actions

- Compared to the Income Tax, there have been fewer broad-based changes to State sales tax structures:
  - Louisiana increased its rate by 1.0 percent and South Dakota by 0.5 percent in 2016
  - Kansas increased its rate by 0.35 percent in 2015
  - New Jersey decreased its rate from 7 to 6.875 percent for tax year 2017.
  - Tennessee reduced the rate on groceries to 4.0 percent effective July 1, 2017 (from 5.0 percent)
- The most prominent changes are to sales tax exemptions.
  - Dozens of goods-specific exemptions
  - Several states have focused on the category of manufacturing equipment and consumables (Florida, Indiana, Iowa)
  - Some exemptions were eliminated (although fewer than added), for example West Virginia eliminated the exemption on durable medical equipment purchased by health care providers (2016), and Louisiana temporarily taxed items formerly exempt



## State Sales Tax Actions (continued)

- While some states have broadened the base to include selective services, there has been little major progress.
  - In Missouri, voters amended the state constitution to prohibit a new state or local sales or use tax on any service or transaction not subject to the sales and use tax as of January 1, 2015
  - Plans by Governors to broadly tax services (including Governor Fallin in Oklahoma, Kasich in Ohio and Wolf in Pennsylvania) were not successful



# Summary



## 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.



# Questions and Discussion