



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

OFFICE OF THE DIRECTOR

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December 7, 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: Information Requested for December 12, 2018 Task Force
Meeting*

Chairmen Hendren and Jean:

At the November 28, 2018 meeting of the Tax Reform and Relief Legislative Task Force, the Bureau of Legislative Services presented the Task Force's proposed legislative package for consideration by the 92nd General Assembly. The Task Force requested the Arkansas Department of Finance and Administration (DFA) to provide fiscal impact statements for each draft bill. Enclosed with this letter are DFA's Legislative Impact Statements for each draft bill, with the exception of JLL076 and JLL077, which I understand were withdrawn by the Task Force.

Additionally, during the November meeting, the Task Force requested the revenue impact of an exemption for public transit advertising, for Opportunity Zones created under the Tax Cuts and Jobs Act, P.L. 115-97, and the 2-4-5.9 income tax reduction plan using two-year and three-year phase-ins. DFA's responses to these three requests are provided below.

Exemption for Public Transit Advertising

At the Task Force presentation in November on this issue, it is my understanding that a very small number of local governments operate public transit buses in Arkansas. DFA has does not have sufficient information to provide a precise revenue impact if the sale of advertising on transit buses were exempt from sales tax. Based upon the limited information DFA has, it would be estimated that such an exemption would have a minimal revenue impact no greater than \$50,000 per year.

Opportunity Zones

According to the Internal Revenue Service, an Opportunity Zone is an economically-distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment. Localities qualify as Opportunity Zones if they have been nominated for that designation by the state and that nomination has been certified by the Secretary of the U.S. Treasury via his delegation of authority to the Internal Revenue Service.

Opportunity Zones are designed to spur economic development by providing tax benefits to investors. First, investors can defer tax on any prior gains invested in a Qualified Opportunity Fund (QOF) until the earlier of the date on which the investment in a QOF is sold or exchanged, or December 31, 2026. If the QOF investment is held for longer than 5 years, there is a 10% exclusion of the deferred gain. If held for more than seven years, the 10% becomes 15%. Second, if the investor holds the investment in the Opportunity Fund for at least ten years, the investor is eligible for an increase in basis of the QOF investment equal to its fair market value on the date that the QOF investment is sold or exchanged.

DFA does not have sufficient information in order to provide a revenue impact should the General Assembly choose to adopt federal treatment of capital gains invested in a Qualified Opportunity Fund.

Revenue Impact – 2-4-5.9 Plan – Fiscal Year Impact of Two-Year Phase-In

2-4-5.9 Plan Fiscal Year Impact					
2-4-5.9/6.5 Bracket			FY 2020		
			Estimated Revenue:	2,514,660,066	
\$0	\$8,000	2.0%	2019 Estimated Revenue:	2,562,073,800	
\$8,001	\$18,000	4.0%	Impact:	\$ (47,413,735)	
\$18,001	\$65,000	5.9%			
\$65,001	and up	6.5%			
2-4-5.9 Bracket			FY 2021		
			Estimated Revenue:	2,418,792,829	
\$0	\$8,000	2.0%	Phase 1 Estimated Revenue:	2,514,660,066	
\$8,001	\$18,000	4.0%	Impact:	\$ (95,867,237)	
\$18,001	and up	5.9%			
			FY 2022		
			Estimated Revenue:	2,370,339,327	
Standard Deduction:			Phase 2 Estimated Revenue:	2,418,792,829	
Single		\$6,800	Impact:	\$ (48,453,502)	
Married		\$13,600			
Head of Household		\$6,800	Total Estimated Fiscal Impact:	\$ (191,734,473)	

Revenue Impact – 2-4-5.9 Plan – Fiscal Year Impact of Three-Year Phase-In

Fiscal Year Impact		Phase 1 TY 2020	2-4-5.9/6.5 Bracket		
FY 2020					
Estimated Revenue:	2,514,660,066		\$0	\$8,000	2.0%
2019 Estimated Revenue:	2,562,073,800		\$8,001	\$18,000	4.0%
Impact:	\$ (47,413,735)		\$18,001	\$65,000	5.9%
			\$65,001	and up	6.5%
			Effective Jan 1, 2020		
FY 2021		Phase 2 TY 2021	2-4-5.9/6.2 Bracket		
FY 2021 Estimated Revenue:	2,442,885,838				
FY 2020 Estimated Revenue:	2,514,660,066		\$0	\$8,000	2.0%
Impact:	\$ (71,774,228)		\$8,001	\$18,000	4.0%
			\$18,001	\$65,000	5.9%
			\$65,001	and up	6.2%
			Effective Jan 1, 2021		
FY 2022		Phase 3 TY 2022	2-4-5.9 Bracket		
FY 2022 Estimated Revenue:	2,394,432,336				
FY 2021 Estimated Revenue:	2,442,885,838		\$0	\$8,000	2.0%
Impact:	\$ (48,453,502)		\$8,001	\$18,000	4.0%
			\$18,001	and up	5.9%
			Effective Jan 1, 2022		
FY 2023					
FY 2023 Estimated Revenue:	2,370,339,327				
FY 2022 Estimated Revenue:	2,394,432,336				
Impact:	\$ (24,093,009)				
Total Estimated Fiscal Impact:	\$ (191,734,473)				

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

Sincerely,



Walter Anger
 Deputy Director and
 Commissioner of Revenue

Enc.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL031

Bill Subtitle: TO AMEND THE INCOME TAX EXEMPTION FOR CAPITAL GAINS; TO REPEAL THE CAPITAL GAINS EXEMPTION FOR CAPITAL GAINS OVER A CERTAIN AMOUNT.

Basic Change:

JLL031 repeals the exemption of the amount of net capital gain in excess of ten million dollars (\$10,000,000) provided in § 26-51-815(b)(3) from a gain realized on or after December 31, 2018. Under the bill, on or after January 1, 2019 all capital gains will be exempt at the 50% rate in accordance with § 26-51-815(b)(2)(c).

Revenue Impact:

Estimated average revenue gain of **\$7.7M** per year beginning FY2020, based upon the last four tax years.

If JLL031 were adopted in the four previous years, the revenue impact would have been as follows:

<u>Tax Year</u>	<u>Revenue Impact</u>
2014	\$11.6M
2015	\$6.4M
2016	\$4.6M
2017	\$8.5M

Taxpayer Impact:

The repeal of the exemption will affect taxpayers claiming over \$10M in capital gains. These taxpayers beginning in TY2019 will be limited to the 50% exemption from capital gains.

Resources Required:

Update computer programs, tax forms, and instructions.

Time Required:

Adequate time is provided.

Procedural Changes:

Computer programs, forms and instructions and training manuals will need to be updated. Employees will need to be educated as well as the tax community.

Other Comments:

None.

Legal Analysis:

None.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL032

Bill Subtitle: TO REPEAL THE LAW PROVIDING FOR AN INCOME TAX CREDIT FOR CERTAIN POLITICAL CONTRIBUTIONS THAT RESULTED FROM INITIATED MEASURE 1 OF 1966.

Basic Change:

JLL032 repeals the individual income tax credit provided in § 7-6-222 for political contributions. Under existing law, a tax credit is allowed not to exceed fifty dollars (\$50.00) on an individual tax return or aggregate contributions not to exceed one hundred dollars (\$100) on a joint return in a taxable year for political contributions.

Revenue Impact:

Estimated revenue gain of \$500,000 per year beginning FY 2020.

Taxpayer Impact:

The repeal of the credit will affect taxpayers contributing to a political candidate, political action committee, or political party.

Resources Required:

Update computer programs, tax forms, and instructions.

Time Required:

Adequate time is provided.

Procedural Changes:

Computer programs, forms and instructions and training manuals will need to be updated. Employees will need to be educated as well as the tax community.

Other Comments:

Revenue impact based on 2016 income tax return data.

Legal Analysis:

JLL032 repeals the tax credit for certain political contributions, including contributions to political candidates, to approved political action committees, and to organized political parties. Because this would repeal a statute enacted by an initiated measure, a two-thirds super majority is necessary for passage of JLL032. Ark. Const. art V, §1. Repeal of this exemption would relieve some administrative burden from DFA associated with administering the exemption. This bill becomes effective for tax years beginning on or after January 1, 2019.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL051

Bill Subtitle: TO CREATE THE PASS-THROUGH ENTITY TAX ACT; TO IMPOSE A TAX ON PASS-THROUGH ENTITIES; AND TO PROVIDE FOR AN OFFSETTING INCOME TAX CREDIT FOR PASS-THROUGH ENTITIES.

Basic Change:

JLL051 creates the "Pass-Through Entity Tax Act." This proposed bill would create a pass-through entity tax with a corresponding offsetting income tax credit for pass-through entities. The affected business entities are S corporations and partnerships.

Public Law 115-97, the Tax Cuts and Jobs Act of 2017, amended the Internal Revenue Code (IRC) of 1986. Prior to the passage of the Act, individuals and corporations could take a deduction for state and local income taxes paid or accrued during the taxable year ("SALT deduction"), and the deduction had no limit. IRC § 164(a)(4) (2017). However, § 11042 of the Act limits during the tax years 2018 through 2025 the deduction of IRC § 164 to \$10,000 or to \$5,000 in the case of a married individual filing a separate return. IRC § 164(b)(6)(B). Also, IRC § 162 provides for a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade of business. The IRS has stated "[a] corporation or partnership can deduct state and local income taxes imposed on the corporation or partnership as business expenses." IRS Publication 535. Further, on September 5, 2018 the IRS issued a news release which stated as follows:

Business taxpayers who make business-related payments to charities or government entities for which the taxpayers receive state or local tax credits can generally deduct the payments as business expenses[.]

Responding to taxpayer inquiries, the IRS clarified that this general deductibility rule is unaffected by the recent notice of proposed rulemaking concerning the availability of a charitable contribution deduction for contributions pursuant to such programs. The business expense deduction is available to any business taxpayer, regardless of whether it is doing business as a sole proprietor, partnership or corporation, as long as the payment qualifies as an ordinary and necessary business expense. Therefore, businesses generally can still deduct business-related payments in full as a business expense on their federal income tax return.

IR-2018-178.

JLL051 provides for: (1) a business-related payment in the form of a tax on what it calls an "affected business entity"; and (2) a corresponding tax credit to the partners, members, or shareholders of the affected business entity. The bill appears to allow taxpayers to deduct as a business expense what they formerly could deduct as a SALT deduction without limit.

JLL051 imposes a tax on an "affected business entities", which includes a partnership or an S corporation. "Partnership" is defined to include an unincorporated organization through which a business, financial operation, or venture is carried out and also to include a limited liability company that is treated as a partnership for state income tax purposes.

The basis of the tax depends on whether the affected business entity elects the calculation under proposed § 26-64-103 or -108. Once the tax is calculated and paid, a member (defined as a shareholder, a partner of a general partnership, a partner of a limited partnership, a partner of a limited

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Legislative Impact Statement

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liability partnership, or a member of a limited liability company that is treated as a partnership or an S corporation for state income tax purposes) of the affected business entity is allowed a credit against their respective state income tax in an amount equal to their pro rata share of the tax paid by the affected business entity multiplied by 93.01%.

Under the formulation set forth in proposed § 26-64-103, a tax of 6.9% is levied on the aggregate taxable income of the members of an affected business activity. Under the alternative basis set forth in proposed § 26-64-108, a tax of 6.9% on the sum of what is defined in the bill as the "resident portion of unsourced income" and the "modified Arkansas source income."

Revenue Impact:

No net revenue impact, but DFA will incur costs to implement and administer the tax.

Taxpayer Impact:

All S corporations and partnership will be required to make estimated payments. This will increase accounting cost and possibly interest and penalties on taxpayers.

Resources Required:

An estimate on computer programming costs is still needed to implement this new tax type from the Arkansas Integrated Revenue System (AIRS) team. One major cost would be allowing combined returns under proposed § 26-64-107. Tax forms and instructions would need to be redesigned or a new form may need to be created. The tax preparation community and income tax personnel will need training. Additional auditors will be required to process and review the pass-through returns and individual income tax returns of the pass-through members. The additional Departmental employees and processing costs would be approximately \$500,000 per year.

Time Required:

Six months after enactment with additional requirements for AIRS to implement system changes.

Procedural Changes:

Computer programs, forms and instructions and training manuals will need to be updated. Employees will need to be educated as well as the tax community. Internal business processes will be reviewed regarding oversight of S corporations and partnerships.

Other Comments:

None.

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Legislative Impact Statement

Bill: JLL051

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Legal Analysis:

It is unclear whether the IRS will determine that the tax approach in JLL051 meets the requirements of the IRS's use of the word "generally" in the September 5, 2018 news release cited above. Also, it is unclear whether the IRS would allow as a business expense deduction the payment of the tax set forth in JLL051 or whether it would allow the deduction for some taxpayers but not for others. As the United States Supreme Court has stated, the "determination of what amounts to carrying on business requires examination of the facts in each case." *United States v. Pyne*, 313 U.S. 127 (1941).

Partnership income tax returns, individual income tax returns, and their respective payments are currently due on the fifteenth day of the fourth month of the year. However, the tax created in JLL051 is due on the fifteenth day of the third month of the year and is not consistent with other tax provisions.

The interest provisions of JLL051 are not clear in context of the Arkansas Tax Procedure Act's (ATPA) existing interest provisions. JLL051 imposes interest on unpaid pass-through entity tax at 1% per month. It is not clear whether this interest replaces the interest set forth in the ATPA or is in addition to the interest set forth in the ATPA. This could increase the implementation costs if a new interest calculation is added to AIRS.

JLL051 does not apply to limited liability companies that are made up of only one member or shareholder. However, it does apply to S corporations made up of only one shareholder. It is unclear therefore whether JLL051 applies to an entity that is a single-member limited liability company, which cannot be treated as a partnership, that elects to be treated as an S corporation.

It is unclear whether the existing penalties of the ATPA in § 26-18-208 apply to the new pass-through entity tax created by JLL051. The required estimated payment mechanism in JLL051 for affected business entities does not address the potential penalties that are imposed when existing estimated payments are made. JLL051 is not clear whether the underestimated payment penalty applies when an affected business entity underestimates its payments below 90%.

For a partnership, the meaning of "unsourced income" under JLL051 is unclear. It could mean the income computed in Arkansas for partnerships subtracted by the aggregate amount of taxable income for income tax purposes for the members of an affected business entity, without regard to its distributive share of the income or add its distributive share of the loss from the other affected business entity to the extent that the income or loss was derived from or connected with sources within this state. Alternatively, "unsourced income" could mean the income computed in Arkansas for partnerships subtracted by the aggregate amount of taxable income for income tax purposes for the members of an affected business entity, without regard to its distributive share of the income or add its distributive share of the loss from the other affected business entity to the extent that the income or loss was derived from or connected with sources within this state and also subtracted by the income computed in Arkansas for partnerships that is derived from or connected with sources within another state that has jurisdiction to subject the affected business entity to tax, as determined under the Arkansas Code. Also, "unsourced income" could mean the income computed in Arkansas for partnerships subtracted by the income computed in Arkansas for partnerships that is derived from or connected with sources within another state that has jurisdiction to subject the affected business entity to tax, as determined

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Legislative Impact Statement

Bill: JLL051

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under the Arkansas Code.

To the extent that Bill JLL051 attempts to address the cap on the SALT deduction, the tax and the credit that this bill creates do not end when the SALT deduction cap is set to end under federal law, i.e., tax year 2025. Further, this bill imposes its obligations on members of an affected business entity regardless of whether their SALT deduction would be impacted by the cap. The bill does not provide any means by which a taxpayer could opt out of the tax and corresponding credit.

JLL051 has an effective date for tax years that beginning on or after January 1, 2019. Because the bill creates a new tax, it appears to require a simple majority vote.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL055

Bill Subtitle: TO IMPOSE AN ADDITIONAL REGISTRATION FEE ON ELECTRIC VEHICLES, HYBRID VEHICLES, AND ALTERNATIVE FUEL VEHICLES; AND TO DEDICATE THE REVENUES COLLECTED FROM THE ADDITIONAL REGISTRATION FEE TO HIGHWAY FUNDING.

Basic Change:

JLL055 would levy an additional annual motor vehicle registration fee on electric vehicles, hybrid vehicles and alternative fuel vehicles. The bill defines "alternative fuel vehicle" as a vehicle that is propelled by an internal combustion engine that is capable of being fueled by propane gas, compressed natural gas, or liquefied natural gas. "Electric vehicle" is a vehicle that is propelled by an electric motor powered by a battery or other electrical device incorporated into the vehicle and is not propelled by an internal combustion engine, and a "hybrid vehicle" is a motor vehicle that draws propulsion energy from both an internal combustion engine and an energy storage device.

The additional registration fees would be levied as follows:

- One hundred dollars (\$100) for each electric vehicle;
- One hundred dollars (\$100) for each alternative fuel vehicle; and
- Fifty dollars (\$50.00) for each hybrid vehicle.

All revenues collected would be deposited for distribution under the Arkansas Highway Revenue Distribution Law, § 27-70-201 with 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.

The Act would be effective 90 days after adjournment.

Revenue Impact:

\$600,000 Total Annual Motor Vehicle Registration Fees on Alternative Fuel Vehicles.

Distribution: \$406,980 --- State Highway and Transportation Department Fund
\$87,210 --- County Aid Fund
\$87,210 --- Municipal Aid Fund

Revenue estimate based on current totals of DFA registered electric, hybrid, and alternative fuel vehicles.

Taxpayer Impact:

Registered owners of electric, hybrid and alternative fuel vehicles would pay an additional fee at time of annual registration.

Resources Required:

Update computer programs and educate taxpayers and employees of the Office of Motor Vehicle and state Revenue Offices.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL055

Bill Subtitle: TO IMPOSE AN ADDITIONAL REGISTRATION FEE ON ELECTRIC VEHICLES, HYBRID VEHICLES, AND ALTERNATIVE FUEL VEHICLES; AND TO DEDICATE THE REVENUES COLLECTED FROM THE ADDITIONAL REGISTRATION FEE TO HIGHWAY FUNDING.

Time Required:

Adequate time is provided.

Procedural Changes:

Updating of the Motor Vehicle registration system and cash processing system to collect and account for the new registration fees will be required.

Other Comments:

None.

Legal Analysis:

None.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL070

Bill Subtitle: TO PROVIDE FOR THE INDEXING OF MOTOR FUEL TAXES AND DISTILLATE SPECIAL FUEL TAXES.

Basic Change:

JLL070 would implement an indexed tax system on motor fuel and distillate special fuels consistent with growth rate changes in the Consumer Price Index for All Urban Consumers. Each year, or before December 1, DFA would determine the percentage by which the average of the Consumer Price Index (CPI) for the twelve (12) months ending September 30 exceeds the average of the CPI for the same twelve-month period of the preceding year. The increased tax rate, to become effective on January 1 of the following year, will be determined by multiplying the then current tax rate by the lesser of: (1) the percentage growth in the CPI; or (2) four percent (4%). The calculated increased total tax rate would be rounded to the nearest one-tenth cent (0.1¢). In the case of a decline in growth or no growth in the CPI during a year, the total motor fuel tax rate would remain unchanged for the following calendar year. The revenue generated would be used to fund the construction, reconstruction, and maintenance of Arkansas highways, roads, streets, and bridges.

The bill provides that the first tax rate change would occur on January 1, 2020.

The bill includes an emergency clause and the Act would become effective on July 1, 2019.

Revenue Impact:

Additional Tax					
Distribution of new revenue is in accordance with the Arkansas Highway Revenue Distribution Law, § 27-70-201, et seq, with fifteen percent (15%) to the County Aid Fund; fifteen percent (15%) to the Municipal Aid Fund; and seventy percent (70%) to the State Highway and Transportation Department.					
Full 12 Month Calendar Year Collection	Total Additional Tax *	Distribution			
		70% State Highways	15% County Aid Fund	15% Municipal Aid Fund	
2020	\$ 11,351,847	\$ 7,946,293	\$ 1,702,777	\$ 1,702,777	
2021	\$ 22,035,424	\$ 15,424,796	\$ 3,305,314	\$ 3,305,314	
2022	\$ 32,050,729	\$ 22,435,511	\$ 4,807,609	\$ 4,807,609	

* Net Annual Available for Distribution Reduced by 3.1% to State Central Services and Constitutional Officers Funds
Analysis uses FY2018 Gasoline and Diesel Fuel Consumption: Gasoline 1,515,422,797 Gallons; Diesel 689,649,744 Gallons

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Legislative Impact Statement

Bill: JLL070

Bill Subtitle: TO PROVIDE FOR THE INDEXING OF MOTOR FUEL TAXES AND DISTILLATE SPECIAL FUEL TAXES.

Estimated CPI Index Growth

	Growth %
2019 Analysis for 2020 Tax Rates	2.5422%
2020 Analysis for 2021 Tax Rates	2.0842%
2021 Analysis for 2022 Tax Rates	2.0268%

(IHS Markit, U.S. Economic Outlook, November 2018)

Estimated Revised Tax Rates per Gallon

<u>Year</u>	<u>Gasoline</u>	<u>Diesel</u>
2020	\$0.220	\$0.231
2021	\$0.225	\$0.236
2022	\$0.230	\$0.240

Taxpayer Impact:

Arkansas wholesale distributors and suppliers of fuels would include the increased taxes when selling fuels to Arkansas retailers. Consumers would incur the increased taxes when purchasing fuel from retailers.

Resources Required:

None.

Time Required:

Adequate time is provided for implementation.

Procedural Changes:

Updating of the Revenue Division's tax system and providing annual updates to licensed distributors and suppliers of the revised tax rates.

Other Comments:

None.

Legal Analysis:

The Arkansas Tax Reform and Relief Legislative Task Force determined that the taxes applicable to motor fuel and distillate special fuel have not changed in over 15 years and indexing those taxes would generate funding to better maintain, improve, and construct roadways in the state. While the tax laws for motor fuel have not changed since 2000, motor fuel taxes were technically last changed in 2001

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL070

Bill Subtitle: TO PROVIDE FOR THE INDEXING OF MOTOR FUEL TAXES AND DISTILLATE SPECIAL FUEL TAXES.

under Act 1028 of 1999.

This bill seeks to increase excise taxes on motor fuels and distillate special fuels by indexing the rates annually based on inflation, as measured by the CPI. These increases would begin on January 1, 2020, and are subject to further increase on January 1 of each succeeding year if the DFA Director determines that the CPI has increased over the preceding October 1 through September 30.

The annual tax increase is equal to the current motor fuel tax rate multiplied by the lesser of the percentage growth in the CPI or 4%, and then rounded to the nearest one-tenth cent. The 4% cap serves as a protective measure to limit the tax increase in the event of high inflation. The bill also provides that motor fuel tax rates will remain unchanged for the year if there is no change in the CPI.

The increase in excise taxes proposed under this bill would require a vote of three-fourths of the members elected to each House of the General Assembly under Article 5, § 38 of the Arkansas Constitution.

This bill contains an Emergency Clause to make the effective date July 1, 2019.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL069

Bill Subtitle: TO CREATE THE ARKANSAS TAX REFORM ACT OF 2019; AND TO REFORM THE SALES TAX, INCOME TAX, PROPERTY TAX, AND FRANCHISE TAX LAWS OF THIS STATE.

Basic Change:

Franchise Tax – Transfers administration of the Arkansas franchise tax from the Secretary of State to DFA. This transfer is effective January 1, 2020.

Property Tax – Requires the Assessment Coordination Department (ACD) to adopt mandatory guidelines to be followed by County Assessors with regard to identifying property exempt from ad valorem tax and for assessing business inventory. Once implemented, these guidelines are to be followed by County Assessors and ACD is to monitor each county's compliance and report any non-complaint county to the General Assembly.

Report of Tax Exemptions and Deductions – Provides that before each regular session of the General Assembly, the Department of Finance and Administration (DFA) shall report to the Legislative Council and the Governor on the effect of each tax exemption, discount, exclusion, credit, deduction, special accounting treatment, or special rate relating to state income tax and state sales and use tax. If actual tax return data is not available, DFA would use statistical data to make an estimate. If the information cannot be determined, an explanation must be provided.

The required report would include:

- An estimate of the loss of revenue for a six-year period beginning with the fiscal year in which the report is submitted;
- A citation to the legal authority for the exemption, discount, exclusion, credit, deduction, special accounting treatment, or special rate; and
- For an exemption, discount, exclusion, credit, deduction, special accounting treatment, or special rate that reduces revenue by more than one percent (1%) of the total revenue for the relevant tax, the effect of the distribution of the tax burden by:
 - Income class; and
 - Industry or business class.

The report may include an assessment of the intended purpose of tax provision and recommendation for retaining the provision.

No current requirement for this type of information is required of DFA and data sources available for this type of reporting is limited from the tax return records maintained. U.S. Economic Census data in conjunction to any private and public reports and publications are generally used in revenue and exemption estimating by DFA for tax purposes. When used, U.S. Economic Census data must be factored to reflect the Arkansas portion based on population and income levels. U.S. Economic data is updated on a five-year cycle which would not correspond to the biennial nature of the proposal.

This provision of the bill would be effective on and after January 1, 2020.

Sales Tax – Car Washes – Amends existing law to provide that sales tax does not apply to a “car wash”. Currently, sales tax code provisions provide that the service of cleaning a motor vehicle is subject to tax. Excluded from taxation are services performed by a “coin-operated car wash” in which the car washing equipment is activated by the insertion of the payment into a receptacle and the labor

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL069

Bill Subtitle: TO CREATE THE ARKANSAS TAX REFORM ACT OF 2019; AND TO REFORM THE SALES TAX, INCOME TAX, PROPERTY TAX, AND FRANCHISE TAX LAWS OF THIS STATE.

of washing the exterior of the car or motor vehicle is performed solely by the customer or by mechanical equipment. Motor vehicle cleaning performed in any other fashion is subject to sales tax including a car wash where attendants perform a portion of the cleaning service in addition to the mechanical equipment performing a portion.

This provision of the bill would be effective the first day of the calendar quarter following the effective date of the act. (October 1, 2019).

Sales Tax – Certain Entities – Repeals existing sales tax exemptions provided to certain entities on their purchase of products and services. The tax exemption would be repealed on sales to: the Boys and Girls Clubs of America; the Poets Roundtable of Arkansas; 4-H Clubs; FFA Clubs; the Arkansas 4-H Foundation; the Arkansas Future Farms of America Foundation; the Arkansas Future Farmers of America Association; Habitat for Humanity; the Salvation Army; Heifer International, Inc.; the Arkansas Symphony Orchestra Society, Inc.; the Arkansas Black Hall of Fame Foundation, Inc.; the Community Service Clearinghouse, Inc. of Fort Smith; and the American Search Dog Association, Inc. Sales to the Boy Scouts of America, the Girl Scouts of the United States of America and the scout councils in Arkansas would continue to be exempt from taxation.

Upon the effective date of the act, the organizations would no longer be eligible to claim the sales tax exemption when making purchases and would pay state and local sales taxes to their suppliers. The bill includes additional provisions that would allow the organizations to submit reports and documentation to DFA to request a rebate of the state tax paid. Local sales taxes would not be eligible for the rebate.

These provisions of the bill would be effective the first day of the calendar quarter following the effective date of the Act. (October 1, 2019).

Sales Tax – All Terrain Vehicles – Amends provisions of the existing sales tax exemption on the purchase of certain types of farm machinery and equipment to provide that to the extent that the exemption applies to an all-terrain vehicle that is not subject to registration, the exemption would be administered as a tax rebate to the consumer administered by DFA.

Presently, commercial farmers purchasing all-terrain vehicles eligible for the sales tax exemption claim the exemption at the time of purchase from the equipment dealer. Upon the effective date of the Act, the commercial farmer would pay the sales tax to the dealer at the time of purchase of the all-terrain vehicle and subsequently submit a request to DFA along with copies of invoices and documentation to substantiate the eligibility of the purchase for the rebate and the amount of the state and local sales taxes paid. DFA would determine adequacy of the claim, complete taxpayer registration, perform desk audit review and conduct procedures necessary for issuance of the refund payment.

This provision of the bill would be effective the first day of the calendar quarter following the effective date of the act. (October 1, 2019).

Sales Tax – Tax Rebates for Certain Entities – Establishes authorization for providing tax rebates of the state sales and use taxes paid on purchases of property and services to certain types of nonprofit organizations. The rebates of state sales and use taxes would be capped at a maximum amount per calendar year for all organizations classified within the specific organization type or classification. The

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types of organizations and the maximum annual amount of authorized state tax rebates are:

- Nonprofit patriotic societies for youth: capped at \$91,000 per year;
- Nonprofit organizations dedicated to the study or performance of the arts: capped at \$4,900 per year;
- International nonprofit organizations dedicated to increasing access to property and services for basic needs: capped at \$333,000 per year;
- Nonprofit halls of fame established to honor current and former Arkansas residents: capped at \$5,000 per year;
- Nonprofit organizations that partner with local agencies and organizations who assist families in need: capped at \$6,000 per year; and
- Nonprofit organizations dedicated to assisting law enforcement and emergency personnel in their official duties: capped at \$700 per year.

Upon the effective date of the act, eligible organizations for the tax rebates would pay state and local sales taxes to their suppliers of products and services at the time of purchase. Eligible organizations would then subsequently submit a tax rebate claim to DFA along with documentation to substantiate the type of organization making the claim, schedules reflecting each purchase transaction, the amounts of state sales taxes paid on each purchase, along with photocopies of each purchase invoice in order to substantiate the claimed amount. DFA would then determine the eligibility of the claimant, the adequacy of the claim documentation, complete a taxpayer registration, perform desk audit review to verify the amounts claimed and conduct procedures necessary for issuance of the refund payment while monitoring total rebates issued to eligible organizations to ensure compliance with the annual maximum rebate limits per type of organization. Local city and county sales taxes would not be eligible for the tax rebates.

Organizations that currently have specific statutory sales tax exemptions that are being eliminated by the bill will be eligible to claim rebates for the state portion of the sales taxes they will begin paying subject to the cap limitations as specified for their type of classified organization. Many other organizations that are not currently exempt from taxation will be eligible for state tax rebates if the organization is one of the eligible types. DFA has no knowledge as to the total number of organizations that may be eligible for the tax rebates.

This provision of the bill would be effective the first day of the calendar quarter following the effective date of the act. (October 1, 2019).

Sales Tax – Car Washes – Levies a new monthly water usage fees or annual fees on car wash operators who operate either an “automatic car wash”, a “car wash tunnel” or a car washing “self-service bay” for public use dependent on their source of the water used. If using water from a public water source, the fees would be calculated and based on the amount of water consumed. If using water from a private well or a nonpublic water system, annual fees would be levied.

For purposes of the fee calculation, an “automatic car wash” is defined as a car wash bay that provides an exterior car wash using mechanical equipment that cleans the motor vehicle while the vehicle remains stationary. A “car wash tunnel” is defined as a car wash bay that provides a fully automated exterior car wash in which the motor vehicle is moved through a tunnel by a conveyor system. A

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“self-service bay” is defined as a car wash bay that allows a person to manually wash the exterior of their motor vehicle using equipment and supplies provided by the car wash operator.

For operators using water from a public water source, fees would be due and calculated on the amount of water consumed by the operator’s “car wash tunnels”. No fees would be levied on water used from a public water source for “automatic car washes” or “self-service bays”. For operators using water from a private well or a nonpublic water source, annual fees would be paid based on the number of “automatic car wash” bays or the number of “self-service bays” in operation. There are no annual fees on “car wash tunnels” using private water sources.

Fee structure for operations using water from a public water system

- Operator with “car wash tunnels” only – monthly reporting of water usage fees at full rate.
- Operator with “car wash tunnels” and either “automatic car washes” or “self-service bays” or both – monthly reporting of water usage fee is due at reduced rate.
- Operator with “automatic car washes” only – no water usage fee is due.
- Operator with “self-service bays” only – no water usage fee is due.

Fee structure for operations using water from a private well or non-public water system

- Operator with “car wash tunnels” only – no annual fees
- Operator with “car wash tunnels” and either “automatic car washes” or “self-service bays” or both - no monthly reporting of water usage fee or annual fees on “car wash tunnels”; annual fees of \$100 per bay or \$500 per automatic car wash.
- Operator with “self-service bays” only - \$100 per year per bay.
- Operator with “automatic car washes” only - \$500 per year for each automatic car wash.
- Operator with both “automatic car washes” and “self-service bays” at the same location – \$500 per year for each automatic car wash with no annual fees being due on the “self-service bays”.

Water usage fees for “car wash tunnels” for an operator using water from a public water system would be calculated as follows:

- Operator with one or more car wash tunnels: Multiply the total number of gallons used the previous month by nine-tenths (0.9). This product is then multiplied by seventy-five hundredths of a cent (.0075) to determine the amount of monthly fee due.
- Operator with one or more car wash tunnels AND one or more self service bays or automatic car washes or both: The total number of self service bays and automatic car washes is multiplied by one-tenth (0.1). Subtract the lesser of this product or five-tenths (0.5) from nine-tenths (0.9), and then multiply this difference by the total aggregate number of gallons used during the preceding month at all of the operator’s car wash tunnels. Multiply this total by the .0075 cents to determine the monthly fee due. The fee is not due on the water used in the operator’s self-service bays or automatic car washes.

All revenue collected under this provision would be deposited as State General Revenue.

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The bill provides that the water usage fees would be in lieu of the operator collecting and remitting state and local sales taxes although under current sales tax law, no sales taxes are collected if the exterior car washing is being performed only by the "automatic car wash" or "car wash tunnel", or by the consumer at a "self-service bay". Sales taxes are due at these facilities only if a portion of the cleaning services are being performed by attendants in conjunction with the mechanical equipment.

The bill does not establish the requirements for filing of a tax return and for remittance of the water usage fees. No due date for the monthly return is provided or the requirement to file and pay the fees electronically. Electronic tax return filing and payment provides an easier solution for taxpayers and reduces administrative overhead for DFA. The language of the bill also does not require DFA to collect and administer the fee in accordance with Arkansas Tax Procedure Act, § 26-18-101 et. seq.

This provision of the bill would be effective the first day of the calendar quarter following the effective date of the act. (October 1, 2019).

Local Sales Taxes – Establishes the maximum aggregate sales and use tax rate a city or county may levy. For counties, the sales and use tax rate may not exceed 3% and for cities, 4%.

This provision of the bill would be effective the first day of the calendar quarter following the effective date of the act. (October 1, 2019).

Revenue Impact:

Sales Tax – Car Washes - Revenue Impact if the intent is to exempt from sales tax all motor vehicle cleaning services performed at facilities that also use "automatic car washes" or "car wash tunnels" to perform a portion of the motor vehicle cleaning service:

FY2020 – (8 Months Deposit Only)

-\$1.4 Million Total Loss to State Sales Tax Revenue

-\$ 29,400 --- State Central Services
-\$ 14,000 --- Constitutional Officers
-\$ 939,184 --- General Revenue
-\$ --- Educational Excellence Trust Fund
-\$ --- Educational Adequacy (GR transfer)
-\$ 182,619 --- Educational Adequacy (7/8% tax)
-\$ 104,353 --- Property Tax Relief Trust Fund
-\$ 26,088 --- Conservation Tax
-\$ 104,353 --- Highway Fund

Loss to City and County Sales Tax Revenue: -\$450,000

FY2021

-\$ 2.1 Million Total Loss to State Sales Tax Revenue

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-\$ 44,100 --- State Central Services
-\$ 21,000 --- Constitutional Officers
-\$ 1,191,967 --- General Revenue
-\$ 199,201--- Educational Excellence Trust Fund
-\$ 17,610 --- Educational Adequacy (GR transfer)
-\$ 273,929 --- Educational Adequacy (7/8% tax)
-\$ 156,531 --- Property Tax Relief Trust Fund
-\$ 39,133 --- Conservation Tax
-\$ 156,531 --- Highway Fund

Loss to City and County Sales Tax Revenue: -\$700,000

Sales Tax – ATVs – All-terrain vehicles purchased for use in commercial farming to be administered as a DFA tax rebate versus a sales tax exemption administered by equipment sellers.

Unknown revenue impact from change in procedures.

Sales Tax – Certain Entities – Revenue Impact from the repeal of existing sales tax exemptions provided to certain entities on their purchase of products and services and replaced with a DFA issued tax rebate program for entities of like kind.

No Change in State Revenues – Capped Rebate availability equal to existing sales tax exemption estimates.

Car Wash Water Usage Fees – Monthly Fees to be paid by operators of “Car Wash Tunnels” and Annual Fees to be paid by certain Operators of Self-Service Car Wash Bays and Automatic Car Washes that use water from private wells or nonpublic water systems.

Unknown Gain to State General Revenue on Fees levied

[DFA has no knowledge of the number of “car wash tunnels” in Arkansas and if the operators of the tunnels also have other “car wash bays” or “automatic car washes” which would determine the rate of fee payment. DFA also has no knowledge of the number of “car wash bays” or “automatic car Washes” operating in Arkansas using private water supply systems.

In a report published in 2018 by Chris Brown Consulting for the International Carwash Association the average tunnel car wash uses 30 gallons of water per vehicle wash. Water usage fees per wash as provide in the bill at this rate of consumption would result in a fee per wash of \$0.2025, with a reduced fee amount due if the operator also operates other car wash bays or automatic car washes. Under current sales tax law, no sales tax is due on a car wash performed by a car wash tunnel if the total washing service is performed by the mechanical equipment only with no portion of the motor vehicle cleaning service being performed by an attendant.]

Taxpayer Impact:

Taxpayers selling all-terrain vehicles would begin collecting sales taxes on all sales and no longer allow the claiming of the farm machinery exemption. Commercial farmers would pay sales tax on

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all-terrain vehicles and request rebate from DFA.

Current specified tax-exempt entities from state and local sales taxes would no longer be entitled to an exemption at time of purchase but could apply to DFA for a rebate of state sales taxes paid. No rebate of local sales tax would be authorized. All entities classified as one of the specified types would be allowed to apply for a rebate of state taxes paid on purchases subject to annual caps of monies available.

Operators of "automatic car washes", "car wash tunnels" or a car washing "self-service bays" would register and report monthly and annual water usage fees based on gallons of water used in exterior car washing dependent on the source of water used.

Resources Required:

Report of Tax Exemptions and Deductions – \$875,000 Additional DFA staff personnel will be needed to prepare the biennial reports of the economic impact from income tax and sales and use taxes exemptions, deductions, exclusions, etc. The dedicated staffing that would be needed to compile the necessary information on a fiscal year basis are the following:

Hiring of 1 economist and 1 statistician and one administrative assistant, \$250,000 per year. Computer programming, forms and instructions modification, \$50,000. Additional data entry costs, \$500,000 per year. \$75,000 Annual estimated cost for staff personnel.

Initially, one additional DFA Tax Research Analyst, A057C position will be needed.

ATV Rebate - \$650,000 estimated personnel costs for an additional ten (10) accountant staff positions who would determine adequacy and accuracy of refund claims of farm use all-terrain vehicles, complete taxpayer registrations, perform desk audit reviews and perform procedures necessary for issuance of the refund payment. \$25,000 estimated additional expenditures for postage and mailings to commercial farmers for the anticipated 12,000 refund claims that will be filed per year.

Rebate for Certain Entities - \$325,000 estimated costs for five additional accountants to determine adequacy and accuracy of refund claims from eligible organizations, complete taxpayer registrations, perform desk audits of submitted documents and perform procedures necessary for issuance of the refund payments.

Time Required:

ATV Rebate – A minimum of 6 months is necessary to notify the taxpayer base of the process for processing a rebate claim on qualifying purchases. Also, the Department would need to create a new rebate claim form and procedures within the State's database development to perform this function.

Rebate for Certain Entities – A minimum of 6 months is needed to develop procedures for claiming of tax rebates by nonprofit organizations and to hire staff personnel to administer this new process. Creating a new tax rebate procedure requires the generation of a new tax reporting form and database development followed by testing to ensure functionality.

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Car Washes – A minimum of 6 months for program development for a new tax type. This will require development of programming, coding and system change to incorporate a new tax type. Development of new forms and procedures and registration of all affected taxpayers.

Procedural Changes:

Report of Tax Exemptions and Deductions - Development of new procedures to implement creation of biennial reports of tax exemptions, discount, exclusion, credit, etc.

Car Washes – Notification of car wash operators of new taxation rules and education of staff personnel in change.

Rebate for Certain Entities – Notification of affected entities and all retailers of the elimination of the tax exemption status of affected entities and the availability of tax rebates of state sales taxes paid. Education of staff of change in exemption status. Development of new system for issuing rebates.

ATVs – Notification of farm implement and all-terrain vehicle dealers of the change in allowing the farm exemption for all-terrain vehicles. Development of new system for issuing rebates to commercial farmers.

Car Wash Usage Fees – Notification of car wash operators of the new tax levy. Car wash operators would begin filing and remitting new fees. Development of new system for issuing rebates to commercial farmers.

Other Comments:

Report of Tax Exemptions and Deductions – The Department does not currently have access to some of the data necessary to provide biennial updates of exemptions discount, exclusion, credit, deduction, special accounting treatment, or special rate relating for state sales and use taxes. U.S Economic Census data is updated on five year cycles with a portion completed each year.

Car Washes – The proposal does not define the term “car wash” or “car washing” for purposes of the exemption. Car washing would generally refer to exterior cleaning with soap and water and would not include any interior cleaning since it is not washed. The bill should be amended to include the definitions for “car wash” or “car washing”.

The bill should be clarified regarding if the exempted service is to be limited to the charges for washing of the exterior of cars only or is it to include other types of motor vehicles and trailers. It is also not clear if the exemption is to include other types of cleaning services that may be included for one nonitemized price with the exterior washing service including interior vacuuming, interior window cleaning, exterior polishing and waxing, interior shampooing, engine bay steam cleaning, application of tire dressing/shine, drying of the vehicle or comprehensive vehicle detailing.

Existing law levies a sales tax on the “cleaning of a motor vehicle.” Repealed by this bill is the exemption for the cleaning of a motor vehicle through a coin operated car wash facility where the consumer does the actual washing (the consumer is not actually purchasing a performed service) or

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through a facility where coin-operated machinery washes the exterior of the motor vehicle. It is not clear if a car wash that provides human intervention pre-wash by applying presoak tire cleaner or any type of spray on bug remover would be exempt from sales tax pursuant to this bill since some of the service is not performed by the automatic or tunnel car washing machinery. Clarity is needed as to the intent of the bill language.

ATV Rebates – The language of the bill refers to “all-terrain vehicle” but does not provide a definition for this term. Without this definition it is not clear which vehicles are eligible for the rebate as an “all-terrain” vehicle. A definition of “all-terrain vehicle” should be added to the legislation.

Rebate for Certain Entities – The bill does not state what entity organizational structure must exist for applicants of the rebates, i.e. corporation, LLC, 501(C)(3), etc.

The tax rebates are based on calendar years. The effective date of this provision should match the rebating period. It is suggested that the effective date be January 1, 2020.

Car Washes (Section 31) – Existing law levies a sales tax on the “cleaning of a motor vehicle.” Repealed by this bill, in section 16, is the exemption for the cleaning of a motor vehicle through a coin operated car wash facility where the consumer does the actual washing (the consumer is not actually purchasing a performed service) or through a facility where coin-operated machinery washes the exterior of the motor vehicle. Section 31 provides a sales tax exemption for the specified type of car wash facilities but it is not clear if an exterior car wash occurs at an automated car wash or a tunnel car wash that also provides attendant pre-wash by applying presoak tire cleaner or any type of cleaner, bug remover, etc. prior to the use of the automatic or tunnel facility would exempt from sales tax pursuant to this bill.

A portion of the sales and use tax revenue currently collected is directed to the Cities and Counties where the car washes were performed. The draft bill would redirect the water usage fee collections to General Revenues only. City and County sales tax collections will be reduced.

The draft bill doesn't reflect the day of the month which the car wash operator is required to report and pay the water usage fee, nor does it specify what day of the year a car wash operator utilizing a private water source is required to submit their annual fees. Due dates for the fees need to be included in the levying provisions.

The draft bill doesn't state that the new tax would be governed by Arkansas Tax Procedure Act. This requirement should be added.

Electronic filing and remittance should be required to eliminate DFA costs for form development, printing and mailing and the subsequent processing, data entry and imaging costs associated with paper tax return filing.

The draft bill doesn't contemplate the theory of bulk services provided in conjunction with car washes. Car wash operators offering bulk services such as detailing in conjunction with car washes will still be subject to sales and use tax if the invoice is not itemized to show taxable and non-taxable services performed.

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A car wash used by the "general public" is not defined in the draft bill. This would leave any self-service bay, car wash tunnels, and/or automatic car wash requiring a water usage fee even if the facility is only used to provide free services to the general public (i.e. complimentary car wash bays at apartment complexes, complimentary car washes at car dealership, etc.). The bill should be amended to provide clarity as to the fee levy.

Car wash operators whose water provider calculates billing based on cubic feet will have to convert their water usage to gallons in order to report the water usage fee in the proper manner.

Legal Analysis:

Franchise Tax:

- Several provisions of state law require the Secretary of State, the Bank Commissioner, the Bail Bondsman Licensing Board, and the Insurance Commissioner to take actions against a corporation that has not paid its franchise tax. The Arkansas Tax Procedure Act prohibits DFA from releasing confidential tax information regarding taxes it collects. The Arkansas Tax Procedure Act should be amended to allow DFA to release information to an agency of state government regarding whether a corporation has filed or paid its franchise tax, the name and address of the registered agent or principal office of the corporation as shown on the franchise tax return, and other information required by the agency to comply with its statutory duties.
- Dissolved corporations are not required to file a franchise tax return under § 4-26-1102. DFA will not know the identity of those corporations that have dissolved unless that information is reported to DFA by the Secretary of State, the Bank Commissioner, or the Insurance Department and will expect a franchise tax return to be filed by those corporations. To prevent unnecessary collection efforts, any agency that processes the dissolution of a corporate charter should be required to notify DFA of that dissolution.
- Section 3 of the bill amends § 4-25-109(c) to require a corporation to provide the Secretary of State with a franchise tax contact sheet. This provision should be amended to provide that the contact sheet also be provided to DFA.
- The bill eliminates the current franchise tax return due date of May 1. Instead, those returns will now be due on the same date the corporation's Arkansas income tax return is due. The bill does not address when franchise tax returns should be filed by entities that do not file Arkansas corporate income tax returns such as LLC's and insurance companies. A specific franchise tax return due date should be added for taxpayers who are required to file a franchise tax return but not required to file a corporate income tax return.
- § 26-54-107(e) provides remedies for franchise tax disputes in accordance with the Arkansas Administrative Procedure Act. Separate remedies and procedures are provided for taxes administered by DFA under the Arkansas Tax Procedure Act. The Tax Procedure Act provides uniform notice, audit, and administrative hearing provisions applicable to all other taxes administered by DFA. The reference to Administrative Procedure Act remedies should be deleted and additional language should be added to provide that the franchise tax is subject to the provisions of the Arkansas Tax Procedure Act.
- § 25-16-708 allows the Attorney General to appoint special counsel to collect delinquent franchise tax. Attorneys employed by DFA represent DFA in tax collection matters and not the Attorney General. Consequently, this language should be deleted.
- Section 27 of the bill requires DFA to send notice by November 1 of each year informing

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corporations that it is subject to forfeiture of its corporate charter for failure to pay franchise tax. Because the franchise tax return filing date will be based on the corporate income tax return filing date, franchise tax returns will be due throughout the year for fiscal year taxpayers. Consequently, the November notification date will occur before some franchise tax returns are due. This provision should be modified to address that issue.

- Section 28 of the bill requires the Secretary of State to issue a proclamation on or before January 31 of each year identifying those corporate charters that are delinquent in the payment of the annual franchise tax. Since the franchise tax will now be due when the corporate income tax return is due, and many corporations file their income tax returns on a fiscal year basis, some franchise tax returns will not be due until November, December, or January of a given year. This may not provide adequate time for the Secretary of State to provide its proclamation as required by law. The Secretary of State should be consulted regarding this issue.
- The bill required DFA to adopt rules regarding franchise tax. It is unclear whether franchise tax rules will be needed. If not, the bill requires the issuance of rules that may unnecessary. Instead, the language should be amended to allow DFA to adopt rules, if needed.

Administrative Provisions:

- The bill requires DFA to provide a biennial report on the effect of an income tax or sales and use tax exemption, discount, exclusion, credit, deduction, special accounting treatment, or special rate. Tax exemptions, discounts, credits, and deductions are clearly identifiable in the law. It is unclear what is intended by the use of the terms "exclusion", "special accounting", and a "special rate" because these terms are not typically used in Arkansas law. Additional specifics are needed to identify the items of concern relating to these terms. As noted in the resource requirements this provision will require significant additional funding for the Department for additional qualified employees and supporting infrastructure.

Sales Tax:

- The bill repeals sales tax exemptions for specific organizations and replaces those exemptions with sales tax rebates for specific types of nonprofit organizations. The rebates provided by the bill are available to a larger group of taxpayers than the current exemptions for specific organizations. For example, the sales tax exemption for the Black Hall of Fame is now expanded to a rebate for any nonprofit hall of fame honoring current or former Arkansas residents. Similar expansions occur for each rebate category. The rebate for arts-related entities would apply to entities that are not currently exempt from sales tax. The rebate for nonprofit organizations that partner with local agencies or organizations to aid the needy would include many churches that are not currently exempt from sales tax. Each of these rebate categories contains an annual cap on the amount of rebates that may be paid during a year. Some taxpayers will likely apply for a rebate, but their rebate claim will be denied because the rebate cap limit has been reached. No provision has been made addressing what happens to those rebate claims received after the annual rebate cap amount has been reached. Guidance should be provided regarding this issue.
- Sales tax exemptions are administered at the time a merchant sells the item to the exempt organization. Little or nothing is required of the exempt organization to purchase an item tax free. This bill establishes a bureaucratic process to obtain a rebate. This process will require the organization to pay the sales tax at the time of purchase, to provide a rebate claim to DFA,

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to provide documentation proving that the tax was actually paid on the item, for DFA to establish an account for the organization, and issue a state refund to that taxpayer's account. These additional requirements may frustrate some taxpayers.

- The tax rebate applies only to the state portion of the sales and use tax paid by the affected organizations. City and county sales and use taxes paid by the organization are not eligible for the rebate. This will result in a tax increase on those organizations that were previously exempt from sales and use tax.
- The sales tax exemption for car washes is contained in § 26-52-301(3)(B)(ii). This is the sales tax levy portion of the Arkansas Code. Placing a tax exemption in the levy statute is confusing. The exemption for car washes would be better placed in § 26-52-401 where many other sales tax exemptions are codified.
- The term "car wash" is not defined for purposes of the car wash exemption. The absence of a definition will create confusion regarding what is exempt since elsewhere in state law the service of cleaning a motor vehicle is specifically identified as a taxable service. It is anticipated that detail shops and other businesses that provide car washing services together with other vehicle related services will be confused regarding whether they are entitled to the car wash exemption.
- The bill provides that sales tax does not apply to a car wash but does not indicate whether that exemption is limited to car wash services or also applies to sales of tangible personal property by the car wash. Many car washes sell tangible personal property in addition to providing car washing services. This issue should be clarified in the bill.
- The bill is unclear regarding whether the car wash exemption extends to items purchased by the car wash for use or consumption in operating the business. Other sales tax exemption provisions contain language limiting the exemption to the gross receipts or gross proceeds derived from a particular sale or activity. The absence of such language in this exemption for car washes creates questions regarding the scope of the exemption. Additional language should be added to clarify whether the exemption is intended to apply to the gross receipts derived from the sale of car washing services, to the gross receipts derived from sales of tangible personal property by the car wash, or to purchases made by the car wash.

Car Wash Fee:

- The bill provides that a person operating a car wash shall pay this new fee in lieu of paying sales and use tax. The bill is unclear regarding whether payment of the fee exempts the car wash from paying tax on its purchases, exempts the car wash from collecting tax on their car wash sales, exempts the car wash from collecting tax on its sales of tangible personal property, or some combination. The bill should be amended to clarify its intent.
- The bill levies the new fee on a "car wash tunnel" that uses water from a public water system but levies no fee on an "automatic car wash" or a "self-service bay" car wash that uses water from a public water system. Additionally, the bill levies no fee on a "car wash tunnel" that uses water from a private well or nonpublic water system but does levy a fee on an "automated car wash" or a "self-service bay" car wash that uses water from a private well or nonpublic water system. It is unclear from the bill whether this is the desired result.
- The \$100 fee for a "self-service bay" car wash clearly applies to each self-service bay. The \$500 fee for an "automatic car wash" is not clearly applied. It is unclear whether an automatic car wash with multiple car washing machines at a single location will pay a single \$500 fee for the location or a separate \$500 fee for each car washing machine at the

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- location. Additional language is needed to address this issue.
- The bill should be amended to clearly address how the reduction of the 0.9 rate for each self-service bay or automatic car wash also operated by the car wash tunnel operator should apply when the operator has multiple locations. Otherwise, uncertainty will exist with regard to whether the 0.1 reduction for each self-service bay or automatic car wash operated by the car wash tunnel operator is limited to self-service bays and automatic car washes at the same physical location at the car wash tunnel or can the car wash tunnel operator reduce the 0.9 rate based on self-service bays and automatic car washes operated by the same operator at a physical location other than at the location where the car wash tunnel is located.

Bill Subtitle

The subtitle of the bill references changes to the income tax; however, no income tax provisions are amended by this bill.

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Bill Subtitle: TO CREATE THE TAX REFORM AND RELIEF ACT OF 2019; TO REFORM ARKANSAS TAX LAWS TO PROVIDE TAX RELIEF FOR ARKANSAS TAXPAYERS; TO GRADUALLY REDUCE INCOME TAX RATES; AND TO REQUIRE THE COLLECTION OF SALES AND USE TAX BY REMOTE SELLERS.

Basic Change:

JLL071 creates the "Tax Reform and Relief Act of 2019." This bill would reform Arkansas' tax laws to provide income tax relief for Arkansas taxpayers. Through a two-step process, this bill would simplify the individual income tax tables by going from a three-table tax system to a one table tax system reducing the rates on middle and upper income taxpayers, then further reducing the top rate from 6.9% to 6.5% provided that certain conditions are met. JLL071 also repeals the income tax cut trigger of § 26-51-201(e) and affiliated seller nexus provisions of § 26-52-110.

JLL071 would also amend the Arkansas Gross Receipts Tax Act of 1941, § 26-52-101 et seq., to require out-of-state sellers having no physical presence in Arkansas to collect Arkansas sales tax. Out-of-state or "remote" sellers subject to the bill would include those sellers meeting either of the following criteria in the previous calendar year or the current calendar year: (1) a seller having gross revenue from sales of products and services delivered into Arkansas that exceeds one hundred thousand dollars (\$100,000); or (2) a seller who has sold products and services for delivery into Arkansas in at least two hundred (200) separate sales transactions.

JLL071 also repeals the exemption from sales and use taxes on the sale of publications though regular subscriptions.

The effective date of JLL071 for Sections 4-7 of the bill is the first day of the calendar quarter following the effective date of the act, which is expected to fall on October 1, 2019.

Revenue Impact:

1. Individual Income Tax

Step 1 – Simplifying Tax Tables*

FY2020 ---	-\$103.4 Million Revenue Reduction – Step 1: Simplifying Tax Tables
FY2021 ---	-\$103.4 Million Revenue Reduction – Step 1: Simplifying Tax Tables
Total ---	-\$206.8 Million General Revenue Reduction

Step 2 – Reducing Top Rate down to 6.5%**

FY2022 ---	-\$30.7 Million Revenue Reduction – Step 2: Reduce Highest Rate
FY2023 --	-\$30.7 Million Revenue Reduction – Step 2: Reduce Highest Rate
Total --	-\$61.4 Million General Revenue Reduction

*Revenue impact assumes that 2018 CPI-indexed tables will be used as the basis for the collapsed tax tables using 2019 tax rates instead of the non-CPI-adjusted tables and rates as provided in the bill.

**Revenue impact assumes that the Step 2 trigger requirements are met in 2021 and the rate reduction to 6.5% is effective for tax years January 1, 2022 and following.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL071

Bill Subtitle: TO CREATE THE TAX REFORM AND RELIEF ACT OF 2019; TO REFORM ARKANSAS TAX LAWS TO PROVIDE TAX RELIEF FOR ARKANSAS TAXPAYERS; TO GRADUALLY REDUCE INCOME TAX RATES; AND TO REQUIRE THE COLLECTION OF SALES AND USE TAX BY REMOTE SELLERS.

2. Gross Receipts (Sales) Tax

A. Total State Revenue Collections: Remote Sellers

8 months of FY 2020 Deposits Only

\$23,592,606 Million Total Gain to State Sales Tax Revenue

+\$ 519,037 --- State Central Services
+\$ 235,926 --- Constitutional Officers
+\$ 15,810,676 --- General Revenue
+\$ 0 --- Educational Excellence Trust Fund
+\$ 0 --- Educational Adequacy (GR transfer)
+\$ 3,074,298 --- Educational Adequacy (7/8% tax)
+\$ 1,756,742 --- Property Tax Relief Trust Fund
+\$ 439,185 --- Conservation Tax
+\$ 1,756,742 --- Highway Fund

Gain to City and County Sales Tax Revenue: +\$7,864,202

Full Year FY 2021

\$35,388,909 Million Total Gain to State Sales Tax Revenue

+\$ 778,556 --- State Central Services
+\$ 353,889 --- Constitutional Officers
+\$ 21,282,750 --- General Revenue
+\$ 2,235,630 --- Educational Excellence Trust Fund
+\$ 197,633 --- Educational Adequacy (GR transfer)
+\$ 4,611,447 --- Educational Adequacy (7/8% tax)
+\$ 2,635,113 --- Property Tax Relief Trust Fund
+\$ 658,778 --- Conservation Tax
+\$ 2,635,113 --- Highway Fund

Gain to City and County Sales Tax Revenue: +\$11,796,303

B. Total State Revenue Collections: Subscriptions to Publications

8 months of FY 2020 Deposits Only

\$1,480,473 Million Total Gain to State Sales Tax Revenue

+\$ 32,570 --- State Central Services

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL071

Bill Subtitle: TO CREATE THE TAX REFORM AND RELIEF ACT OF 2019; TO REFORM ARKANSAS TAX LAWS TO PROVIDE TAX RELIEF FOR ARKANSAS TAXPAYERS; TO GRADUALLY REDUCE INCOME TAX RATES; AND TO REQUIRE THE COLLECTION OF SALES AND USE TAX BY REMOTE SELLERS.

+\$	14,805	---	Constitutional Officers
+\$	992,145	---	General Revenue
+\$	0	---	Educational Excellence Trust Fund
+\$	0	---	Educational Adequacy (GR transfer)
+\$	192,917	---	Educational Adequacy (7/8% tax)
+\$	110,238	---	Property Tax Relief Trust Fund
+\$	27,560	---	Conservation Tax
+\$	110,238	---	Highway Fund

Gain to City and County Sales Tax Revenue: +\$493,491

Full Year FY 2021

\$2,220,710 Million Total Gain to State Sales Tax Revenue

+\$	48,856	---	State Central Services
+\$	22,207	---	Constitutional Officers
+\$	1,335,526	---	General Revenue
+\$	140,289	---	Educational Excellence Trust Fund
+\$	12,402	---	Educational Adequacy (GR transfer)
+\$	289,376	---	Educational Adequacy (7/8% tax)
+\$	165,357	---	Property Tax Relief Trust Fund
+\$	41,339	---	Conservation Tax
+\$	165,357	---	Highway Fund

Gain to City and County Sales Tax Revenue: +\$740,237

Taxpayer Impact:

Reducing the individual income tax rates as provided in JLL071 will affect all taxpayers with taxable income over \$21,000 by reducing their tax liability. An out-of-state seller having no physical presence in Arkansas would be required to collect and remit Arkansas sales tax. An out-of-state seller having no physical presence in Arkansas meeting the sales volume criteria of this draft bill could voluntarily register with the Department of Finance and Administration (DFA) to collect and remit sales taxes. Taxpayers that are exempt from sales and use tax on sales of publications through regular subscriptions will now be required to collect tax.

Resources Required:

Reducing the individual income tax rates will require updating computer programs, tax forms, and instructions.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL071

Bill Subtitle: TO CREATE THE TAX REFORM AND RELIEF ACT OF 2019; TO REFORM ARKANSAS TAX LAWS TO PROVIDE TAX RELIEF FOR ARKANSAS TAXPAYERS; TO GRADUALLY REDUCE INCOME TAX RATES; AND TO REQUIRE THE COLLECTION OF SALES AND USE TAX BY REMOTE SELLERS.

Time Required:

Adequate time is provided.

Procedural Changes:

Computer programs, forms and instructions will need to be updated. Updates to the Gross Receipts Tax Rules will be necessary.

Other Comments:

1. The tax brackets in JLL071 are higher than the 2018 tax year approved tax brackets that have been adjusted for changes in the consumer price index (CPI). As an example, the lowest individual income tax bracket at 0% for JLL071 is 0-\$4,299. The lowest bracket for tax year 2018 at 0% is 0-\$4,499 following previous CPI adjustments. It is unclear if the intent of the bill is to apply prior CPI adjustments to the new tax tables as provided in the bill.
2. The revenue impact for the individual income tax reduction was calculated by using actual tax return data. Tax return information was from tax year 2016 using the 2018 indexed brackets with 2019 rates (low income rates will be reduced effective January 1, 2019 per Act 78 of 2017) compared to the new brackets and rates in the bill.

Legal Analysis:

JLL071 modifies the existing income tax rate tables, by creating a new table effective for tax year 2020 and reducing all income tax rates for income thresholds below \$80,001. Income falling within the \$80,001 and above bracket will be taxed at the current top rate of 6.9%.

The bill also allows for a reduction of the top rate upon the triggering of certain determinations by the Director of DFA. Should the determinations be made, the top tax rate will be reduced by four-tenths of a percent from 6.9% to 6.5%. This further reduction will be allowed if the following conditions are met:

- (1) The amount of personal income tax collections for the fiscal year ending the immediately preceding June 30 exceeds the amount of personal income tax collections for FY2019 by at least the percentage that is the product of: (A) the difference in the number of years between the immediately preceding fiscal year and FY2019; and (B) 2%.
- (2) The net available for distribution for the fiscal year ending the immediately preceding June 30 exceeds the net available for distribution for FY2019 by at least the percentage that is the product of: (A) the difference in the number of years between the immediately preceding fiscal year and FY2019; and (B) 2%;
- (3) The balance of the Long Term Reserve Fund for the most recently completed fiscal year is at least equal to the balance of the fund for the fiscal year immediately preceding the most recently completed fiscal year.

The bill requires that the Director of DFA provide a yearly report by October 1 of every year beginning October 1, 2021, to determine whether the 6.9% to 6.5% rate reduction should be implemented.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL071

Bill Subtitle: TO CREATE THE TAX REFORM AND RELIEF ACT OF 2019; TO REFORM ARKANSAS TAX LAWS TO PROVIDE TAX RELIEF FOR ARKANSAS TAXPAYERS; TO GRADUALLY REDUCE INCOME TAX RATES; AND TO REQUIRE THE COLLECTION OF SALES AND USE TAX BY REMOTE SELLERS.

JLL071 also eliminates a previous triggered reduction of the 4.5% income tax bracket in the middle-income tax table in the event that federal law authorized DFA to collect sales and use tax from remote sellers. The bill also repeals the affiliated sellers nexus legislation passed in 2011 codified at § 26-52-110.

The bill also empowers DFA to impose collection of sales tax on remote sellers who deliver taxable goods or services into the state if the seller receives gross revenue of \$100,000 or conducts at least 200 transactions into the state annually. These thresholds are identical to those imposed by South Dakota which were recently upheld by the United States Supreme Court in *South Dakota v. Wayfair, Inc.*, 138 S.Ct. 2080 (2018). However, the bill does not provide clear guidance on the emerging issue of marketplace facilitators who facilitate sales between remote sellers and purchasers and often collect payments and/or arrange shipments. This could cause a significant gap in anticipated remote seller collections.

The bill also eliminates the sales tax exemption for the sale of publications through regular subscription.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL072

Bill Subtitle: TO CREATE THE TAX REFORM AND RELIEF ACT OF 2019; TO SIMPLIFY THE INCOME TAX IMPOSED ON INDIVIDUALS, TRUSTS, AND ESTATES; TO INCREASE THE STANDARD DEDUCTION AND TO REQUIRE THE COLLECTION OF SALES AND USE TAX BY REMOTE SELLERS.

Basic Change:

JLL072 creates the "Tax Reform and Relief Act of 2019." This bill would reform Arkansas' tax laws to provide income tax relief for Arkansas taxpayers. Through a two-step process, this bill would simplify the individual income tax tables by going from a three-table tax system to a one table tax system with restructured and simplified brackets, then further reducing the top rate from 6.5% to 5.9% provided that certain conditions are met. Additionally, the existing itemized deductions for single and head of household filers are increased from \$2,200 to \$6,800 and for married filers, \$4,400 to \$13,600. JLL072 also repeals the income tax cut trigger of § 26-51-201(e) and affiliated seller nexus provisions of § 26-52-110.

JLL072 would also amend the Arkansas Gross Receipts Tax Act of 1941, § 26-52-101 et seq., to require out-of-state sellers having no physical presence in Arkansas to collect Arkansas sales tax. Out-of-state or "remote" sellers subject to the bill would include those sellers meeting either of the following criteria in the previous calendar year or the current calendar year: (1) a seller having gross revenue from sales of products and services delivered into Arkansas that exceeds one hundred thousand dollars (\$100,000); or (2) a seller who has sold products and services for delivery into Arkansas in at least two hundred (200) separate sales transactions.

JLL072 also repeals the exemption from sales and use taxes on the sale of publications through regular subscriptions and the tax credit for political contributions.

The effective date of JLL072 for Sections 3 and 6 of the bill is tax years beginning on and after January 1, 2020. The effective date for Sections 4, 5, and 7-9 is July 1, 2019.

Revenue Impact:

1. Individual Income Tax

Step 1 – Simplifying Tax Tables with New Standard Deduction

FY2020 --	-\$47.4 Million Revenue – Step 1 – Creating new tax table highest rate 6.5%
FY2021 --	-\$47.4 Million Revenue – Step 1 – Creating new tax table highest rate 6.5%
	+\$500 Thousand Revenue Increase – Political Contributions
Total --	-\$94.3 Million General Revenue

Step 2 – Reducing Top Rate to 5.9%*

FY2022 --	-\$48.5 Million Revenue Reduction – Reducing Highest Rate
FY2023 --	-\$48.5 Million Revenue Reduction – Reducing Highest Rate
Total --	-\$96.9 Million General Revenue

*Revenue impact assumes that the Step 2 trigger requirements are met in 2021 and the rate reduction to 5.9% is effective for tax years January 1, 2022 and following.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL072

Bill Subtitle: TO CREATE THE TAX REFORM AND RELIEF ACT OF 2019; TO SIMPLIFY THE INCOME TAX IMPOSED ON INDIVIDUALS, TRUSTS, AND ESTATES; TO INCREASE THE STANDARD DEDUCTION AND TO REQUIRE THE COLLECTION OF SALES AND USE TAX BY REMOTE SELLERS.

2. Gross Receipts (Sales) Tax

A. Total State Revenue Collections: Remote Sellers

11 months of FY 2020 Deposits Only

+\$32,439,833 Million Total Gain to State Sales Tax Revenue

+\$ 681,236 --- State Central Services
+\$ 324,398 --- Constitutional Officers
+\$ 21,762,137 --- General Revenue
+\$ 0 --- Educational Excellence Trust Fund
+\$ 0 --- Educational Adequacy (GR transfer)
+\$ 4,231,527 --- Educational Adequacy (7/8% tax)
+\$ 2,418,015 --- Property Tax Relief Trust Fund
+\$ 604,504 --- Conservation Tax
+\$ 2,418,015 --- Highway Fund

Gain to City and County Sales Tax Revenue: +\$10,813,277

Full Year FY 2021

+\$35,388,909 Million Total Gain to State Sales Tax Revenue

+\$ 743,167 --- State Central Services
+\$ 353,889 --- Constitutional Officers
+\$ 20,086,848 --- General Revenue
+\$ 3,356,909 --- Educational Excellence Trust Fund
+\$ 296,756 --- Educational Adequacy (GR transfer)
+\$ 4,616,211 --- Educational Adequacy (7/8% tax)
+\$ 2,637,835 --- Property Tax Relief Trust Fund
+\$ 659,459 --- Conservation Tax
+\$ 2,637,835 --- Highway Fund

Gain to City and County Sales Tax Revenue: +\$11,796,303

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL072

Bill Subtitle: TO CREATE THE TAX REFORM AND RELIEF ACT OF 2019; TO SIMPLIFY THE INCOME TAX IMPOSED ON INDIVIDUALS, TRUSTS, AND ESTATES; TO INCREASE THE STANDARD DEDUCTION AND TO REQUIRE THE COLLECTION OF SALES AND USE TAX BY REMOTE SELLERS.

B. Total State Revenue Collections: Subscriptions to Publications

11 months of FY 2020 Deposits Only

+\$2,035,651 Million Total Gain to State Sales Tax Revenue

+\$ 44,784 --- State Central Services
+\$ 20,357 --- Constitutional Officers
+\$ 1,364,199 --- General Revenue
+\$ 0 --- Educational Excellence Trust Fund
+\$ 0 --- Educational Adequacy (GR transfer)
+\$ 265,261 --- Educational Adequacy (7/8% tax)
+\$ 151,578 --- Property Tax Relief Trust Fund
+\$ 37,894 --- Conservation Tax
+\$ 151,578 --- Highway Fund

Gain to City and County Sales Tax Revenue: +\$685,503

Full Year FY 2021

+\$2,220,710 Million Total Gain to State Sales Tax Revenue

+\$ 48,856 --- State Central Services
+\$ 22,207 --- Constitutional Officers
+\$ 1,335,526 --- General Revenue
+\$ 140,289 --- Educational Excellence Trust Fund
+\$ 12,402 --- Educational Adequacy (GR transfer)
+\$ 289,376 --- Educational Adequacy (7/8% tax)
+\$ 165,357 --- Property Tax Relief Trust Fund
+\$ 41,339 --- Conservation Tax
+\$ 165,357 --- Highway Fund

Gain to City and County Sales Tax Revenue: +\$740,237

Taxpayer Impact:

Restructuring the individual income tax rates will generally affect middle and upper income taxpayers by reducing their tax liability. Increasing the standard deduction will enable more taxpayers to take the standard deduction rather than itemized deduction and would reduce taxpayer requirement to retain itemized deduction records and reduce taxable income. Repealing § 7-6-222 for Political Contributions will affect taxpayers contributing to political candidates or political action committees. Magazines purchased through regular subscription will be subject to sales tax.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL072

Bill Subtitle: TO CREATE THE TAX REFORM AND RELIEF ACT OF 2019; TO SIMPLIFY THE INCOME TAX IMPOSED ON INDIVIDUALS, TRUSTS, AND ESTATES; TO INCREASE THE STANDARD DEDUCTION AND TO REQUIRE THE COLLECTION OF SALES AND USE TAX BY REMOTE SELLERS.

Resources Required:

Reducing the individual income tax rates will require updating computer programs, tax forms, and instructions.

Time Required:

Adequate time is provided.

Procedural Changes:

Computer programs, forms and instructions will need to be updated. Updates to the Gross Receipts Tax Rules will be necessary.

Other Comments:

1. The revenue impact for the individual income tax reduction was calculated by using actual 2016 tax return data.

Legal Analysis:

JLL072 repeals § 26-52-201(e) concerning the income tax imposed on individuals, trusts, and estates, and amends the income tax rates set forth in § 26-51-201(a)(11) on individuals, trusts, and estates for tax years beginning January 1, 2020. This bill seeks to simplify and reduce the current income tax rates in two steps. Step 1 will collapse the existing income tax tables into a single table with rates of 2%, 4%, and 6.5%, as determined by the taxpayer's net income, and will increase the standard deduction under § 26-51-430(b) for all taxpayers.

The bill also allows for a reduction of the 6.5% top rate upon the triggering of certain determinations by the Director of DFA. Should the determinations be made, the top tax rate will be reduced by four-tenths of a percent from 6.9% to 6.5%. This further reduction will be allowed if the following conditions are met:

- (1) The amount of personal income tax collections for the fiscal year ending the immediately preceding June 30 exceeds the amount of personal income tax collections for FY2019 by at least the percentage that is the product of: (A) the difference in the number of years between the immediately preceding fiscal year and FY2019; and (B) 2%.
- (2) The net available for distribution for the fiscal year ending the immediately preceding June 30 exceeds the net available for distribution for FY2019 by at least the percentage that is the product of: (A) the difference in the number of years between the immediately preceding fiscal year and FY2019; and (B) 2%;
- (3) The balance of the Long Term Reserve Fund for the most recently completed fiscal year is at least equal to the balance of the fund for the fiscal year immediately preceding the most recently completed fiscal year.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL072

Bill Subtitle: TO CREATE THE TAX REFORM AND RELIEF ACT OF 2019; TO SIMPLIFY THE INCOME TAX IMPOSED ON INDIVIDUALS, TRUSTS, AND ESTATES; TO INCREASE THE STANDARD DEDUCTION AND TO REQUIRE THE COLLECTION OF SALES AND USE TAX BY REMOTE SELLERS.

The bill requires that the Director of DFA provide a yearly report by October 1 of every year beginning October 1, 2021, to determine whether the 6.5% to 5.9% rate reduction should be implemented.

JLL072 also eliminates a previous triggered reduction of the 4.5% income tax bracket in the middle-income tax table in the event that federal law authorized DFA to collect sales and use tax from remote sellers. The bill also repeals the affiliated sellers nexus legislation passed in 2011 codified at § 26-52-110.

The bill also empowers DFA to impose collection of sales tax on remote sellers who deliver taxable goods or services into the state if the seller receives gross revenue of \$100,000 or conducts at least 200 transactions into the state annually. These thresholds are identical to those imposed by South Dakota which were recently upheld by the United States Supreme Court in *South Dakota v. Wayfair, Inc.*, 138 S.Ct. 2080 (2018). However, the bill does not provide clear guidance on the emerging issue of marketplace facilitators who facilitate sales between remote sellers and purchasers and often collect payments and/or arrange shipments. This could cause a significant gap in anticipated remote seller collections.

JLL072 repeals § 7-6-222 concerning tax credits for certain individual political contributions for tax years beginning on or after January 1, 2020, and repeals § 26-52-401(14) concerning the sales tax exemption for magazine subscriptions.

This bill contains an emergency clause and shall become effective on July 1, 2019 for Sections 4, 5, and 7-9. The remaining substantive sections are effective for tax years beginning on and after January 1, 2020.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL073

Bill Subtitle: TO REDUCE CORPORATE INCOME TAX RATES; TO AMEND THE UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT; TO EXTEND THE NET OPERATING LOSS CARRY-FORWARD PERIOD; AND TO CREATE A BUSINESS INVENTORY TAX CREDIT.

Basic Change:

JLL073 provides amendments to Arkansas tax law pending implementation of the "Tax Reform and Relief Act of 2019" (Phase 1). Phases 2 and 3 involve the following amendments to Arkansas law concerning income tax to do the following:

- Reduce the maximum income tax rates for corporations from 6.5% to 5.9% as part of Phase 3 of this bill.
- Repeal the throwback rule for the sale of tangible assets except sales to the U.S. Government as part of Phase 2 of the bill.
- Provide for a single sales factor apportionment formula for business income for businesses that operate in Arkansas and other states except for financial institutions as part of Phase 2 of the bill.
- Phase in an extension of the net operating loss carry-forward period from 5 years to 20 years for computing Arkansas income tax as part of Phase 3 of the bill.
- Phase in an extension of the net operating loss carry-forward period for computing Arkansas income tax for qualified manufacturers of steel from 10 to 15 years as part of Phase 3 of the bill.
- Create an income tax credit for property taxes paid on business inventory in the first year after Phase 3 of the bill is implemented and the Director determines that the tax reform determinations are met. Unused inventory tax credits may be carried forward for 10 years.
- The bill requires the director by October 1 of each year to determine if net individual income tax collections have increased by 2% per year multiplied by the number of years since FY2019 until the most recent fiscal year and that the balance of the Long Term Reserve Fund for the most recently completed fiscal year is at least equal to the balance of the fiscal year immediately preceding the most recently completed fiscal year for each next phase to be implemented. Each phase is to be implemented for tax years beginning January 1 of the calendar year beginning after the Director has determined that the previous phase of tax reform is complete and that provisions for the next phase have been met.

Revenue Impact:

Step 1 – Eliminate Throwback Rule and Single Sales Factor Apportionment

FY2023 --- -\$28.5 Million Revenue Reduction – Step 1: Throwback & Single Sales Factor
FY2024 --- -\$28.5 Million Revenue Reduction – Step 1: Throwback & Single Sales Factor
Total --- -\$57.0 Million General Revenue Reduction

Step 2 – Reduce Corporate Tax Rate to 5.9% & Phase-in 20 year NOL Carryforward

FY2024 --- -\$19.8 Million Revenue Reduction – Step 2: Reduce Corporate Tax Rate
FY2025 --- -\$19.8 Million Revenue Reduction – Step 2: Reduce Corporate Tax Rate
Total --- -\$39.6 Million General Revenue Reduction

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL073

Bill Subtitle: TO REDUCE CORPORATE INCOME TAX RATES; TO AMEND THE UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT; TO EXTEND THE NET OPERATING LOSS CARRY-FORWARD PERIOD; AND TO CREATE A BUSINESS INVENTORY TAX CREDIT.

FY2030 --- -\$16.8 Million Revenue Reduction – Step 2: Phase-in 20 year NOL
FY2031 --- -\$32.8 Million Revenue Reduction – Step 2: Phase-in 20 year NOL
FY2032 --- -\$47.8 Million Revenue Reduction – Step 2: Phase-in 20 year NOL
Total --- -\$97.4 Million General Revenue Reduction

Step 3 – Inventory Tax Credit

FY2025 --- -\$35.1 Million Revenue Reduction – Step 3: Inventory Tax Credit
FY2026 --- -\$35.1 Million Revenue Reduction – Step 3: Inventory Tax Credit
Total --- -\$70.2 Million General Revenue Reduction

Taxpayer Impact:

Taxpayers will need to retain records sufficient to support a deduction for net operating losses for up to 20 years after the loss occurs. Taxpayers will be required to provide proof of the amount of personal property tax paid on inventory during the tax year. Taxpayers will not have to throwback tangible personal property sales from non-taxable jurisdictions except sales to the U.S. Government. Taxpayers will compute tax on income exceeding \$25,000 at 5.9% instead of 6.5%.

Resources Required:

Computer programs, forms, and instructions will need to be updated for years in which the amendments to the income tax laws take place. It is likely that a new form will need to be developed to administer the income tax credit for property taxes paid on business inventory. Computer programming for NOL carry forwards will need to be reprogrammed for 5 consecutive years.

Time Required:

Six months after enactment.

Procedural Changes:

Computer programs, forms and instructions and training manuals will need to be updated each year as the income tax law changes take place.

Other Comments:

1. The bill changes the NOL carry-forward of qualified manufacturers of steel to the same provisions as most other types of corporation. In addition, it only gives qualified medical companies a NOL carry-forward of 15 years.
2. If DFA does not create a form for counties to use for the income tax credit for property taxes paid on inventory, it is possible that DFA will get different versions from each county.
3. Section 12 only amends the definition of all other receipts for financial institutions. Therefore, it appears that financial institutions will apportion income using an equally weighted three-factor formula. Assuming that part of the intent of the bill is to have financial institutions file using a

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL073

Bill Subtitle: TO REDUCE CORPORATE INCOME TAX RATES; TO AMEND THE UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT; TO EXTEND THE NET OPERATING LOSS CARRY-FORWARD PERIOD; AND TO CREATE A BUSINESS INVENTORY TAX CREDIT.

single sales factor, then various parts of §§ 26-51-1401 and -1402 would likely need to be amended. In addition, §§ 26-51-1404 and -1405 would need to be repealed.

4. The bill reduces the top corporation income tax rate from 6.5% to 5.9% on net income exceeding \$25,000.
5. Language concerning the NOL carryforward is unclear that the additional carry forward is for losses occurring in the first year of Phase 3 and thereafter as designated in Sections 2 and Section 5, § 26-51-427 (1)(C) of the bill, but is clarified in § 26-51-427(3)(C) of Section 5 of the bill. All language in Section 2 and in -427(1)(C) may need to be clarified to be consistent with -427(3)(C). Otherwise the revenue impact of FY 2023 could possibly be increased each year until the full fiscal impact is realized earlier than intended under the bill.

Legal Analysis:

First, this bill extends the ability to carry a net operating loss corporate income tax deduction carryforward. Previously, these deductions could be carried forward for five (5) years. In Section 5, the bill gradually increases how long net operating losses can be carried forward each year until it ultimately allows for net operating losses to be carried forward twenty (20) years. This provision also modifies the net operating loss carryforward in the Special Incentives for Qualified Steel Manufacturers to reach the same maximum of twenty (20) years in Section 2.

Second, Section 3 of the bill modifies the corporate income tax rate beginning January 1 the year after the bill's passage. For net income amounts from \$25,000 to \$75,000, the corporate income tax rate will be reduced from 6% to 5.9%. For net income amounts in excess of \$100,000, the corporate income tax rate will be reduced from 6.5% to 5.9%.

There is a drafting inconsistency in section 3 on page 4, line 36 to page 5, line 1. After "twenty-five thousand dollars" there should be a bracket reading "(\$25,000)".

Third, the bill allows for an income tax credit on property tax paid on inventory of a merchant or manufacturer in Section 6. The credit can only be used to reduce income but cannot exceed the amount of income tax due. However, the credit can be carried forward for ten (10) consecutive tax years following the tax year it was earned. Section 3 requires personal property assessment tax bills to contain information on what inventory property assessment credit is attributable to business inventory.

There are several potential issues with this section. First, the draft uses the language "with the view to." This language mirrors language from the local tax assessment statutes. This language is found in line 13, line 18, and line 35 of page 10 as well as line 3 of page 11. This language is potentially vague and open to different interpretations.

Next, this section appears to define "manufacturer" in a way that is different from the sales and use tax section. This may lead to interpretive difficulty and confusion for taxpayers who may qualify as manufacturers for the income tax credit based on property tax purposes, but not sales or use tax purposes.

Department of Finance and Administration

Legislative Impact Statement

Bill: JLL073

Bill Subtitle: TO REDUCE CORPORATE INCOME TAX RATES; TO AMEND THE UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT; TO EXTEND THE NET OPERATING LOSS CARRY-FORWARD PERIOD; AND TO CREATE A BUSINESS INVENTORY TAX CREDIT.

The section will also cause administrative difficulty and confusion for taxpayers, because county assessors are required to identify what qualifies as “business inventory” for the purposes of the credit on the yearly tax bill. This could lead to (1) counties interpreting “business inventory” differently and (2) counties interpreting “business inventory” in a manner inconsistent with the state taxing authority.

Finally, this section may also create compliance issues. The credit is not allowed where a deduction has been taken, however, deductions for taxes paid are typically not itemized on the return. It will not be possible to determine where one entity has taken both a credit and a deduction without an audit or additional reporting requirements on the corporate return.

Fourth, the bill substantially modifies Arkansas's corporate income tax apportionment formula and eliminates the “throwback rule” in Section 8. Previously, corporations would calculate their apportionment factor by using the following a three-factor formula (sales, property, and payroll). The sales factor is double-weighted under Arkansas law.

This bill would change the apportionment formula to only consider (sales in Arkansas/sales everywhere). The bill also eliminates the “throwback rule.”

This bill is a “Phase 2” bill which will not be triggered unless “Phase 1” of the Tax Reform and Relief Act of 2019 has gone into effect.