

Act 465 of 2017: Sales and Use Tax Exemption for Repair and Replacement of Manufacturing Machinery and Equipment



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Senate Bill 362, signed into law on March 13, 2017 as Act 465 of 2017 (“Act 465”), will significantly reduce the sales and use tax burden on most Arkansas manufacturers once fully phased in by 2022. Act 465 provides for a gradually increasing refund over the next five years for sales and use tax paid on the purchase of machinery, equipment, parts and services for the repair and partial replacement of manufacturing equipment, followed by a full exemption for such purchases effective July 1, 2022.

In conjunction with the phased in exemption, Act 465 also sunsets two Arkansas Economic Development Commission sales and use tax refund and credit programs. The first program, which provides for a 100% refund of sales and use tax on qualifying manufacturing equipment repair and replacement projects, is being directly replaced by the new exemption. The other, commonly referred to as “InvestArk,” is a sales and use tax credit available to a wide range of businesses who commit to make substantial capital investment in the state. Businesses may still benefit from these incentive programs before they are phased out, and should be keenly aware of the approaching deadline dates.

The exemption enacted under Act 465 will eliminate a distinction under current law between manufacturing machinery and equipment purchased to repair or partially replace existing equipment - which is currently subject to sales and use tax - and machinery and equipment purchased to replace substantially all of the equipment required to perform an essential manufacturing function, which is exempt from tax. Machinery and equipment installed into a new or substantially expanded manufacturing facility is also exempt. “Manufacturing” for purposes of the sales tax rules includes the manufacture, fabrication, assembly, processing, finishing, and packaging of articles of commerce, as well printing services.

The existing distinction between “repair/partial replacement” and a “substantially all” replacement often perplexes manufacturers and their advisors as it frequently yields arbitrary results. This is especially true with respect to advanced technology, electronic equipment and quasi-manufacturing operations not contemplated by the current statutes and regulations. Fortunately, Act 465 will eliminate this confusion. The Act essentially creates a blanket exemption for the purchase of all equipment and machinery to be used in manufacturing, whether for a new or existing facility, and without any requirement to show that “substantially all” of a piece of equipment has been replaced.

Specifically, Act 465 expands Ark. Code Ann. §§ 26-52-477 and 26-53-149, which were enacted effective July 1, 2014, as part of Act 1404 of 2013. These sections provide for a one percent (1%) sales and use tax

rate reduction (payable as a refund) for purchases of manufacturing machinery and equipment purchased to repair or partially replace existing machinery or equipment. Act 465 increases this refund amount to 2% on July 1, 2018; 3% on July 1, 2019; 4% on July 1, 2020; and 5% on July 1, 2021. On July 1, 2022, purchases of machinery, equipment and services eligible for the refund will become fully exempt from sales and use tax.

The 1% refund continues to be available to direct pay permit holders until July 1, 2018, at which time the increased refund will become available to any taxpayer holding an active Arkansas sales and use tax permit. Businesses may claim the refund by offsetting the amount of the claimed refund against the tax to be remitted with the taxpayer's monthly sales and use tax reports. The reports must be filed electronically to be eligible for the refund.

In addition to the 1% sales and use tax refund under §§ 26-52-447 and 26-53-149 discussed above, Act 1404 of 2013 also enacted Ark. Code Ann. § 15-4-3501, which established an increased refund of 100% of sales and use taxes levied against purchases of manufacturing machinery and equipment for certain projects approved by AEDC. The 100% refund program is a discretionary AEDC incentive for taxpayers that undertake a major manufacturing equipment repair, improvement or modernization project. To qualify for this discretionary refund, a taxpayer must expend at least \$3 million on an approved project that is otherwise eligible for the 1% refund under §§26-52-447 or 26-53-149. Eligible businesses must apply and, if accepted, enter into a financial incentive agreement with the AEDC.

The full exemption provided under Act 465 will eliminate the need for the 100% refund incentive program. As such, Act 465 amends § 15-4-3501 to provide that AEDC will no longer accept applications for the 100% refund after June 30, 2022, the day the full exemption becomes effective. Manufacturers planning a qualifying repair or maintenance project prior to 2022 should still strongly consider applying for the refund. More information about the refund program can be obtained from the [AEDC website](#).

Act 465 also eliminates the InvestArk program, a sales and use tax credit program enacted in 2003 aimed at incentivizing capital investment in the state. InvestArk is available to businesses established in Arkansas for two years or longer that invest five million dollars (\$5,000,000) or more at a single location in land, buildings and equipment for new construction, expansion or modernization of the business' facilities.

Eligible businesses that are approved for the program are awarded a credit against the business' sales and use tax liability for a portion of the total project cost equal to one-half percent (1/2%) above the state sales and use tax rate in effect at the time of application (currently, 7% of project expenditures). The tax credits claimed under the program cannot exceed 50% of the business' sales and use tax liability in any year, but may be carried forward for five years after completion of the project. Total project expenditures must be incurred within four (4) years of the date the project is approved by AEDC. The credit is not limited to manufacturing businesses, and may be awarded to a wide range of business projects, including businesses engaged in the design and development of software, computer processing and data services; motion picture production; distribution centers; intermodal facilities; non-retail office sector businesses; corporate headquarters; commercial, physical and biological research; and scientific and technological services. The [AEDC website](#) includes a full list of eligible businesses and application instructions.

Act 465 imposes a rather immediate final deadline of June 30, 2017 for applications for the InvestArk credit program. Projects that have already received approval or that apply prior to the deadline will be eligible for the credit and carryforwards as currently in place.

Although the expanded manufacturing equipment exemption will provide some relief to manufacturers, the InvestArk credit provides a blanket credit to a much broader range of businesses and projects. Businesses that are considering a substantial expansion to their physical operations in the state in the near future should strongly consider submitting an application for the InvestArk credit before the June 30 deadline.