



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

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July 20, 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: Estimate of Revenue Impact following Wayfair v. South Dakota

Chairman Hendren and Chairman Jean:

DFA has attempted to determine the fiscal impact of potential increased collections of Arkansas sales and use taxes following the June 21, 2018 decision of the U.S. Supreme Court in *South Dakota v. Wayfair*, 138 S.Ct. 2080 (2018). In *Wayfair*, the Court held as constitutional South Dakota’s law requiring online and other remote out-of-state sellers to collect state and local sales and use taxes where the seller did not have a physical presence but had annual sales to South Dakota customers of more than \$100,000 or engaged in 200 or more transactions per year. This decision also held that the “physical presence” test of *Quill v. North Dakota*, 112 S.Ct. 1904 (1992) is not the appropriate analysis for determining when a company has sufficient nexus to be required to collect and remit sales tax to a state.

During the 2017 General Assembly, DFA noted that it did not have a specific fiscal impact or estimate of the amount of revenue that would be captured if remote sellers were required to collect and remit sales tax. The estimates below are the attempts to provide an estimate since the 2017 legislative session:

Estimated Revenue Impact of Remote Seller Sales Tax Collection			
	DFA	GAO Low	GAO High
General Revenue (4.5%)	\$24,491,000	\$21,765,000	\$49,417,000
Special Revenue (2.0%)	\$10,883,000	\$9,673,000	\$21,963,000
Total State (6.5%)	\$35,374,000	\$31,438,000	\$71,380,000
Locals estimates at 1.5%	\$8,162,000	\$7,254,750	\$16,472,250

In DFA’s estimate, Dr. John Shelnett of DFA’s Office of Economic Analysis and Tax Research used a Residual Market Share Revenue Estimation process to approximate uncollected Arkansas sales and use tax. This involved a process of evaluating U.S. market shares of eCommerce retail shopping sales from the industry data source eMarketer. Dr. Shelnett’s residual estimation used a

subtraction process from the list of top market share groups using confidential taxpayer data in Arkansas from the existing tax base. In other words, online retailers that have current sales tax registrations with DFA are not included in DFA estimate above. The estimate also used assumptions for untaxed affiliate sellers within marketplaces and the smaller market shares below the top marketplace share group as an aggregate. Although no specific provision was made in Dr. Shelnett's estimate for very small affiliate sellers and small-scale independent sellers, the estimate is reasonably conservative to allow for this fraction of the online market and fits within the legal exclusion of the low end of the market sellers.

Dr. Shelnett cross-checked the industry market share lists with the names and revenue collections from voluntary online payers, which narrowed the subset of outstanding sellers. Dr. Shelnett also made a downward adjustment to the estimate to account for digital downloads and music in comparing existing and untaxed sellers.

Dr. Shelnett believes that a 10% compound average growth rate (CAGR) for internet sales appears reasonable for the sector given eCommerce data from the U.S. Census Bureau in consideration of annual growth rates. This data source shows 10.6% CAGR for Electronic Shopping and Mail-Order Houses at the national level for the 5-year period of 2012-17. Higher growth rates are evident for business-to-business eCommerce and wholesale activity.

Additionally, Dr. Shelnett believes the estimate of outstanding sales tax revenue from online sales will probably fall as a result of additional registrations from out-of-state sellers irrespective of any new legislation. Therefore, the estimate will remain fluid with no discrete point of contribution as more online retailers merge into the tax base. Dr. Shelnett recommends the monitoring of new registrations to provide as a guide to changes in compliance rates.

Independent of Dr. Shelnett's analysis, an estimate was prepared based on the General Accounting Office (GAO) Study released in November of 2017. Specifically, the GAO study looked at the total estimated amount of sales being made in an online remote seller posture and also did estimates of how much of that total sales volume was already being captured by Arkansas compensating use tax, such as business to business transactions. DFA took both the "High" and "Low" estimates of the numbers and applied the GAO estimated capture rate to create an overall estimated market amount. This was then factored down by Arkansas approximate percentage of the total United States population (1%) to identify the potential Arkansas market. The Arkansas market amount had the total amount of tax applied at the state rate of 6.5% and the amount was then adjusted based on amounts received pursuant to Voluntary Compliance Agreements and sellers registered through the Streamlined Sales and Use Tax agreement registration process. This resulted in the GAO's estimated fiscal impact for increased general revenues between \$21,765,000 and \$49,417,000 compared to Dr. Shelnett's general revenue estimate of \$24,491,000.

As a final matter, it is important to note that DFA's fiscal impact above attempts to provide an estimate of additional sales tax collections assuming a majority or substantially all online retailers that would be subject to *Wayfair*-level annual sales thresholds have registered with DFA to collect sales tax. Businesses may determine to immediately register with DFA to collect sales

Arkansas Tax Reform and Relief Task Force

Re: Estimated Revenue Impact Following *South Dakota v. Wayfair*

Page 3 of 3

tax following the *Wayfair* decision or may opt to wait and see if the General Assembly enacts substantive legislation in the 2019 legislative session requiring registration by online retailers. In fact, DFA has received new sales and use tax account registrations via the Streamlined Sales and Use Tax system following the *Wayfair* decision. However, it is premature to quantify the estimated revenue impact of these new accounts by reason that no new account has reported a full month of sales data on a sales and use tax return. Therefore, the amount of time required for Arkansas to realize collection of DFA's additional revenue estimate is uncertain.

Should you have any questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in cursive script that reads "Walter Anger".

Walter Anger
Deputy Director and
Commissioner of Revenue

