Arkansas State Sales and Use Tax

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The sales and use tax is an increasingly popular method of generating revenue for state and local governments in Arkansas\(^1\). The state sales tax rate, 6.5%, is the highest that it has ever been, as the state government has turned increasingly to this tax in the past two decades to fund special projects. At the same time, the state has reduced the state sales tax on food for home consumption to 0.125% and provided some additional sales tax exemptions for businesses.

In 2019, the state government generated more than $3.6 billion in revenue from the sales and use tax\(^2\), 123% more than in 1990 after adjusting for inflation. Nationally, Arkansas has the ninth highest state sales tax rate\(^3\). The share of total state gross revenues in Arkansas derived from sales and use taxes has also increased during this time, from 35% in 1990 to 38% in 2019.

Authority to Tax

Arkansas’ power of taxation comes from its inherent power as a sovereign state\(^4\). While the federal government has the authority to impose taxes, states retain the right to impose any type of tax, except those expressly forbidden by the U.S. and its states’ constitution\(^5\). Despite this grant of power, the Arkansas constitution contains provisions that limit the ability of the state government to implement a new, or alter an existing, tax:

1. The state government may only institute a new tax by a two-thirds (66.7%) majority in both houses of the state General Assembly\(^6\).
2. The state may increase the tax rate if one of two conditions are met\(^7\):
   a. The increase is approved by a majority of voters at a general election, or
   b. A majority vote for an increase by both houses of the General Assembly.

There is no cap on the state sales tax rate.

History of Arkansas’ State Sales & Use Tax

Arkansas first exercised its constitutional power to levy a state sales tax in 1935. The Emergency Retail Sales Tax (Act 233) of 1935, a temporary two-year 2% tax, was instituted by the state to fund aid for the poor and public education. The tax base established under this law required retailers to collect sales tax revenue from the sale of all goods, except on goods that were considered “necessary to life.” Specifically, the Act exempted several foods and food ingredients (for example, flour, meat, sugar and eggs) and medicines. Legislation in 1937 created the Arkansas Retail Sales Tax Law to extend Act 233, with about the same provisions as the Act of 1935.

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\(^1\) Hereafter we will refer to the Gross Receipts and Compensating Use tax, commonly referred to as the sales and use tax, as the “sales tax,” except in instances where both terms are needed for clarity.

\(^2\) Sales and use taxes are made up of Gross Receipts and Compensating Use taxes.


\(^4\) See Constitution of the United States of America, Amendment X. That power rests with the general assembly, and it is limited by both the state constitution and the Constitution of the United States. Pulaski Cty. v. Irvin, 4 Ark. 473, 481 (1842).

\(^5\) State and Local Taxes, U.S. Department of the Treasury.

\(^6\) Article 5 §31 (current as of 2017).

\(^7\) This applies to the state sales tax since it was in effect before Arkansas voters approved Amendment 19, which requires approval by a two-thirds majority of both houses of the General Assembly for any new tax.
Arkansas' current sales and use tax is governed by two laws passed in the 1940s. The first law, the Gross Receipts Tax Act of 1941, governs the sales tax portion of the law while the Compensating Tax Act of 1949 governs the use tax portion of the law. The tax base for each law was similar. The Gross Receipts Tax Act levied a sales tax on “tangible personal property” purchased in Arkansas as well as specified services, while the Compensating Tax Act levied a tax on “tangible personal property” purchased outside of Arkansas for use (including storage, distribution or consumption) within the state. As with previous sales tax laws, a tax rate of 2% was codified by the laws of 1941 and 1949.

The 1997 sales tax rate increase signaled a shift in the state government’s approach to how it uses sales tax revenue. During the first 62 years of state sales tax in Arkansas, the vast majority state sales tax revenue was deposited to the state General Revenue Fund to finance selected programs and operating expenses of state government. However, over the past three decades, the state has turned to the sales tax with growing frequency for the purpose of financing special programs.

From 1949 until 1990 the state sales tax rate increased on two occasions, resulting in a sales tax rate of 4% from 1983 to 1990 (Figure 1). Since 1990, there were five increases in the sales tax rate, four of which were for financing special programs. The exception was the sales tax rate increase from 4% to 4.5% in 1991.

Arkansas Constitutional Amendment 75 in 1997 increased the sales tax rate by one-eighth of 1% to 4.625% while directing all revenue generated by this additional tax to the Conservation Tax Fund. Four programs receive a share of this revenue as defined by state law:

1. Game Protection Fund (45%)
2. Department of Parks and Tourism Fund (45%)
3. Arkansas Department of Heritage (9%)
4. Keep Arkansas Beautiful Fund (1%)

The next sales tax rate increase of one-half of 1% resulted from legislation to compensate local governments for property tax revenue lost by the state's Homestead Tax Credit, which currently provides a $375 tax credit for an individual's primary residence. This increase raised the sales tax rate to 5.125% in 2001.

All revenue generated by this increase is earmarked for the Property Tax Relief Fund, which is distributed to counties based on lost property tax revenue of all local government entities. Counties then distribute these funds to the local government entities based on their share of lost revenue.

Two important changes to state sales tax law occurred in 2003. First, the Legislature passed Act 1273, paving the way for Arkansas' participation in the Streamlined Sales Tax Agreement, which is discussed in detail later. Second, the state Legislature passed an emergency measure to address growing disparity among Arkansas public schools, increasing the state sales tax rate by seven-eighths of 1% to 6%, which took effect in 2004. As a result, $0.00875 of every state sales tax dollar generated in the state goes to the Educational Adequacy Trust Fund. This revenue can be used for “grants and aids” for programs administered by the Arkansas Department of Education.

The most recent increase of one-half of 1% to the state sales tax rate went into effect in 2013, after Arkansas voters passed Constitutional Amendment 91. The amendment was enacted to maintain and improve Arkansas' system of state highways, county roads and city streets. This one-half cent increase, which raised the sales tax rate to 6.5%, is temporary and will be removed once the bonds issued under Amendment 91 have been repaid8. The Arkansas Department of

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8This ½ cent sales tax to maintain and improve Arkansas' system of state highways, county roads and city streets will be extended indefinitely if voters approve Issue 1 during the November 2020 General Election.

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**Figure 1. Arkansas State Sales Tax Timeline. Arkansas Bureau of Legislative Research.**
Transportation receives 70% of this revenue, and cities and counties each receive 15% of the revenue.

Along with the above increases in the sales tax rate, Arkansas gradually reduced the state sales tax on food for home consumption from 6% in 2007 to 0.125% beginning Jan. 1, 2019.

Arkansas’ Sales Tax Base and Exemptions

The Sales Tax Base

The sales and use tax base is composed of the “bundle” of goods and services taxable under Arkansas law. Two broad categories of taxable goods are defined in the Gross Receipts and Compensating Tax Acts:

1. Tangible personal property
2. Services

Notably, all tangible personal property is included in the sales tax base unless explicitly exempted, while taxable services only include those explicitly listed in the law as taxable.

In contrast to the Gross Receipts Tax Act, which applies to goods and services purchased in the state, the Compensating Tax Act taxes tangible personal property and taxable services purchased outside Arkansas for storage, use, distribution or consumption in the state.

Exemptions

In addition to defining the types of goods and services that can be taxed, the Gross Receipts and Compensating Tax Acts contain 119 provisions exempting listed goods and services from the state sales tax. A few of the most notable exemptions include the sales of certain agricultural products, new and used farm machinery, and prescription drugs and oxygen.

Food and food ingredients are subject to a partial exemption from sales tax. Rather than taxing food for home consumption at the 6.5% state sales tax rate, Arkansas law specifies a food state sales tax rate of 0.125% for most foods9.

Administration of the Sales and Use Tax

Sales and use taxes are administered by the Arkansas Department of Finance and Administration (ADFA). Except in a few select cases, collection of sales and use tax revenue begins with retailers and service providers who charge customers applicable sales tax at the time of payment10. All sales tax revenue collected, less the collector’s discount, is given to the ADFA, which then remits the funds, less a 3% deduction for state administrative expenses, to the state treasury. The revenue is deposited into the funds required by each sales tax law. However, the 3% deduction for state administrative expenses does not apply to the revenue received from the 0.5% sales and use tax for the improvement of state, county and city roads and streets11.

The substantive and procedural provisions of Arkansas’ sales and use tax laws reflect the state’s commitment to reduce the administrative and cost burdens of the sales tax through participation in the Streamlined Sales Tax Agreement (SSTA).

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9A.C.A. § 26-52-317
10There are provisions in Arkansas law that allow the payment of sales tax on motor vehicles to the state directly by consumers.
Participation in the SSTA also positions Arkansas to collect sales tax revenues for purchases made by Arkansas businesses and individuals from businesses in other states.

**State Sales & Use Tax Revenue**

Between 1990 and 2019, total state sales tax revenue grew 123%, from $1.6 billion to $3.6 billion in constant 2019 dollars. This growth reflects the increase in state sales tax rates and growth in the economy. Sales tax revenue is also affected by downturns in the economy as can be seen by the effect of the Great Recession, resulting in a decline in revenue from 2007 to 2010 (Figure 2).

However, the Great Recession was not the sole contributor to the decline in sales tax revenue during this period. The reduced state sales tax rate on food for home consumption also contributed to the decline in sales tax revenue from 2007 to 2010. Also contributing to the decline were some additional sales tax exemptions passed by the state legislature during this period. Fluctuations in state sales tax revenue reflect the growth and decline of the state economy, increases and reductions in sales tax rates, and changes in the tax base.

**Sales Tax Revenue as a Share of Total State Revenue**

The share of total state revenue from sales tax increased from 35% in 1990 to a high of 41% in 2005, 2006 and 2007, then declined to 36% in 2013 before increasing to 38% in 2019 (Figure 3). Much of the downward trend in the share of sales tax revenue during this time can be attributed to the Great Recession, decline in the state sales tax rate on food for home consumption, and new sales tax exemptions.

**Effect on Households**

The sales tax is a regressive tax meaning that lower-income households pay a larger share of their income on the sales tax than higher-income households. For example, suppose that Individual 1 earns $25,000 annually and Individual 2 earns $100,000 annually. If each individual spends $20,000 on taxable goods and services, they would both be subject to sales tax liability of $1,300. Individual 1, who has a sales tax liability of 5.2% of her total income, is disproportionately impacted by the sales tax compared to Individual 2.

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12 Due to data limitations, calculations for the sales taxes’ share of total revenue are done a per fiscal year basis.
to Individual 2, whose sales tax liability is only 1.3% of her total income.

To illustrate the regressive nature of sales and excise taxes, we include Figure 4, which shows the share of household income by income category that goes to pay state and local sales and excise taxes in the United States. The households with the lowest income use 7.1% of their income to pay state and local sales and excise taxes compared to 0.9% for the households with the highest income.

However, it should be noted that Arkansas has mitigated some of the regressivity of the sales tax by reducing the state sales tax on food for home consumption from 6% in 2007 to 0.125% in 2019. This is because households of all income levels spend money on food and lowering the tax on these purchases helps offset some of the regressive impacts of the sales tax for people with lower incomes.

**National Comparisons**

According to the Tax Foundation, Arkansas’ state sales tax rate of 6.5% ranked the ninth highest in the nation in 2020 (Figure 5). Five states—Alaska, Delaware, Montana, New Hampshire and Oregon—had no state sales tax in 2020 and California had the highest at 7.25%. The average (mean) state sales tax rate was 5.1% and the median was 6% as of January 2020. Most states, 32 of the 45 states with a state sales tax, exempt groceries from the state sales tax. Another six states, including Arkansas, tax groceries at a reduced rate, and 13 states tax groceries at the state sales tax rate.

**Summary**

While the state sales and use tax has been a part of Arkansas law for many decades, the reliance on the sales tax to generate state revenue grew considerably over the past 30 years. Between 1990 and...
2019, state revenue from the sales tax more than doubled, from $1.6 billion to $3.6 billion in constant 2019 dollars. However, sales tax revenue is more volatile than other forms of tax revenue. Despite increases in the state sales tax rate and increases in the tax base, the state sales tax revenue declined from 2007 to 2010. This was in part due to the effect of the Great Recession on the economy and in part due to a declining state sales tax rate on food for home consumption and an increase in sales tax exemptions. In recent years, the gap between sales tax revenue and income tax revenue narrowed as sales and use tax revenues increased. In 2018, the share of gross state revenue coming from sales and use taxes was 2 percentage points less than revenue from income tax, the smallest difference since 2007. These changes coincide with more widespread adoption of the sales tax to fund special needs and projects.

Acknowledgement is given to Tyler Knapp, former community and economic development program associate, for his significant contribution to this publication.

Acknowledgement is also given to Arkansas Department of Finance and Administration (ADFA) staff for their valuable comments and suggestions during the development of this publication. Any errors or misstatements are entirely the responsibility of the authors, not ADFA staff.