



Arkansas Sales and Income Tax Exemptions

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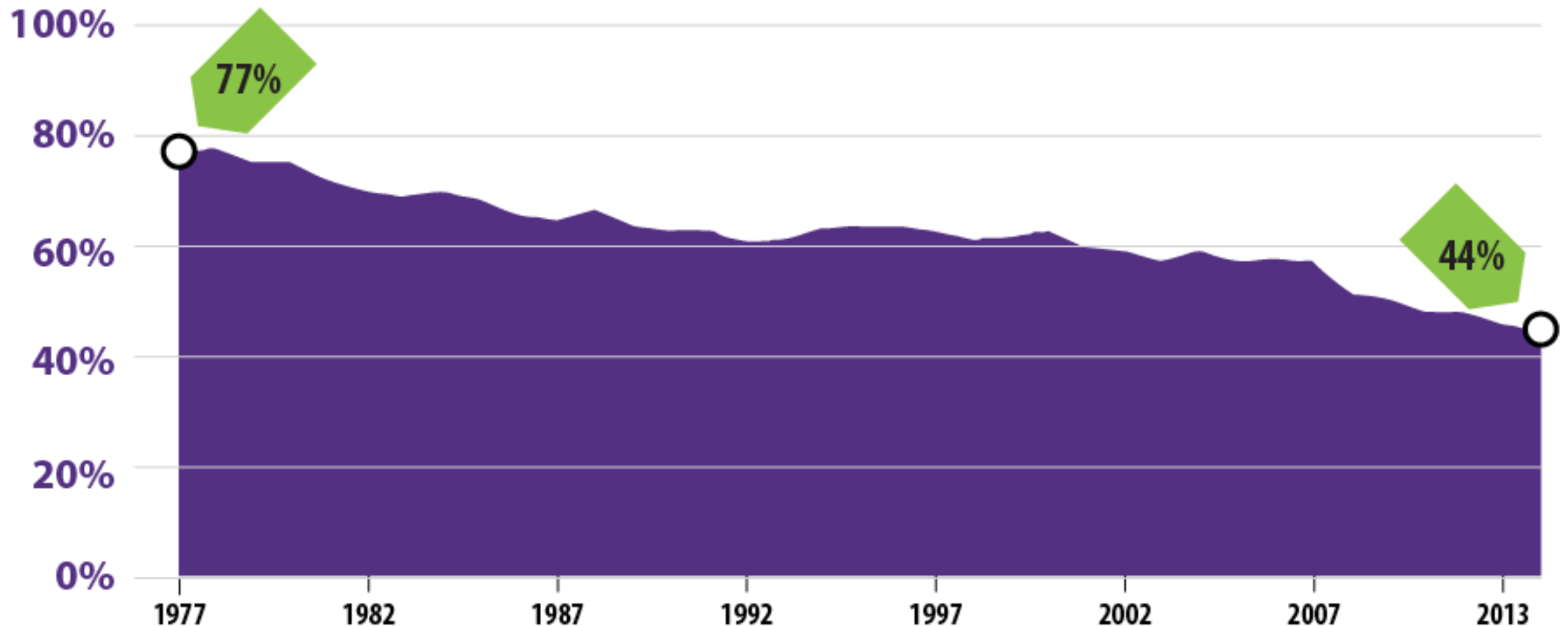
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General Principles for Sales Taxes

1. Tax base should include *final consumer* purchases of all goods and services
2. Don't use exemptions to address equity issues
3. Business inputs should be exempt

Sales Tax Base Has Been Eroding

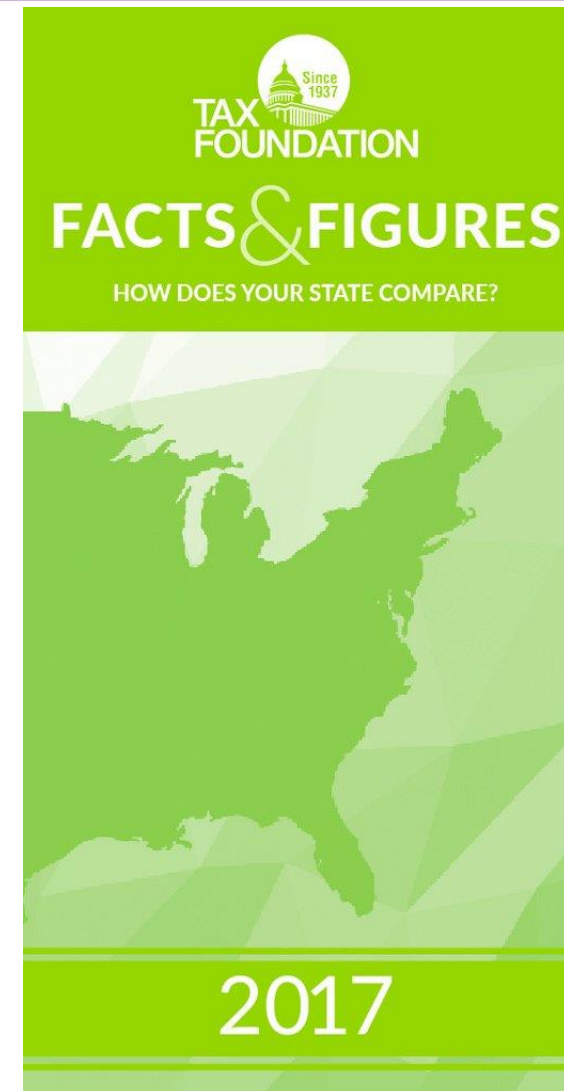
Arkansas's Sales Tax Breadth (1977 – 2013)



Sales Tax Breadth in the 50 States

Table 22.
State Sales Tax Breadth
Fiscal Year 2015

State	Sales Tax Breadth	Rank	State	Sales Tax Breadth	Rank
U.S.			Mont.	--	--
Ala.	35%	23	Nebr.	35%	24
Alaska	--	--	Nev.	49%	6
Ariz.	41%	11	N.H.	--	--
Ark.	43%	8	N.J.	24%	42
Calif.	28%	35	N.M. (a)	59%	5
Colo.	35%	26	N.Y.	27%	36
Conn.	26%	37	N.C.	34%	29
Del.	--	--	N.D. (a)	73%	2
Fla.	40%	12	Ohio	35%	24
Ga.	32%	32	Okla.	34%	29
Hawaii (a)	104%	1	Ore.	--	--
Idaho	38%	14	Pa.	26%	39
Ill.	23%	43	R.I.	26%	38
Ind.	40%	13	S.C.	32%	33
Iowa	35%	22	S.D. (a)	65%	3
Kans.	36%	19	Tenn.	34%	28
Ky.	36%	20	Tex.	42%	9
La.	37%	18	Utah	34%	27
Maine	41%	10	Vt.	25%	41
Md.	26%	39	Va.	23%	44
Mass.	22%	45	Wash.	38%	15
Mich.	36%	20	W.Va.	37%	16
Minn.	33%	31	Wis.	37%	16
Miss.	47%	7	Wyo.	62%	4
Mo.	31%	34			



State Sales Tax Rate History

ARKANSAS STATE SALES TAX RATES (1935 – 2016)

1935	2.000%	First Temporary Sales Tax
1941	2.000%	First Permanent Sales Tax
1958	3.000%	
1984	4.000%	
1991	4.500%	
1997	4.625%	0.125% for Game Protection, Parks & Tourism, and Heritage
2001	5.125%	0.5% for Property Tax Relief
2004	6.000%	0.875% for Educational Adequacy
2013	6.500%	0.5% for Four Lane Highways (temporary)

Note: Combined city and county rates average about 2.8%, first allowed in 1981. This means the average tax rate is more than 3 times what it was pre-1984

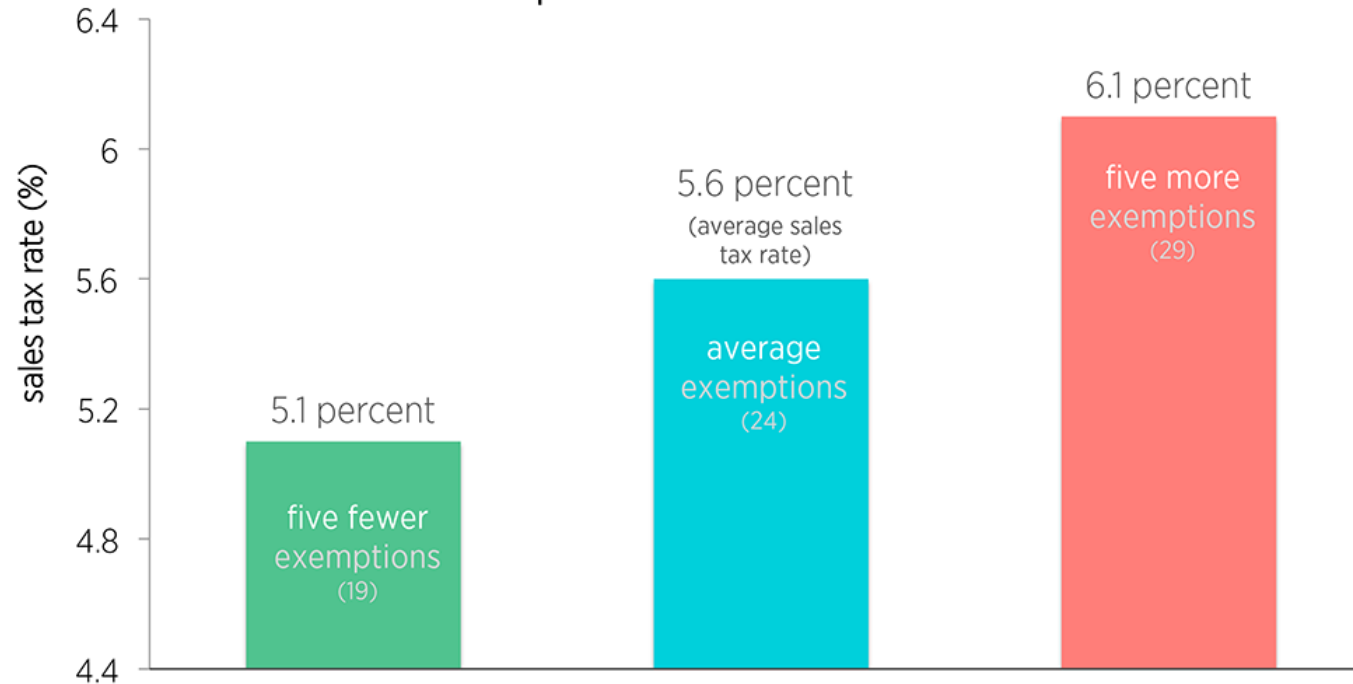
Major Sales Tax Exemptions (Goods)

Good	General Rev.
Gasoline and Motor Fuel	\$225,164,401
Food and food ingredients (lower rate)	\$123,318,060
Prescription drugs	\$98,667,733
Trade-in Deduction for Motor Vehicles	\$88,400,000
Sales to Nonprofit Hospitals	\$77,000,000
New or used motor vehicles or trailers of less than \$4000	\$25,000,000
Sales, rentals, or repair of durable medical equipment	\$6,831,066
Self storage	\$3,000,000
Subscription Publications	\$2,896,152
First 500 KWH of Electric to LIH	\$2,405,057
Manufactured Housing	\$2,400,000
ATVs and off-road vehicles	\$1,700,000
Newspapers	\$1,450,292
Blood Sugar Test Strips	\$1,114,828
Membership Fees to Private Clubs	\$520,000
Sales of raw products to consumer (e.g., farmers' markets)	\$347,160
Coin-Operated Car Washes	\$93,058

Very Important Note:
Does not include any
estimates for services,
which are 63.4% of
personal consumption
expenditures in
Arkansas!

Evidence from the 50 States

The Relationship between the Number of Sales Tax Exemption and Sales Tax Rates



Source: Author's calculations based on data presented in Andreea Militaru and Thomas Stratmann, "A Survey of Sales Tax Exemptions in the States: Understanding Sales Taxes and Sales Tax Exemptions" (Working Paper No. 14-01, Mercatus Center at George Mason University, Arlington, VA, January 2014).

Produced by Thomas Stratmann, Rachel Reese, and Rizqi Rachmat, Mercatus Center at George Mason University, September 16, 2014.

Don't Address Equity Issues with Sales Tax

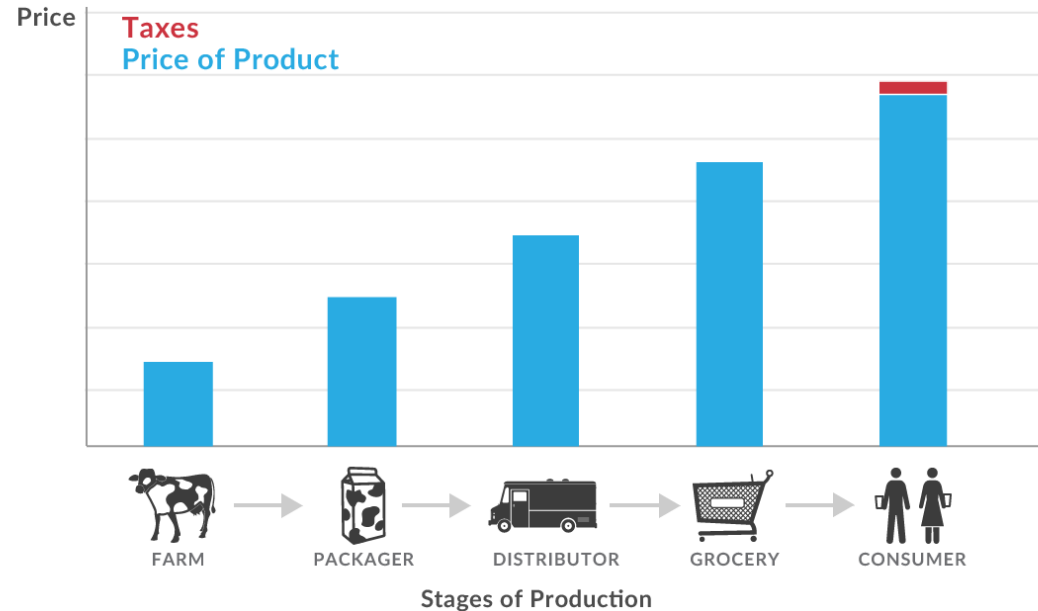
- Example: lower rate for groceries (most states exempt completely)
- Problem: not targeted
 - Both peanut butter sandwiches and filet mignon are exempted
 - Applies to rich and poor families alike
- Better ways to address equity issues
 - Low-income tax credits (AR already has one, many states have EIC)
 - Grocery credits or rebates (HI, ID, KS, OK)



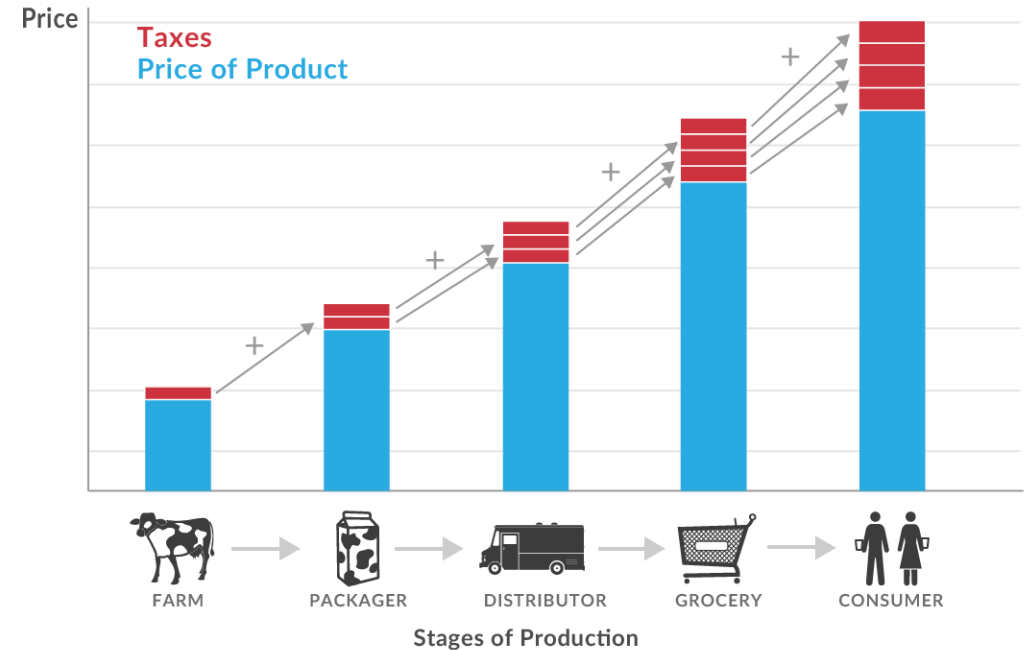
Business Inputs Should *Not* Be in Sales Tax

Taxing Business Inputs Results in Tax Pyramiding

Ideal Sales Tax on Final Consumption



Sales Taxes on Business Inputs



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Tax Pyramiding Treats Industries Differently

How Tax Pyramiding Penalizes Industries with Multiple Production Stages

Lumber Products Production Stage	Cost of Business Inputs	Value Added	Sale Price to Next Production Stage	Gross Receipts Tax (1 Percent, Fully Forward- Shifted)
Timber Cutting	\$ 0	\$ 1,000	\$ 1,000	\$ 10
Milling and Processing	\$ 1,010	\$ 1,000	\$ 2,010	\$ 20.10
Wholesale Distribution	\$ 2,030.10	\$ 1,000	\$ 3,030.10	\$ 30.30
Retail Sales	\$ 3,060.40	\$ 1,000	\$ 4,060.40	\$ 40.60
Total		\$ 4,000		\$ 101.01
Effective Tax Rate on Lumber and Wood ($\$101.01 \div \$4,000$): 2.53 percent				
Auto Repair				
Parts Manufacturing	\$ 0	\$ 1,000	\$ 1,000	\$ 10
Retail Sales of Parts & Labor	\$ 1,010.00	\$ 1,000	\$ 2,010.00	\$ 20.10
Total		\$ 2,000		\$ 30.10
Effective Tax Rate on Auto Repair ($\$30.10 \div \$2,000$): 1.51 percent				
Computer Programming				
Programming Labor Time	\$ 0	\$ 1,000	\$ 1,000	\$ 10
Total		\$ 1,000		\$ 10
Effective Tax Rate on Computer Programming ($\$10 \div \$1,000$): 1 percent				

Note: Illustration assumes a one percent gross receipts tax levied on business sales, full forward-shifting of the economic incidence of the tax, and \$1,000 of value added at each stage of production. Producers at the first stage of production are assumed to have zero input costs to simplify calculations.

Source: Tax Foundation

Note: Tax pyramiding may even treat firms in the *same* industry differently if one firm is more vertically integrated (not something tax code should encourage)

Tax Treatment of Business Inputs

Table 5d.

Arkansas's Tax Treatment of Business Input Services

Business Input Service	Taxed in Arkansas?	
Advertising, Billboards		Packing & Crating
Advertising, Magazine		Process Server Fees
Advertising, Newspaper		Public Relations & Management Consulting
Advertising, Radio & Television (Local)		Rental of Films & Tapes by Theaters
Advertising, Radio & Television (National)		Rental of Hand Tools to Licensed Contractors ✓
Advertising Agency Fees (Excluding Ad Placement)		Secretarial & Court Reporting Services
Armored Car Services ✓		Security Services ✓
Bulldozers, Draglines, & Construction Machinery Rentals (Long-Term) ✓		Seismograph & Geophysical Services
Bulldozers, Draglines, & Construction Machinery Rentals (Short-Term) ✓		Sign Construction & Installation
Check & Debt Collection		Software, Material Custom Programs ✓
Commercial Art & Graphic Design		Software, Modifications to Canned Programs
Commercial Linen Supply ✓		Software, Professional Services Custom Programs ✓
Credit Information & Credit Bureaus		Soil Preparation, Custom Bailing, & Other Agricultural Services
Custom Fabrication Labor		Swimming Pool Cleaning & Maintenance ✓
Data Processing Services		Telemarketing Services (Contract)
Employment Agencies		Telephone Answering Services ✓
Financial & Tickertape Reporting		Temporary Help Agencies
Food Storage		Test Laboratories (Excluding Medical)
Industrial Sewer & Refuse Services ✓		Test Laboratories (Medical)
Information Services		Typesetting & Platemaking for Print Trades
Interstate Telephone & Telegraph ✓		Utilities, Electricity (Nonresidential) ✓
Intrastate Telephone & Telegraph ✓		Utilities, Natural Gas (Nonresidential) ✓
Labor Charges, Repairs to Commercial Fishing Vessels ✓		Utilities, Other Fuel (Including Heating Oil, Nonresidential) ✓
Labor Charges, Repairs to Interstate Vessels ✓		Utilities, Water (Nonresidential) ✓
Labor Charges, Repairs to Intrastate Vessels ✓		Welding Labor (Fabrication & Repair) ✓
Labor Charges, Repairs to Railroad Rolling Stock ✓		
Lobbying & Consulting Services		Source: Federation of Tax Administrators (2010).
Mainframe Computer Access & Processing Services		
Maintenance & Janitorial Services ✓		
Marketing		
Metal, Non-Metal, & Coal Mining Services		
Mini-Storage ✓		
Oil Field Services		
Online Data Processing Services		

Income Tax Exemptions (AR Specific)

Arkansas Specific Individual Income Tax Expenditures

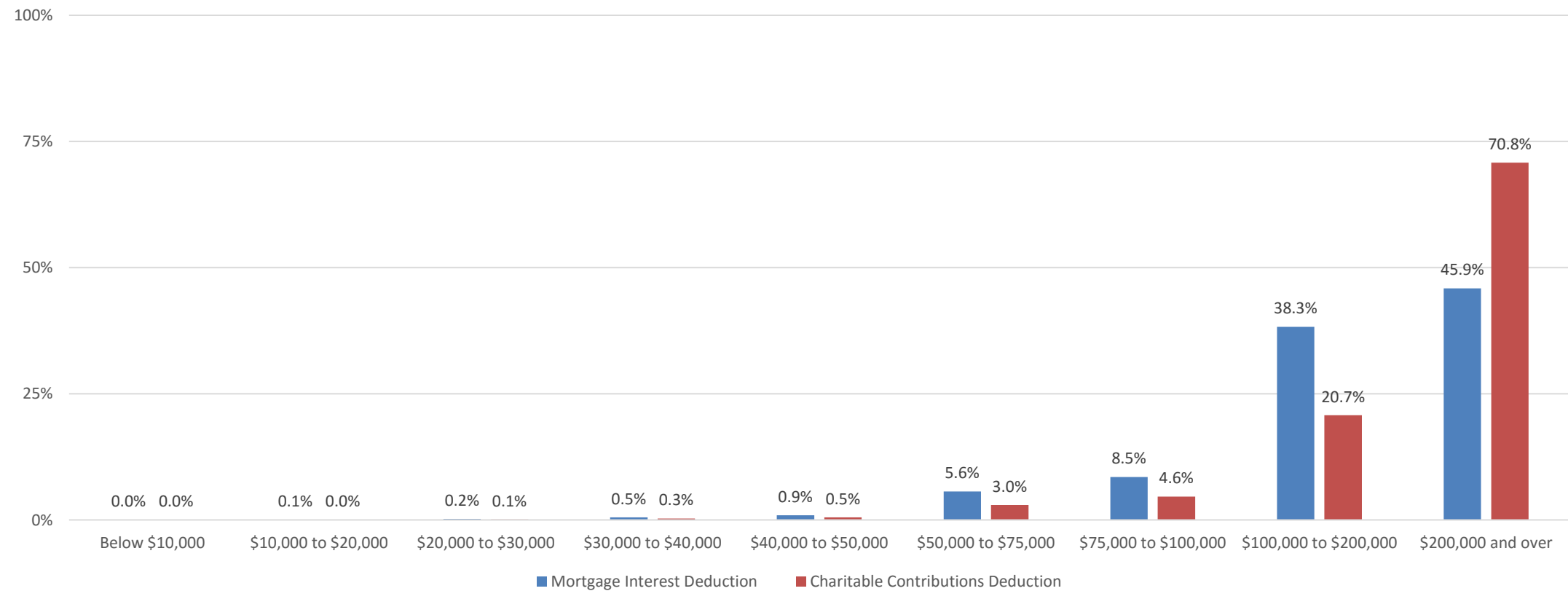
Standard Deduction	\$2000/person	\$870,360,028
Retirement Income	First \$6,000 exempt	\$224,826,733
Capital Gains Exemption	First 50% of gains exempt	\$10,600,000
Personal Tax Credit	\$26/per person	\$19,005,064
Border City Exemption (Texarkana)	net of sales tax revenue	\$15,000,000
Military Exemption	Exempts Active Duty pay	\$8,260,423
Individuals with Development Disabilities	\$500 credit per disabled dependent	\$5,181,000
Capital Gains Exemption	Exempt 100% over \$10M	\$1,200,000
Arkansas Tax-Deferred Tuition Savings	Deduction for savings	\$627,793
Political Contribution Credit	\$50/person credit	\$601,253
Phenylketonuria and other metabolic disorders	Up to \$2400/yr per child	\$60,103
Low-Income Tax Credit	Roughly FPL for full credit, no DFA estimate	?

Income Tax Exemptions (Federal Conforming)

Arkansas Federal Conforming Individual Income Tax Expenditures		
Mortgage Interest Deduction	No estimate from DFA	?
Charitable Contributions		\$56,092,523
Medical And Dental Expenses		\$24,350,615
Health Savings Accounts		\$20,746,416
Deduction for health insurance	For self employed	\$6,490,114
Deduction to retirement funds	For self employed	\$6,398,956
Child Care Credit	20% of federal credit	\$5,169,569
Deduction for cash to IRA		\$3,555,858
Deduction for Alimony		\$1,806,362
Moving Expenses		\$956,481
Adoption Expense Credit	20% of federal credit	\$651,052
Early Childhood Program Credit	20% of federal credit	\$102,892

Major Federal Tax Exemptions Overwhelming Benefit Wealthy

Percentage of Total Benefits for Two Major Tax Expenditures, by Income Class
(at Federal Level, estimates from JCT for 2016)

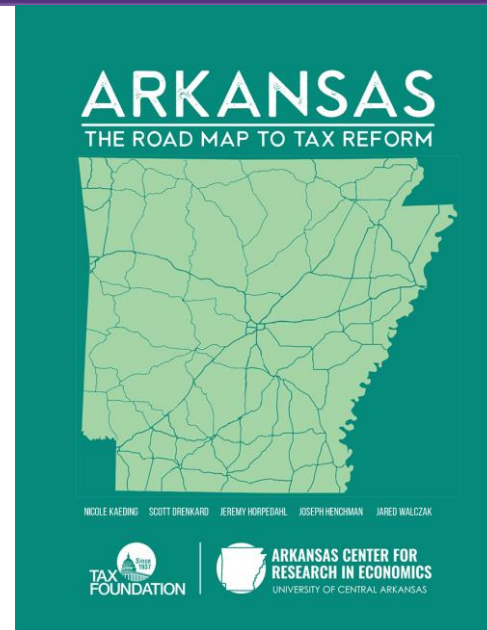


QUESTIONS?

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