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Testimony before the Arkansas Tax Reform and Relief Task Force July 11, 2017

by
Douglas L. Lindholm
President & Executive Director
Council On State Taxation (COST)

Members of the Task Force, thank you for inviting me to provide the Council On State Taxation's views on the Arkansas tax system to aid in your deliberations. My testimony will focus on the Legislature's goals of recommending reforms that modernize and simplify the tax code, increase its competitiveness to facilitate job creation and economic growth, and ensure fairness to Arkansas taxpayers. With a view towards improving the State's tax competitiveness and fairness for business taxpayers, I plan to address three fundamental questions regarding the State's business taxation:

(1) Are businesses paying their fair share of Arkansas taxes?
(2) What is the compelling economic justification for taxing businesses at all? and
(3) What steps can Arkansas take to implement a fair, efficient, and competitive state business tax system?

About COST

COST is a nonprofit trade association consisting of approximately 600 multistate corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

Are Businesses Paying Their Fair Share of Arkansas Taxes?

EY, in conjunction with COST, annually estimates the total state and local tax burden imposed on businesses in each state. Our fourteenth annual report *"Total State and Local Business Taxes"* was released in December 2016.

This "State Tax Burden" study provides estimates of the total taxes paid by businesses in each state, an important first step in any evaluation of business taxes or tax reform. The total tax burden paid by businesses includes corporate income taxes, franchise taxes, property taxes, sales taxes on business inputs, excise taxes, business taxes paid through the personal income tax by pass-through entities, unemployment taxes, and license taxes. To enable comparisons across states, the study also measures benefits received by

businesses due to government spending and calculates a tax-benefit ratio to estimate the extent businesses are "getting what they paid for" through their tax dollars.

The annual study was developed to answer questions from legislators asking, "Are businesses paying their fair share of taxes?" Increasing economic competition among states and around the globe has transformed the initial question into a more fundamental query: "What is the basis or rationale for business taxation at the state or local level?" The basic rationale for business taxes, recognizing that the economic burden of business taxes is ultimately borne by consumers or owners of factors of production (including workers), is to pay for government services that directly benefit businesses.

If state and local business taxes are equal to the value of the benefits business received from state and local public services, they would be considered a payment for services, and taxes would not influence business location decisions or impact competitiveness. However, if state and local business taxes exceed the value of the benefits received from government services, the difference represents an excess cost to business that will reduce profitability in the absence of shifting the tax through higher prices or lower payments to labor. When such excess costs exist, they can affect a company's choice of locations. This excess cost also affects a company's profitability in a price competitive market, which in turn restricts investment in capital assets. Those businesses that do not have the resources to move locations are stuck and suffer the tax burden, and if the burden is too excessive then business ceases.

In FY 2015, the Study[1]estimates that Arkansas businesses paid $4.7 billion in state and local taxes, or 40.6% of all taxes collected in Arkansas. Neighboring states vary in the business share of their respective tax burdens: Louisiana – 48.8%; Mississippi – 51.8%; Missouri – 40.3%; Oklahoma – 49.1%; Tennessee – 53%; and Texas – 61.5%. Nationwide, businesses contributed $707.5 billion, or 44.1% of all state and local taxes. While this metric is useful in the larger context of evaluating a "fair share," it should not be used to compare business tax burdens generally. For example, Texas businesses pay a relatively high percentage of state and local taxes because of the low tax burden on individuals (no personal income tax.) It does not mean Texas is necessarily a "high tax state" for businesses.

The Study allows the calculation of a better comparative measure, however – a "tax benefit ratio" that compares the amount of taxes paid by businesses with the value of benefits received by businesses through government spending. Arkansas fares generally well against its surrounding states using this measure. Using the Study's mid-range for education spending deemed to benefit business, Arkansas' tax benefit ratio is 1.5; that is, for every $1.50 paid in state and local taxes, Arkansas businesses receive only $1.00 in government benefits. Tax benefit ratios for surrounding states are as follows: Louisiana -- 1.3; Mississippi -- 1.8; Missouri – 1.5; Oklahoma – 2.1; Kentucky – 1.3; Tennessee – 2.1; and Texas – 2.2. The national average tax benefit ratio for all states is 1.64. Thus, although Arkansas is below the national average, Arkansas businesses still pay 50% more in taxes to Arkansas than they receive in benefits provided by the State.

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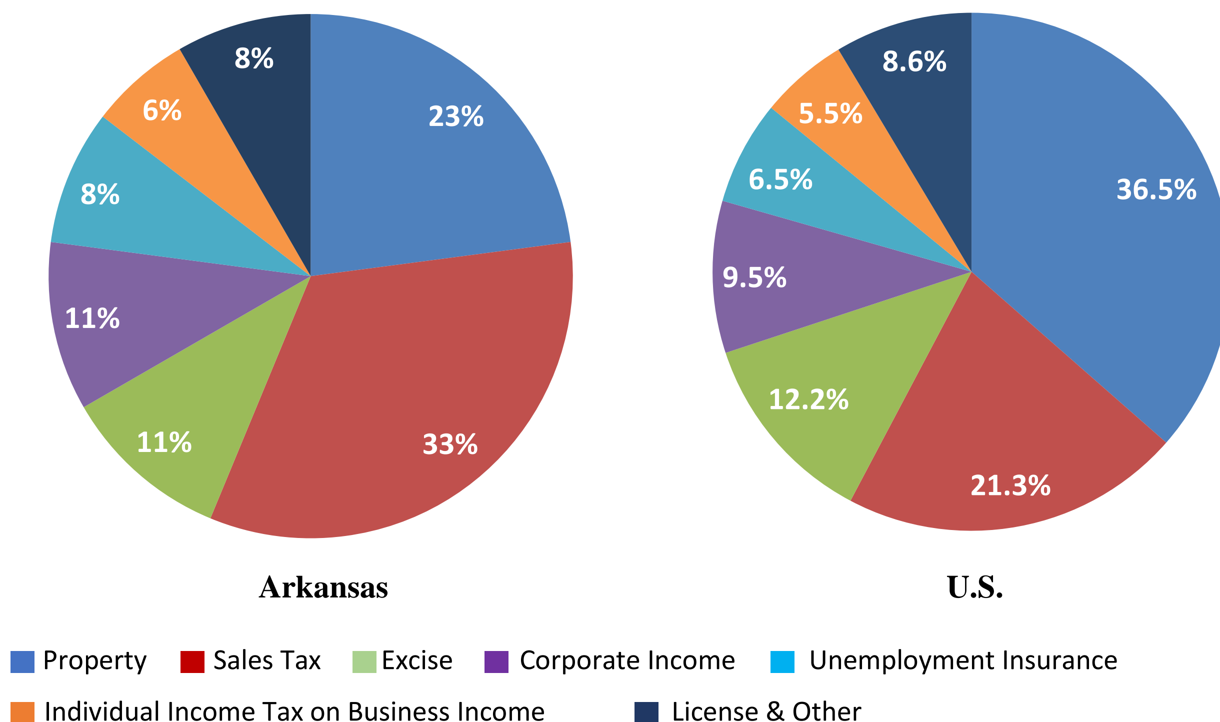
[1] Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2015, December 2016, available at: http://www.cost.org/WorkArea/DownloadAsset.aspx?id=94697.

Evaluating State Corporate Income Taxes

State corporate income taxes seem to garner an inordinate amount of attention from policymakers, commentators, and interest groups – perhaps because the tax is often perceived by the uninformed to be the primary source of business taxation levied by states. In fact, state corporate income taxes contribute relatively small amounts to state coffers. Nationally, in FY 2015 state corporate income taxes generated only 9.5% of total state and local business taxes. In Arkansas, the tax generates approximately 11% of total business taxes.

Taxes Paid by Business – Arkansas v. U.S. Average



Because the corporate income tax is inherently unstable (it only operates when a corporation earns income) and because the myriad of bases, rates, and rules among states allow tax planning opportunities, it is widely vilified as rife with "loopholes" that need closing. State corporate income taxes are also tremendously complex, creating costs of compliance and tax administration that are far out of proportion to other significant taxes paid by businesses, such as property or sales taxes. Indeed, many public finance economists "find little justification for the state corporate income tax" in the first instance.[2] Professor Charles McLure of the Hoover Institution says:

> It is hard to think of a good reason to tax corporate income…. The case against state corporate income taxes is even stronger. It is common among economists to acknowledge

[2] Fox, William F., Matthew N. Murray and LeAnn Luna, "How Should a Subnational Corporate Income Tax on Multistate Businesses Be Structured?" National Tax Journal, March 2005.

> that a small open economy (one that cannot affect the world price of capital) should not tax the return required to elicit investment within its boundaries…. The difficulty of actually taxing corporate income where it originates is a further reason for not trying to tax it.[3]

Despite the economic consensus that the state corporate income tax is a poor tax, it exists. And, because of the erroneous public perception that the corporate income tax is the primary business tax, it is often the focus of "corrective" legislation in efforts to "save" the tax. In many cases, however, attempts to fix the tax can have greater repercussions from a competitiveness and economic development perspective than the tax itself. Because the corporate income tax is inherently volatile and difficult to administer, policymakers should not rely on the tax as a consistent and stable source of revenue. Instead, programs and legislation that ease the burdens of the tax can be a significant economic development tool and a means of improving the State's business climate.

Policy Choices to Reform Arkansas Business Taxes

Avoid Mandatory Unitary Combined Reporting:

One of the most controversial business tax policy issues currently debated by state legislators, tax administrators, and corporate taxpayers is how a state should determine the corporate income tax base for multistate corporations with multiple businesses and entities. One method -- mandatory unitary combined reporting -- is touted by proponents as a "loophole closer" and as a way to stop "income shifting" to low tax jurisdictions. In actuality, however, mandatory unitary combined reporting carries severe economic consequences: it arbitrarily assigns income to a state, negatively impacts the real economy, and imposes significant administrative burdens on both the taxpayer and state.[4] No other Southeastern state employs mandatory unitary combined reporting.

The administrative and compliance burdens of mandatory unitary combined reporting can be severe, particularly if the state revenue department expects to achieve what are often "aspirational" fiscal estimates. The concept of a "unitary business" is uniquely factual and universally poorly defined. It is a constitutional (Due Process) concept that looks at the business as a whole rather than individual separate entities or separate geographic locations. In order to evaluate a taxpayer's determination of a unitary relationship, state auditors must look beyond accounting and tax return information. Auditors must annually determine how a taxpayer and its affiliates operate at a fairly detailed level to determine which affiliates are unitary. Auditors must interact with a corporation's operational and tax staff to gather this operational information. In practice, however, auditors routinely refuse to make a determination regarding a unitary relationship based on operational information and instead wait to determine unitary relationships until after they have performed tax computations. In other words, the tax result of the finding that a unitary relationship exists (or does not exist) often significantly influences, or in fact controls,

[3] McLure, Charles, "How to Improve California's Tax System: The Good (But Infeasible), the Bad, and the Ugly," California Commission on the 21st Century Economy, February 2009

[4] A thorough discussion of the problems associated with MUCR can be found in the study prepared for COST by Ernst & Young LLP, "Understanding the Revenue and Competitive Effects of Mandatory Unitary Combined Reporting" (http://www.cost.org/WorkArea/DownloadAsset.aspx?id=70000).

the auditor's finding. Determining the scope of the unitary group is a complicated, subjective, and costly process that is not required in separate filing states and often results in expensive, time-consuming litigation.

Repeal the "Throwback" Rule in Apportioning Corporate Income Taxes:

The "throwback" rule in Arkansas provides that receipts from sales are included in the numerator of a taxpayer's Arkansas sales factor if the sales originate in Arkansas, but the purchasers are in other states and the taxpayer is not subject to tax in those states.[5] Simply stated, throwback and related "throwout" rules tax the wrong income at the wrong rate by the wrong state. COST encourages the Committee to consider recommending the repeal of the Arkansas throwback rule for all taxpayers.[6] National trends show more and more states moving to a single sales factor formula to apportion corporate income. Arkansas currently levies a double-weighted sales factor for apportionment purposes. If the Legislature adopts a single sales factor apportionment methodology to avoid penalizing business property and payroll located in Arkansas, the throwback rule works at cross purposes to the goals of single sales factor apportionment.

Conform the NOL Carryover Rule to the Federal Rule:

Arkansas currently only allows net operating losses to be carried forward to offset income for five years, with no ability to carry back losses to offset income from prior years. The federal rule allows a 20-year carryforward and a two-year carryback. Three of Arkansas' neighbors conform to the Federal rule (Oklahoma, Missouri and Mississippi), while Louisiana and Tennessee provide a carryforward of 20 years and 15 years, respectively. Net operating loss provisions are an essential part of a fair and efficient tax structure that help account for the timing differences between the annual tax reporting cycle and the vagaries of a typical business cycle. To disallow NOL amounts through a shortened carryforward or carryback picks winners and losers between industries with different business cycles, and places the State at a significant disadvantage to its neighbors, particularly in its efforts to secure capital-intensive industries (*e.g.,* manufacturing) where up-front investments are often not recouped for many years. Arkansas should conform to the federal treatment of NOLs, or at a minimum, match its neighboring states' carryforward periods.

Federal Conformity Generally:

Arkansas selectively conforms to the Internal Revenue Code ("IRC"). In some instances, when Arkansas does not specifically conform to the IRC, Arkansas adopts its own rules. In many instances, however, Arkansas neither specifically conforms to the IRC nor provides its own Arkansas specific guidance. This lack of guidance creates uncertainty for both taxpayers and the Arkansas tax authorities, making it difficult for taxpayers to comply with tax law and the taxing authorities to administer the tax law. Arkansas should review its income tax code in relation to the

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[5] Source: Bloomberg BNA Corporate Income Tax Navigator. The throwback rule does not apply to elective single sales factor apportionment. The impact of the throwback rule is also mitigated by the states' aggressive assertion of economic nexus. *See Lorillard Licensing Co. v. Director, Div. of Taxation*, 29 N.J. Tax 275, N.J. Super. A.D., Dec. 4, 2015, *cert. den.*, 226 N.J. 212, N.J., June 17, 2016.
[6] See COST's policy statement on throwback and throwout rules, available at: http://www.cost.org/uploadedFiles/About_COST/Policy_Statement/Throwback-Throwout.pdf.

IRC to identify gaps in Arkansas tax law. The gaps can be remedied by adopting additional sections of the IRC or by adopting Arkansas-specific law.

Avoid "Alternative Base" Business Taxes:[7]

In part because of the flaws associated with the corporate income tax, a handful of states have considered or enacted new business taxes that are based on some alternative base. These alternative base taxes are generally derived from—or linked to—gross receipts. Gross receipts taxes are widely acknowledged to violate numerous tax policy principles. Gross receipts taxes had largely disappeared as an important revenue source for state governments by the later years of the twentieth century, usually after considerable effort by state business groups to eliminate them. Analysts and scholars presumed that these taxes—also known as "turnover taxes"—had forever been replaced with options that made more sense as ways of distributing the cost of government and had less undesirable impact on the taxpaying public, including businesses, and generally lost interest in them. In recent years, however, such broad base, low-rate taxes have again entered state tax policy discussions. With this re-emergence comes a need for a new analysis of gross receipts taxes to aid policymakers who are unfamiliar with their structure and drawbacks. This examination of American and European experience with gross receipts taxation has identified several significant conclusions about the tax. These may be summarized:

- *Broad Base:* The gross receipts tax base can be broad, broader than the total value production of the economy, but it lacks any link either to capacity to bear the cost of government services or to the amount of government services used—the normal standards for assigning tax burdens.

- *Low rate:* Whether a gross receipts tax has a low rate depends on how much revenue the government intends to raise from it. Unlike most taxes, the effective rate of a gross receipts tax is higher than the statutory (or advertised) rate. A broad-based, low-rate gross receipts tax is unlikely to contribute a major share of tax revenue to a modern state government.

- *Stable revenue:* A gross receipts tax appears to be roughly as stable as a retail sales tax. Its variations do not contribute to the overall stability of total state revenue because its fluctuations follow generally the same pattern as other major taxes.

- *Economic neutrality:* A gross receipts tax interferes with private market decisions. Its pyramiding creates a haphazard pattern of incentives and disincentives for business operations. Most significantly, it establishes artificial incentive for vertical integration and discriminates against contracting work with independent suppliers and the advantages of scale and specialization that production by independent firms can bring.

- *Competitiveness:* A gross receipts tax interferes with the capacity of individuals and businesses to compete with those in other states and other parts of the world. The tax embedded in prices

[7] This section is excerpted from a joint COST/Tax Foundation Study: *"Gross Receipts Taxes in State Government Finances: A Review of Their History and Performance"* (January 2007) by John Mikesell, professor of public finance and policy analysis and director of the Master of Public Affairs program at the Indiana University School of Public and Environmental Affairs. Link: *http://www.cost.org/WorkArea/DownloadAsset.aspx?id=67458.*

grows as the share of a production chain within the state increases, so there is incentive to purchase business inputs from outside the state. It discourages capital investment by adding to the cost of factories, machinery, and equipment, and the disincentive increases as more of those capital goods are produced in the taxing state. This tax structure does not promote the growth and development of the state.

- *Fairness:* A gross receipts tax does not treat equally situated businesses the same. Firms with the same net income will face radically different effective tax rates on that income, depending on their profit margins. Low-margin firms will be at great disadvantage relative to higher-margin firms, regardless of their overall profitability. Many new and expanding firms have low margins (or even are initially unprofitable) and the gross receipts tax reduces the chance that these firms will survive. This also is not consistent with a climate for growth and development.

- *Transparency:* A gross receipts tax is a stealth tax with its true burden hidden from taxpayers. Hiding the cost of government is inconsistent with efficient and responsive provision of government services and contrary to the fundamentals of democratic government.

There is no sensible case for gross receipts taxation. The old turnover taxes—typically adopted as desperation measures in fiscal crisis—were replaced with taxes that created fewer economic problems. They do not belong in any program of tax reform.

Phase-Out the Arkansas Franchise Tax:

The Arkansas corporate franchise tax – a direct tax on all new and existing investments in the state – is truly an anachronism. Only ten states levy a franchise tax with no upper limit, and many of those states are also taking serious steps to eliminate a tax widely viewed by economists as a disincentive to economic growth. Under the Arkansas franchise tax, corporations must annually pay a percentage of the value of all investments made in the State. Unlike the corporate income tax, the franchise tax is levied even on businesses with little or no profits. Gradual elimination of the State franchise tax will encourage business investment and job creation by significantly reducing the direct costs imposed on businesses seeking to expand or relocate in the State. While franchise tax revenues will decline gradually over the phase-out period, the benefits to the State – including increased tax revenues in other areas and job creation – will begin to accrue from the moment the State signals its intention to stop penalizing capital investment.

Elimination of the tax would also set Arkansas apart from its neighbors. Alabama, Louisiana, Oklahoma, and Tennessee all levy the antiquated franchise tax. By eliminating its franchise tax, Arkansas will enhance its attractiveness for new and expanded business investment in the State, standing out from neighboring states that still maintain taxes penalizing companies for investment. Repealing the franchise tax over time reflects a growing trend. Missouri, Mississippi, and New York are currently phasing out their respective franchise taxes; West Virginia, Rhode Island, and Pennsylvania recently completed similar phase-outs. In Pennsylvania, the phase out was sustained across multiple administrations headed by both Republican and Democratic Governors.

Improve State Tax Appeals and Procedural Requirements:

COST regularly evaluates states' statutes, rules, and practices that impact taxpayer access to an independent appeals system and that impact fairness and efficiency. In the latest COST administrative scorecard (December 2016),[8] Arkansas received a B+ grade, up from a C- in the 2013 scorecard, and was recognized for its enactment of significant administrative improvements with Act 896 of 2015. Below are our findings that contributed to that grade, including any updates to our prior research.

- *Independent appeals forum*: States with fair and efficient tax appeal systems share four essential elements: 1) an independent tribunal; 2) no prepayment requirement (or bond posting) for taxpayers disputing a tax before receiving an independent, impartial hearing; 3) the record for further appeals is established before an independent body; and 4) tribunal judges with specific training and experience in tax law. With the passage of Act 896 of 2015 repealing the requirement to post a bond or pay an assessment before reaching circuit court, the circuit courts now meet the first three of these requirements. However, although suits challenging a final tax assessment or determination are tried *de novo* in circuit court, circuit court judges are not required to have tax expertise and, in fact, hear all types of disputes beyond taxation. While most circuit court judges are fully equipped to hear tax cases, special consideration should be given to the handling and disposition of large, complex tax appeals. As such, COST recommends that the legislature seek ways to provide judges who hear such disputes with the resources to secure sufficient tax training or designate sufficiently experienced arbiters to handle such cases.

- *Pay-to-play*: As a result of Act 896 of 2015, Arkansas taxpayers are no longer required to pay tax, penalties, or interest prior to filing suit for judicial relief from a final assessment or determination. However, if a taxpayer loses in circuit court the final assessment remains in effect and the Department may proceed with collection activities. COST recommends that the legislature bar collections during the entire pendency of an appeal of a final assessment or determination until a case challenging the assessment is final.

- *Corporate return due date and extensions*: Arkansas' corporate income tax return due date is currently 30 days after the federal tax return is due, and the state automatically applies the federal extended due date when a taxpayer obtains a federal extension. However, COST encourages Arkansas to automatically provide an extended due date of at least 30 days after the federal extended due date, requiring only the attachment of the extended federal return with the state return to qualify. By extending state due dates to this point, state tax administrators allow taxpayers to file correct returns based on complete federal return information. Although corporate taxpayers often file a single consolidated federal return, the adjustments necessary to generate the multitude of state tax returns are complex and time-consuming.

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[8] COST Scorecard on Tax Appeals & Procedural Requirements, December 2016, available at: http://www.cost.org/WorkArea/DownloadAsset.aspx?id=94726.

- *Reporting of federal changes*: COST supports clear and consistent rules for determining when a "final determination" of a federal income tax audit triggers a reporting requirement to a state.[9] The reporting requirement should only require a taxpayer to file one return after the audit is truly final (*i.e.,* all appeals exhausted). A taxpayer should also be able to make estimated payments to address a potential tax deficiency, while preserving the taxpayer's right to a refund. COST urges a review of Arkansas' statutory definition of "final determination" against these standards. Further, the Department has one year following the filing of an amended return to assess additional tax resulting from a federal change, however taxpayers only have 180 days following receipt of a notice of federal change from the IRS to file for a state tax refund. Though COST commends providing taxpayers with 180 days to report federal changes, Arkansas should not provide the Department more time to issue assessments based on federal adjustments than it provides taxpayers to seek refunds based on federal adjustments.

- *Additional issues impacting fair and efficient tax administration*: To COST's knowledge, Arkansas has not enacted significant tax legislation making retroactive changes to statutes, and the State should be commended for this. Retroactive tax legislation potentially violates due process under the U.S. Constitution. Pursuant to the U.S. Supreme Court in *U.S. v. Carlton*, 512 U.S. 26 (1994), retroactive legislation will survive a due process challenge only where a legislature has acted with a "legitimate legislative purpose" and "promptly," imposing "only a modest period of retroactivity." States have increasingly attempted to sweep these Constitutional requirements aside, even waiting until after appellate courts have rendered final decisions in tax disputes before reversing the courts' decisions. Such legislation turns the judicial process into results-oriented decision making, undermining taxpayers' perceptions of fair and impartial tax appeals in the states. Retroactive tax legislation is one of the most corrosive elements undermining our voluntary state tax compliance system today, fostering a lack of trust in the tax system and reducing voluntary compliance because taxpayers fear the law will not be fairly applied. COST encourages Arkansas to avoid adopting such legislation in the future.

Improve Sales Tax Design and Administration:

COST is currently researching a new Scorecard on Sales Tax Administration that will provide states with best practices and comparative data for measuring state sales tax systems against an ideal consumption-based sales tax. Paramount in the design of an ideal sales tax is a system that only imposes tax on the final consumption of goods or services. A strong consensus of economists indicates that sales taxation of business inputs or other business-to-business transactions violates fundamental principles of a well-designed retail sales tax, resulting in tax pyramiding and multiple other harmful effects.[10] Our research shows that companies subject to high sales taxes on their purchases of goods and services are put at a competitive disadvantage to many of their competitors in other states and in foreign markets. Although the Scorecard will

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[9] For COST's policy position and a recommended definition of "final determination," see http://www.cost.org/uploadedFiles/About_COST/Policy_Statement/COST%20Federal%20Tax%20Changes%20(RAR)%20POLICY%20%20FINAL%204.%2016.15.pdf.

[10] *What's Wrong with Taxing Business Services? Adverse Effects from Existing and Proposed Sales Taxation of Business Investment and Services;* EY/COST, April 2013; see http://www.cost.org/WorkArea/DownloadAsset.aspx?id=83841.

contain a plenary compilation of recommendations, several prominent issues regarding the Arkansas sales tax are worth noting herein:

- *Participation in national sales tax simplification efforts:* COST has regularly participated in the Streamlined Sales Tax project since its inception, representing the business community and working cooperatively with state tax administrators and legislators to simplify and harmonize state sales tax and use tax systems. COST commends Arkansas for its continued conformity with and participation as a full member state of the Streamlined Sales and Use Tax Agreement (SSUTA). And given the inability of Congress and the courts to resolve the remote sales tax collection issue after *Quill v. South Dakota*, it is our view that sustained collaborative efforts by states and taxpayers under SSUTA will lead to the quickest resolution of the problem of under-collection of sales taxes on remote transactions via the Internet.

- *Taxation of business inputs*: As noted, a well-designed sales tax exempts business-to-business (B2B) transactions. Arkansas currently imposes approximately 34% of its sales taxes on business purchases.[11] For example, Arkansas limits its manufacturing exemption to machinery and equipment "directly used" in manufacturing and to materials that become "a recognizable integral part" of the manufactured products. Further, it taxes equipment purchases used to provide taxable services to customers, such as cable equipment and electric and gas distribution facilities. These costs are borne directly by businesses and not billed through to customers. We urge the Task Force to examine ways to reduce Arkansas' reliance on sales taxes on business-to-business transactions.

- *Reasonable vendor compensation*: Reasonable compensation for expenses incurred by a vendor in administering, collecting, and remitting sales, use, or similar transaction taxes (other than use taxes on goods and services purchased for the consumption of the vendor) should be provided to vendors for their efforts on behalf of the State. These costs of collection are 3.09% of sales tax collections on average for all vendors (2.17% for large retailers), a substantial portion of which consists of card transaction fees alone.[12] Arkansas currently provides vendor compensation of 2% of collections, but caps that amount at a *de minimis* $1,000 per month. COST encourages the Task Force to recommend removing the cap on vendor compensation and to provide vendors with a reasonable level of compensation to offset costs of collection incurred on behalf of the State.

<u>Improve Property Tax Design and Administration:</u>

Property taxes on inventory, machinery, and equipment are direct taxes on capital investment in the state and a specific disincentive to relocate or expand in Arkansas. Specifically, the legislature should address the following issues with respect to the design of property taxes in Arkansas and their impact on the State's competitiveness:

- *Repeal the property tax on manufacturing inventory*: The vast majority of states do not tax manufacturing inventories. This tax places Arkansas at a substantial disadvantage in attracting new industries and encouraging existing industries to expand in the state. The

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[11] Id.
[12] "PricewaterhouseCoopers LLP, *Retail Sales Tax Compliance Costs: A National Estimate;* Volume One, April 2006.

states surrounding Arkansas are very familiar with this issue and use it very effectively in competing with Arkansas for site locations and expansions.

- *Simplify property tax abatements for expansion projects:* In Arkansas the only way to obtain a partial property tax abatement on new manufacturing plants, machinery and equipment and major expansion projects is to ask a local government to issue "Act 9 Bonds" for a period of years, subject to a "payment in lieu of tax" arrangement whereby the industry agrees to pay at least 35% of the taxes that would otherwise be owed. This is an expensive and cumbersome process and is no longer consistent with abatement policies other states follow when competing for new industries and expansions. Most states permit government authorities to enter into straightforward abatement agreements to bring desirable projects to a state.

- *Treat property taxes on residential vs. commercial/industrial properties equally:* Arkansas permits property taxes on commercial and industrial properties to increase faster than taxes may increase for residential properties, provides direct homestead tax subsidies paid for with a portion of Arkansas' very high sales and use taxes, and freezes valuation increases for various favored classes of residential taxpayers. These discriminatory practices place business and industry at a significant disadvantage, are not equitable, and create another "talking point" for states competing with Arkansas for headquarters and manufacturing projects.

COST evaluates both U.S. and international property tax systems to provide tax policymakers with best practices and a comparative measure of the fairness and efficiency of worldwide property tax administrative practices.[13] Arkansas received a C grade in this most recent scorecard (September 2014). 2017's Act 659 made some improvements to property tax administration, much room for improvement remains. There are several issues that would help improve the administration of Arkansas property taxes levied upon businesses. These include:

- Providing a *de minimis* exclusion;
- Providing consistent report due dates across property types and taxing jurisdictions;
- Excluding intangible property;
- Providing at least 60 days to appeal;
- Allowing the taxpayer to defer payment on the disputed tax rather than prepay for centrally assessed property (although the taxpayer may defer payment on locally assessed property);
- Providing property tax forms, including exemption forms, on a centralized website;
- Including documentation explaining the State's property tax system online;
- Making valuation of property available via a website; and
- Providing property taxpayers with valuation notices, including appeals process information.

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[13] COST's Property Tax Scorecard is available at http://www.cost.org/WorkArea/DownloadAsset.aspx?id=88125.

Conclusion

Arkansas, like most states, is grappling with fiscal problems. Those problems result from the significant downturn in the real economy that began in 2008 and low economic growth in subsequent years. Most economic indicators suggest that the economy is slowly but steadily improving. Arkansas' business taxation currently relies on a balanced "three-legged stool" of income, property, and sales taxes. Business taxes can either help drive or hinder State economic growth. Accordingly, in making recommendations regarding tax reform, this Task Force should seek opportunities to minimize obstacles to investment and job creation. Please feel free to contact me with any questions or comments at *dlindholm@cost.org*.

cc: COST Board of Directors