

**SUMMARY OF PROPOSAL #11**  
*for consideration by the*  
**ARKANSAS TAX REFORM AND RELIEF LEGISLATIVE TASK FORCE**

**TOPIC: Sales Tax Exemption For Sales of Machinery and Equipment Used Directly in Manufacturing or Processing**

**Summary of Proposal for Consideration**

To repeal the sales tax exemption on the sale of machinery and equipment used directly in manufacturing or processing under Arkansas Code § 26-52-402, effective for tax years beginning on or after January 1, 2019.

**Fiscal Analysis**

Repeal of the exemption may result in an estimated \$73,752,885 per year increase to General Revenue based upon FY17, as provided by the Department of Finance and Administration's "Sales and Use Tax Revenue Impact of Exemptions" presentation to the Arkansas Tax Reform and Relief Legislative Task Force on March 19, 2018.

**Legal Analysis**

***Background***

Arkansas currently has a sales tax exemption on the sale of machinery and equipment used directly in manufacturing or processing.

ACT 386 of 1941 created the sales tax exemption on the sale of machinery and equipment used directly in manufacturing and processing and applied to goods, wares, merchandise, and property sold for use in manufacturing only in the event that such goods, wares, merchandise, or property became a recognizable and integral part of the manufactured product.

ACT 113 of 1967 expanded the sales tax exemption to include all tangible personal property used for repair, replacement, or expansion of existing manufacturing, including all machinery and equipment used in manufacturing or processing, but not including machines, equipment, and supplies used solely in administrative, accounting, sales or other non-operational activities of the business involved.

ACT 5 of 1968 clarified that the sales tax exemption providing that only machinery and equipment utilized directly in the actual manufacturing or processing operation, at any time from the initial stage where actual manufacturing or processing began through the completion of the finished product, would be subject to the sales tax exemption; clarified that the exemption also applied to mining, quarrying, refining, extracting oil and gas, printing, cotton ginning and agricultural facilities. This ACT also clarified that machinery and equipment "used directly" in the manufacturing process shall not include: hand tools, buildings, transportation equipment, office machines and equipment, machinery and equipment used in administrative, accounting, sales or other such activities of the business involved and all other machinery and equipment not

directly used in the manufacturing or processing operation. This ACT also clarified that machinery and equipment required by state law or regulations to be installed and utilized by manufacturing and processing plants or facilities in the state to prevent or reduce air or water pollution or contamination which might otherwise result from the operation of the plant or facility.

ACT 492 of 1985 further clarified the sales tax exemption to include machinery and equipment which cause a recognizable and measurable mechanical, chemical, electrical, or electronic action to take place as a necessary and integral part of manufacturing, the absence of which would cause the manufacturing operation to cease. As well as machinery and equipment “used directly” in the manufacturing process such as molds, frames, cavities, and forms that determine the physical characteristics of the finished product or its packaging material at any stage of the manufacturing process, and machinery and equipment that produce steam, electricity, or chemical catalysts and solutions that are essential to the manufacturing process but which are consumed during the course of the manufacturing process and do not become necessary and integral parts of the finished product.

ACT 841 of 1985 expanded the definition of machinery and equipment under the sales tax exemption to include retreading of tires for automobiles, trucks, and other mobile equipment powered by electrical or internal combustion engines or motors.

ACT 1233 of 1997 expanded the definition of machinery and equipment under the sales tax exemption to include machinery and equipment used in the production of protective coatings which increase the quality and durability of a finished product.

ACT 1208 of 2009 clarified that machinery and equipment under the sales tax exemption included dies, tools, and devices attached to or a part of a unit of machinery that determine the physical characteristics of the finished product or its packaging material at any stage of the manufacturing process.

ACT 233 of 2013 clarified that the sales tax exemption includes machinery and equipment required by state or federal law or regulations to be installed and utilized by manufacturing and processing plants or facilities, such as machinery and equipment required by state or federal law or regulations to be used in the refining of petroleum-based products to remove sulfur pollutants from the refined product, and any repair parts and repair labor for machinery or equipment required by state or federal law or regulations to be used in the refining of petroleum-based products to remove sulfur pollutants from the refined product.

ACT 300 of 2014 included special language clarifying that machinery and equipment included sand and other proppants used to complete a new oil or gas well or to recomplete, redrill, or expand an existing oil or gas well, and has not been amended since.

***Potential Legal Issues***

None.

### ***Other States***

- Iowa: Sales tax exemption on the sales of machinery and equipment used directly in manufacturing or processing, includes farm machinery and equipment (IA St. §423.3)
- Louisiana: Sales tax exemption on the cost of machinery and equipment used by a manufacturer in a plant facility predominately and directly in the actual manufacturing for agricultural purposes or the actual manufacturing process of an item of tangible personal property, which is for ultimate sale to another and not for internal use, at one or more fixed locations within Louisiana. (LA St. § 47:301)
- Mississippi: Reduced sales tax rate of 1.5% for sales of manufacturing machinery or manufacturing machine parts when made for a manufacturer or custom processor for plant use only when the machinery and machine parts will be used exclusively and directly within this state in manufacturing a commodity for sale, rental or in processing for a fee, and sales of machinery and machine parts when made to a technology intensive enterprise for plant use only when the machinery and machine parts will be used exclusively and directly within this state for industrial purposes, including, but not limited to, manufacturing or research and development activities; sales tax exemption on farm machinery and equipment; sales tax exemption for farm implements. (MS St. § 27-65-17)
- Missouri: Sales tax exemption for sales of machinery, equipment, and materials used or consumed in the manufacturing, processing, compounding, mining, or producing of any product, or used or consumed in the processing of recovered materials, or used in research and development related to manufacturing, processing, compounding, mining, or producing any product; sales tax exemption for sales of farm machinery and equipment. (MO. St. § 144.054 & §144.030)
- Oklahoma: Sales tax exemption on sales of goods, wares, merchandise, tangible personal property, machinery and equipment to a manufacturer for use in a manufacturing operation, additional sales tax exemption for farm equipment and machinery. (OK St. 68 §1359)
- Tennessee: Sales tax exemption for “industrial machinery” includes only machinery, apparatus and equipment used during manufacturing process, and not that used before raw materials were brought in to start process, nor after completed product was shipped away from manufacturing site, and sales tax exemption for farm equipment and machinery. (TN St. § 67-6-206 & § 67-6-207)
- Texas: Sales tax exemption on the sale of machinery and equipment used directly in manufacturing or processing, and used in the production of farm or ranch products or timber. (TX St. § 151.318)