

SUMMARY OF PROPOSAL #1
for consideration by the
ARKANSAS TAX REFORM AND RELIEF LEGISLATIVE TASK FORCE

TOPIC: Ad Valorem Personal Property Tax on Business Inventory

Summary of Proposal for Consideration

To exempt business inventory from ad valorem personal property tax under the Arkansas Constitution, effective for assessment years beginning January 1, 2019.

Fiscal Analysis

According to the Assessment Coordination Department (ACD), creating an exemption for business inventory from ad valorem personal property tax would result in an estimated reduction of over seventy million two hundred ten thousand dollars (\$70,210,000) of revenues for municipal, county, and school district funding based on tax collections from 2016. An estimated fifty-five million one hundred thousand dollars (\$55,100,000) represents the revenue that would be lost by school districts if business inventory were exempt from ad valorem property tax based on tax collections from 2016.

Legal Analysis

Background

Arkansas Constitution, Article 16, § 5, states that all property subject to taxation is to be taxed according to its value and that no species of property from which a tax is collected is to be taxed higher than another species of property of equal value. Accordingly, Arkansas levies ad valorem personal property tax on business inventory. Business inventory includes goods produced and held for sale in the normal course of business with the intent of making a profit from such goods, raw materials, works-in-process, finished goods, and supplies and packaging. Ad valorem personal property tax levied on business inventory applies to merchants and manufacturers. Ark Code Ann. §§ 26-26-1203 and 26-26-1205. However, business inventory that is in transit through Arkansas, including raw materials from within or outside of Arkansas used in the manufacturing process, and business inventory that is manufactured, processed, or refined in Arkansas and stored for shipment outside of Arkansas is not subject to ad valorem personal property tax. Ark. Code Ann. § 26-26-1102(b).

ACT 114 of 1883 clarified that all real and tangible personal property is subject to ad valorem property tax, including the property of corporations. This provision is codified under Arkansas Code § 26-3-201. The act further clarified that real and tangible personal property is to be assessed in the town, township, or school district where the property is situated. This provision is codified under Arkansas Code § 26-26-1102(a).

The act also clarified that ad valorem property tax on business inventory applies to merchants. The act provided that a merchant is any person who owns, possesses, or controls tangible personal property with the authority to sell the property at a profit or property that has

been consigned to the merchant from any place outside of Arkansas to be sold within Arkansas. These provisions are codified under Arkansas Code § 26-26-1203.

The act further clarified that ad valorem property tax on business inventory applies to manufacturers. The act provided that a manufacturer is defined as a person who purchases, receives, or holds property of any description for the purpose of adding value to the tangible personal property to incur a gain or profit through a process of manufacturing, refining, rectifying, or combining different materials. Additionally, the act provided that tangible personal property that is part of a manufacturer's stock and the value of all engines and machinery are subject to ad valorem property tax. These provisions are codified under Arkansas Code § 26-26-1205.

ACT 172 of 1929 provided that all tangible personal property is assessed for taxation in the taxing district in which the property is located and kept for use and that tangible personal property in transit is to be assessed in the taxing district of its destination. These provisions are codified under Arkansas Code § 26-26-1102.

ACT 269 of 1969 provided that tangible personal property in transit through Arkansas and tangible personal property manufactured, processed, or refined in Arkansas and stored for shipment outside of Arkansas do not acquire legal jurisdiction to be subject to ad valorem property tax in Arkansas. The act further clarified that "tangible personal property in transit through Arkansas" means tangible personal property that is:

- Moving in interstate commerce through or over the territory of Arkansas;
- Consigned to or stored in or on a warehouse, dock, or wharf in Arkansas in transit to a destination outside of Arkansas; or
- Manufactured, processed, or refined within Arkansas and stored in or on a warehouse, dock, or wharf in Arkansas for shipment to a destination outside of Arkansas.

These provisions are codified under Arkansas Code § 26-26-1102.

ACT 1294 of 1997 provided that tangible personal property in transit through Arkansas also includes raw materials from within or outside Arkansas used in the manufacturing process. This provision is codified under Arkansas Code § 26-26-1102(b)(1)(B). The provisions relating to ad valorem property tax levied on business inventory have not been amended since.

Potential Legal Issues

Arkansas Constitution, Article 16, § 6, states that all laws exempting property from ad valorem property tax are void unless provided under the Arkansas Constitution. Property that is considered business inventory in Arkansas is not exempt under the constitution. In order to exempt business inventory from ad valorem property tax, a constitutional amendment will be required to comply with Arkansas Constitution, Article 16, § 6.

Other States

- Iowa: Iowa does not levy ad valorem property tax on business inventory. In Iowa, all tangible personal property is exempt from ad valorem property tax. (IA St. § 427A.2)
- Louisiana: Louisiana levies ad valorem property tax on business inventory. All property situated within Louisiana, unless provided an exemption, is subject to ad valorem property tax. (LA St § 47:1951). Under Louisiana law, ad valorem property tax is levied on business inventory, which includes merchandise, fixtures, machinery, and equipment for all persons engaged in manufacturing or in the business of retailing or wholesaling merchandise in Louisiana, when gross sales are in excess of fifteen thousand dollars (\$15,000). Business inventory also includes all goods held as raw materials, goods-in-process, or finished goods by manufacturers, wholesalers, distributors, or retailers. (LA St § 47:1961.1).

However, Louisiana exempts ad valorem property tax levied on business inventory as follows:

- Raw materials, goods, commodities and other articles imported into Louisiana from outside of the continental United States if: the imports remain on the property of the port authority or the docks of a common carrier after arrival to Louisiana; the imports are held in their original bulk form or original packaging, and raw materials are held in bulk to be used in manufacturing or processing; or the imports are held in their original packaging by an importer in storage, unless a retail merchant is holding the imports as part of his stock in trade for sale at retail (LA Const. art. 7, § (D)(1) and LA St. § 47:1951.1);
 - Raw materials, goods, commodities and other articles held in Louisiana for the purpose of being exported from Louisiana (LA Const. art. 7, § (D)(2) and LA St. § 47:1951.2); and
 - Raw materials, goods, commodities, and personal property stored in transit in Louisiana while moving in interstate commerce and property received from outside of Louisiana held in storage to be shipped to a point outside of Louisiana. (LA Const. art. 7, § (D)(3) and LA St. § 47:1951.3).
- Mississippi: Mississippi levies ad valorem property tax on property, which includes inventory used by a business in its operation. (MS Const. art 4, § 112 and MR 35.VI.2.06). Business inventory is defined as goods on hand and available for sale by a business, including without limitation products held in reserve or put on shelves for sale, resale, or consumption by the public, raw materials, works-in-progress, finished goods, consigned goods, or ingredients used in food preparation. (MR 35.VI.2.06). Additionally, the property of all private corporations for pecuniary gain are taxed in the same way and to the same extent as the property of individuals. (MS Const. art. 7, § 181).

However, in Mississippi the governing bodies may exempt from ad valorem property tax business inventory that is:

- Moving in interstate commerce through or over the territory of Mississippi;
- Consigned or transferred to a licensed “free port warehouse” within Mississippi for storage in transit to a final destination outside of Mississippi;
- Manufactured in the State of Mississippi and temporarily stored in separate facilities licensed as a free port warehouse pending transit to a final destination outside of Mississippi; or
- Consigned or transferred to a licensed “free port warehouse” for storage pending transit to a location for production or processing into a component or part that is then transported to a final destination outside of Mississippi. (MS St. § 27-31-53).

Additionally, Mississippi exempts business inventory from ad valorem property tax that is intended for export or import in Mississippi and that is in transit and assembled or stored on wharfs, railway cars, in warehouses, or ports of entry (as designated by the United States government). (MS St. § 27-31-13).

Finally, to encourage manufacturers and other new enterprises of public utility to establish new facilities in Mississippi or expand existing facilities, the governing authority of a county or municipality may exempt all or any portion of the value of products, including finished goods, owned by a manufacturer or any distributor or wholesale merchant located in the county or municipality. However, this business inventory exemption may not exceed ten (10) years and does not apply to property taxes for school districts. (MS Const. art. 7, § 182 and MS St. § 27-31-7)

- Missouri: Missouri does not levy ad valorem property tax on business inventory. All tangible personal property held as industrial inventories, including raw materials, works-in-progress, and finished works on hand by manufacturers and refiners and all personal property held as goods, wares, merchandise, stock in trade, or inventory for resale by distributors, wholesalers, or retail merchants or establishments are exempt from ad valorem property tax. (Missouri Const. art. 10, § 6.1). However, Missouri imposes a countywide replacement tax on all lost revenues as a result of the ad valorem property tax exemption on business inventory. (MO Const. art. 10, § 6.2). The countywide tax is determined by each county clerk. (MO. St. § 139.600(1)).
- Oklahoma: Oklahoma levies ad valorem property tax on business inventory. In Oklahoma, all real and tangible personal property is subject to ad valorem property tax unless exempted by law or through a payment in lieu of tax program. (68 OK St. § 2804). All corporations organized, existing, or doing business in Oklahoma, other than railroads, air carriers, public service corporations assessed by the State Board of Equalization, national banks, state banks, trust companies, and building and loan associations are assessed ad valorem property tax on the value of their real

and tangible personal property. (68 OK St. § 2837). Oklahoma's ad valorem property tax on business inventory includes items such as:

- All goods, chattels and effects;
- All goods, wares, and merchandise, including oil, gas, and petroleum products severed from the realty; and
- All agricultural implements or machinery, goods, wares, merchandise, or other chattels that are in the possession of, under the control of, or held for sale by any warehouseman, agent, factor, or representative in any capacity of any manufacturer or any dealer or agent of any such manufacturer.

(68 OK St. § 2807).

However, Oklahoma provides several exemptions from ad valorem property tax on business inventory. Qualifying manufacturers with new, expanded, or acquired manufacturing facilities are exempt from ad valorem property tax, including ad valorem property tax levied on business inventory for a period of five (5) years. The exemption may also be extended for an additional five (5) years. The exemption applies not only to new facilities but also to the expansion of existing facilities. However, in the case of an expansion of an existing facility, the business inventory property tax exemption is limited to only the increase in ad valorem taxes directly attributable to the expansion and not the entire facility. (Okla. Const. art. 10, § 6B, and 68 OK St. § 2902). Additionally, manufacturing facilities may delay the tax exemption for up to five (5) years following the expiration or termination of the previously agreed-to ad valorem property exemption. (68 OK St. § 2902.5)

Finally, all property consigned to a consignee in Oklahoma that is forwarded at through rates from the point of origin is exempt from ad valorem property tax if the property is not located in Oklahoma for more than ninety (90) days. Additionally, all goods, wares, and merchandise held for assembly, storage, manufacturing, processing, or fabricating that are not detained in Oklahoma for more than nine (9) months, regardless of whether the property is moving on through rates, are exempt from ad valorem property tax. (Okla. Const. art. 10, § 6A).

- Tennessee: Tennessee, generally, does not levy ad valorem property tax on business inventory. Under Tennessee law, businesses subject to the Tennessee Business Tax Act are exempt from ad valorem property tax on business inventory. (TN St. §§ 67-4-701 and 67-5-901). According to the Tennessee Department of Revenue, nearly every type of business is subject to the Tennessee Business Tax Act. In the rare instances where a business is not subject to the Tennessee Business Tax Act, business inventories are subject to ad valorem property tax.
- Texas: Texas levies ad valorem property tax on business inventory. All real and tangible personal property is subject to ad valorem property tax unless exempted by law. (TX St. Tax Code § 11.01). Texas has jurisdiction to tax tangible personal property that is located in Texas for longer than a temporary period, temporarily located outside Texas and the owner of the property resides in Texas, or property

that used continually, whether regularly or irregularly, in Texas. (TX St. Tax Code § 11.01). Property is considered to be used continually, whether regularly or irregularly, if the property is used in Texas three (3) or more times on regular routes or for three (3) or more completed assignments occurring in close succession within a short period of time throughout the year. (TX St. Tax Code § 11.01).

Texas provides an exemption from ad valorem property tax on business inventory that is considered a free port good. (TX St. Tax Code § 11.251). Free port goods are:

- Property acquired in or imported into Texas to be forwarded outside of Texas;
- Property detained in Texas for assembling, storing, manufacturing, processing, or fabricating purposes by the person who acquired or imported the property; and
- Property transported outside of Texas no later than one hundred and seventy-five (175) days after the date the person acquired or imported the property into Texas, or if applicable, a later date established by the governing body of a political subdivision in Texas.

(Texas Const. art. 8, § i-j and TX St. Tax Code § 11.253).

A person is also entitled to an exemption from ad valorem property tax levied on tangible personal property, including business inventory, if the property is held or used for the production of income and has a taxable value of less than \$500. (TX St. Tax Code § 11.145).