DEPARTMENT OF TAXATION
2001 Fiscal Impact Statement

1. Patron Rust

2. Bill Number HB 2036

House of Origin:
X **Introduced**
___ **Substitute**
___ **Engrossed**

Second House:
___ **In Committee**
___ **Substitute**
___ **Enrolled**

3. Committee House Finance

4. Title State and Local Income Tax

5. Summary/Purpose:

This bill would reduce the state individual income tax rates and authorize localities, at their option, to impose a local income tax at rates equivalent to the reduction in the state income tax rates. The bill would also exempt all motor vehicles used for nonbusiness purposes from the personal property tax and, as a result, repeal the Personal Property Relief Act of 1998.

This bill would be effective for taxable years beginning on or after January 1, 2003, if a Constitutional amendment is ratified by voters exempting motor vehicles used for nonbusiness purposes from taxation in the November election of 2002.

6. Fiscal Impact Estimates are:

6a. Expenditure Impact:

Fiscal Year	*Dollars*	*Positions*	*Fund*
2000-01	$0	0	GF
2001-02	$0	0	GF
2002-03 *	$709,050	3	GF

*** Does not include systems costs. (See line 8.)**

6b. Revenue Impact:

	State Revenues	
Fiscal Year	*General Fund*	*Special Fund*
2000-01	$0	$0
2001-02	$0	$0
2002-03	<$570.7 million>	$311.4 million
2003-04	<$1.2 billion>	$61.0 million

	Local Revenues		
Fiscal Year	***Distribution from Special Fund***	***Tangible Personal Property Tax***	***Net***
2000-01	$0	$0	$0
2001-02	$0	$0	$0
2002-03	$259.3 million	<$449.6 million>	<$190.3 million>
2003-04	$1.15 billion	<$1.21 billion>	<$67.0 million>

7. **Budget amendment necessary:** No.

8. **Fiscal implications:**

Administrative Costs

Because this bill is contingent upon the passage of a constitutional amendment in November of 2002, there would be no administrative costs directly related to the passage of this bill.

For the purposes of the administrative cost discussion below, it is assumed that all eligible localities would enact the local income tax if this bill is enacted and a Constitutional amendment is ratified.

While this bill does have costs associated with systems development, these cannot be ascertained at this time. The cost for implementing a **single** piece of legislation cannot be calculated precisely due to economies of scale. The actual cost to implement **all** legislation enacted during a given session will more than likely be less than the sum of the costs attributed to individual bills. Further, the ability to accurately predict costs is complicated because the department is replacing its current database system. As a result, legislative changes may need to be made to both the current and the future system, depending on the effective date. Therefore, the department is not providing specific systems costs for this bill, but will calculate the total for all tax bills once they have been acted upon favorably in both houses and prior to the conference committee report. The department would incur costs of $709,050 to implement this bill in Fiscal Year 2003, and ongoing costs of $544,400 in Fiscal Year 2004 and thereafter for revisions to forms and withholding tables, additional processing, and new equipment for the creation of 3 full time positions.

This bill, if the Constitutional amendment is passed, would relieve the Department of Motor Vehicles ("DMV") and the Auditor of Public Accounts from administrative responsibilities of tracking local reimbursements associated with the Personal Property Relief Act of 1998. However, in the first year, it is estimated that the DMV would incur administrative costs of $18,900 for systems changes.

This bill would also create administrative relief and a reduction in responsibility for local commissioners of the revenue and treasurers in assessment, billing and collections responsibilities associated with both the tangible personal property tax on nonbusiness motor vehicles and the Personal Property Relief Act of 1998.

Revenue Estimate

This bill would reduce General Fund revenue by an estimated $570.7 million for Fiscal Year 2003 and $1.21 billion for Fiscal Year 2004. Revenues generated from the local income tax would be deposited into the General Fund and transferred monthly to a special fund called the Collections of Local Income Taxes (the "Fund"). Because distributions would be made from the Fund at the end of each calendar quarter, a lag would occur between the time deposits are made to the Fund and distributions are made to localities. As a result the Fund would experience net revenue increase of an estimated $311.4 million for Fiscal Year 2003 and $61.0 million for Fiscal Year 2004.

It is estimated that the elimination of the personal property tax on nonbusiness motor vehicles would reduce local revenues by an estimated $449.6 million for Fiscal Year 2003 and $1.22 billion for Fiscal Year 2004. Because of the lag time explained above, the net effect on local revenues would be an estimated decrease of $190.3 million for Fiscal Year 2003 and $67.0 million for Fiscal Year 2003. Also, because income tax revenues would not be distributed to localities in proportion to lost revenues, many localities tax bases would change either positively or negatively as a result of this bill.

9. Specific agency or political subdivisions affected:

State Comptroller
Localities
Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Background

Personal Property Tax on Motor Vehicles

The Personal Property Relief Act (the "Act") calls for a five-year phase out of the tax based on local tax rates in effect on August 1, 1997. Under the Act, the tax on the first $20,000 of value of personal passenger cars, motorcycles, and pickup or panel trucks under 7,501 pounds is scheduled to be eliminated in 2002. The phase out involves the Commonwealth's reimbursement to localities for the local revenues forgone under the phase out.

Local Income Tax

Legislation enacted during the 1989 Generally Assembly session authorized certain cities and counties to impose a local income tax on individual residents of the localities and corporations, estates, and trusts with income from sources within the localities. Under current law, the city or county must hold a referendum and, upon voter approval, pass an ordinance to impose the tax. The 1989 legislation permits the levy of an income tax on individuals, estates, trusts and corporations at any increment of ¼% up to a maximum rate of 1% above the state income tax rate. Counties and cities can levy an income tax for a period of not more than five years, and any revenue from the tax must be expended for transportation purposes.

No city or county currently imposes the local income tax.

Proposed Changes

Income Tax

This bill would reduce the state individual income tax rates by approximately 13.75% and authorize all localities, at their option, to impose a local income tax at rates equivalent to the reduction in the state income tax. The following table shows how the tax rates would change from current statutes.

Individual Income Tax Rates Income Brackets	Current State Rates	Proposed State Rates	Proposed Local Rates
Less than $3,000	2%	1.7%	0.3%
$3,000 to $5,000	3%	2.6%	0.4%
$5,000 to $17,000	5%	4.3%	0.7%
More than $17,000	5.75%	5.0%	0.75%

Under this bill, local income tax revenue would be distributed to localities on a quarterly basis according to the residency claimed by individuals on their tax returns. However, returns would not be available until after the end of the taxable year. As such, the department would have to use a formula to make quarterly distributions and reconcile annual revenues once all individual income tax returns for a taxable year are filed.

In order for this bill to become effective, a Constitutional amendment would have to be ratified by voters exempting motor vehicles used for nonbusiness purposes from taxation in the November 2002 election. If such a Constitutional amendment were to pass, all localities would be given the authority to impose the local income tax. In order to avoid the loss of revenues for Fiscal Year 2003, localities would have to pass an ordinance to impose a local income tax on or before December 31, 2002, in order to replace lost personal property tax revenues.

Personal Property Tax

Subject to the passing of a constitutional amendment, this bill would also exempt all nonbusiness motor vehicles from the local personal property tax and, as a result, repeal the Personal Property Relief Act of 1998. The local income tax could be utilized as replacement revenue stream for localities to offset revenue losses from the exemption of motor vehicles used for nonbusiness purposes from the personal property tax.

Other Legislation

House Joint Resolution 609 and **House Joint Resolution 811** propose a Constitutional amendment that would exempt motor vehicles used for nonbusiness purposes from personal property taxation.

House Bill 1994 would increase the corporate income tax rate and the individual income tax rates in each tax bracket by 1%. The additional income tax revenues would be distributed to localities based on the residence of each individual taxpayer (individual income tax) and each locality's share of total full-time employees (corporate income tax). The maximum tax rate localities could levy on any personal property would be reduced to $0.01 per $100 of assessed value.

House Bill 2017, House Bill 2446, Senate Bill 1165, and **Senate Bill 1218** would establish the Localities' Share of Individual Income Tax Revenue Fund. A portion of individual income tax revenues would be deposited into this fund for distribution to localities. The first deposit would be made by September 1, 2003, based on 2% of individual income tax collections for FY 2002. The percentage of individual income taxes deposited into this fund would increase 2% each year until it reaches 10% in 2007. Distributions to counties would be shared with towns located within the counties based on the towns' relative share of total population within the county.

House Bill 2249 would establish the Localities' Portion of State Tax Revenues Fund. 1% of individual income tax revenues would be deposited into this fund for distribution to localities. Distributions to localities would be based on each individual income taxpayer’s residence. Distributions to localities would be made each September 1 of the year following the taxable year.

House Bill 2867 is essentially the same as this bill with different language.

Senate Bill 1083 would increase in the retail sales and use tax and repeal the local tax on tangible personal property for certain motor vehicles and boats only if voters ratify a constitutional amendment exempting such motor vehicles and boats.

cc: Secretary of Finance

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