DEPARTMENT OF TAXATION
2001 Fiscal Impact Statement

1. **Patron** Colgan

2. **Bill Number** SB 1083

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

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

3. **Committee** Senate Finance

4. **Title** Retail Sales and Use Tax and Tangible Personal Property Tax: Increase Sales Tax by 1.5%; Repeal Personal Property Relief Act of 1998; Exempt Motor Vehicles and Boats from the Tangible Personal Property Tax

5. **Summary/Purpose:**

This bill would:

- Repeal the Personal Property Tax Relief Act of 1998 (PPTRA);
- Provide an exemption from the local tangible personal property tax for motor vehicles and boats;
- Increase the state sales and use tax by 1.5% from 3.5% to 5.0%. This would increase the combined state and local sales and use tax rate from 4.5% to 6%;
- Distribute the revenue generated by the sales tax increase to the localities on a formulary basis. This would replace the current funding mechanism provided under the PPTRA; and
- Create a reserve fund on the books of the Comptroller to be used for the state distributions to the localities.

The provisions of this bill would become effective provided a constitutional amendment exempting the motor vehicles and boats is ratified in November 2002.

The sales and use tax increase and the exemption for motor vehicles and boats would become effective on January 1, 2003.

6. Fiscal Impact Estimates are: Tentative. (See Line 8).

6a. Expenditure Impact:

Fiscal Year	***Dollars***	***Fund***
2002-03	$86,300	GF
2002-03	$31,900	NGF
2003-04	$3,700	GF

*** These amounts do not include systems costs (See Line 8).**

6b. Revenue Impact: (See Line 8).

FISCAL IMPACT - LOCALITIES

Fiscal Year	**Sales & Use Tax Increase** (millions)	**Local TPP Revenue Loss** (millions)	**Transfers to Localities** (millions)	**Net Local Revenue Impact** (millions)
2003	$ 668.6	$ 614.1	$1,009.6	$ 395.5
2004	1,387.7	1,871.1	2,263.7	392.6
2005	1,463.7	2,015.0	2,575.7	560.7
2006	1,541.5	2,170.0	2,713.5	543.5

FISCAL IMPACT - STATE

Fiscal Year	**Sales & Use Tax Increase** (millions)	**Mandated Transfers to Localities** (millions)	**Cessation of Locality Transfer Under PPTRA** (millions)	**Net State Revenue and Transfer Effect** (millions)
2003	$ 668.6	$1,009.6	$ 436.0	$ 95.1
2004	1,387.7	2,263.7	1,178.8	302.8
2005	1,463.7	2,575.7	1,220.5	108.4

2006	1,541.5	2,713.5	1,261.1	89.1

7. Budget amendment necessary: No.

8. Fiscal implications:

Administrative

The Department of Taxation (TAX) would incur administrative costs of $86,300 in fiscal year 2003 and continuing costs of $3,700 in fiscal year 2004 and beyond for personnel, forms development, printing, and postage charges to notify and educate taxpayers regarding the sales tax increase.

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 TAX 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, TAX 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.

This bill would relieve the Department of Motor Vehicles (DMV) and the Auditor of Public Accounts from the administrative responsibilities of tracking local reimbursements associated with the PPTRA. DMV would incur costs of $31,900 in fiscal year 2004 for systems changes to implement the tangible personal property provisions of this bill.

Revenue

The bill provides that the tangible personal property tax exemption for motor vehicles and boats and the sales tax increase provisions are effective January 1, 2003. Therefore, the revenue estimates for fiscal year 2003 represent the period January through June 2003. The estimates for fiscal year 2004 represent a full year period.

Sales and Use Tax

It is estimated that the sales tax increase provided in this bill would generate additional revenues of $668.6 million in fiscal year 2003 and $1,387.7 million in fiscal year 2004.

The bill provides that revenues generated by the tax increase would be distributed to the localities in monthly payments based on a calendar year

formula. In developing the estimates, sales tax revenue forecast data provided on a fiscal year basis was converted in order to develop the estimates on a calendar year basis.

Local Tangible Personal Property Tax

The elimination of the local tangible personal property tax from motor vehicles and boats, including non-qualifying motor vehicles under the PPTRA, would have a negative impact on local revenues. The percentage of local personal property tax assessments attributable to motor vehicles and boats is unknown. Using survey data from 1995 on localities, it is assumed that motor vehicles and boats account for an average of 85% of local tangible personal property revenue for all localities. Assuming growth, it is estimated that the negative impact on local revenues would be $614.1 million in fiscal year 2003 and $1,871.1 million in fiscal year 2004.

State Distributions to the Localities

Revenues from the local tangible personal property on motor vehicles and boats are not lost to the localities, as the bill requires that the state appropriate and transfer to the localities funding on a formulary basis. Using revenues generated from the sales tax increase, the state would transfer to the localities estimated appropriations of $1,009.6 million in fiscal year 2003 and $2,263.7 million in fiscal year 2004. As a result, the localities would realize a net gain of $395.5 million in fiscal year 2003 and $392.6 million in fiscal year 2004. The transfer amounts are estimated consistent with the intent of the bill and the proposed amendment in the nature of a substitute.

Net Revenue Gain to the State

It is estimated that the state would realize a net gain after all transfers and appropriations to the localities of $95.1 million in fiscal year 2003 and $302.8 million in fiscal year 2004. This net revenue gain to the state results from the increase in sales tax revenues and the savings in transfers required under the PPTRA.

Other Issues

The bill implies that the revenues generated from the sales tax increase would be designated as restricted GF monies. The bill designates these monies for distribution to the localities. However, the appropriations to the localities exceed the increase in the sales tax revenues. Therefore, unrestricted GF monies would be included in the distributions to the localities.

The cessation of the reimbursements to the localities under the PPTRA represent a savings to the state. The bill does not speak to the designation of the monies saved and it is assumed that such monies would be retained in the GF for unrestricted use. The creation of the Tangible Personal Property Reimbursement Fund under this bill provides a depository for the funding to the localities, but does not address the above issues.

9. Specific agency or political subdivisions affected:

Department of Taxation
Department of Motor Vehicles
Department of Accounts
Auditor of Public Accounts
All Virginia Localities

10. Technical amendment necessary: No.

It is the department's understanding that an amendment in the nature of a substitute to clarify the bill will be offered. The fiscal impacts on localities and the state are based on the provisions of the substitute.

11. Other comments:

Constitutional Amendment

This bill would take effect provided that a constitutional amendment exempting motor vehicles and boats is ratified by a majority of voters voting on such measure in November 2002. The constitutional amendment for this bill is provided in Senate Joint Resolution No. 418.

Sales and Use Tax

The Virginia Retail Sales and Use Tax is currently imposed at a combined rate of 4.5% (state: 3.5%: local: 1.0%). This bill would increase the state portion of the tax by 1.5% to 5%, for a combined (state and local) tax rate of 6%. This increase would be the first increase in the sales and use tax rate since a one-half percent increase enacted by the 1986 Special Session of the General Assembly. The revenues generated by the 1986 one-half percent increase are dedicated to the Transportation Trust Fund.

Under the provisions of this bill, the revenues generated by the 1.5% increase in the sales tax rate would be distributed to the localities to replace the current reimbursement to the localities under the PPTRA.

Of the 46 states which impose a sales and use tax (including the District of Columbia), Virginia's combined rate of 4.5% is the second lowest in the country. Virginia's rate is currently lower than all bordering jurisdictions. A 6% rate would equal that charged in Kentucky, North Carolina, Tennessee, and West Virginia and would exceed the sales and use tax rates charged in the District of Columbia (5.75%) and Maryland (5%).

Local Tangible Personal Property Tax

Generally

Virginia localities have administered a tangible personal property tax since 1926. Currently, localities may exempt household goods and personal effects from the tangible personal property tax. Localities may also exempt tangible farm property and products from the tangible personal property tax or tax such property at rates lower than rates applicable generally to tangible personal property. The General Assembly has also enacted legislation establishing separate classifications of tangible personal property tax (automobiles, trucks, and other property) to give localities the option of taxing such classified property at rates lower than rates applicable generally to tangible personal property.

Currently, localities tax tangible personal property by adopting different tax rates for tangible personal property classifications and multiplying such rates by the fair market value of the tangible personal property so classified. Localities are not limited in the amount of revenue that can be generated from levying the tangible personal property tax.

The tangible personal property tax provides approximately 15% of a locality's revenue. Comparative Report of Local Government Revenues and Expenditures, June 30, 1999. It is the second largest revenue source for localities, with local real estate taxes being the largest source.

Exemption for Motor Vehicles and Boats

While the bill does not define the term "boats" for purposes of the exemption, all motor vehicles, as defined in Code of Virginia § 46.2-100, would be exempt from the tangible personal property tax. Under this code section, "motor vehicle" is defined to mean:

> *"Every vehicle as defined in this section which is self-propelled or designed for self-propulsion except as otherwise provided in this title*.
> *Any structure designed, used, or maintained primarily to be loaded on or affixed to a motor vehicle to provide a mobile dwelling, sleeping place, office, or commercial space shall be considered a part of a motor vehicle.*

> *For purposes of this title, any device herein defined as a bicycle or a moped shall be deemed not to be a motor vehicle."*

The exemption would apply regardless of whether the qualifying motor vehicles and boats are for personal or business use.

Personal Property Relief Act of 1998

The PPTRA provides a five-year phase-out of the tangible personal property tax based on local tax rates in effect on August 1, 1997. Under the PPTRA, 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 completely phased-out in calendar year 2002. Under the PPTRA, the Commonwealth reimburses the localities for the revenues forgone under the phase-out of the tax. In 2001, the Commonwealth is scheduled to reimburse the localities for 70 percent of the tax on the first $20,000 of value for qualified vehicles.

This bill would repeal the PPTRA and deletes language throughout the Code of Virginia that references the tangible personal property tax on motor vehicles and boats.

Impact on the Localities

This bill may ease the administrative burden of the local Commissioners of Revenue and Treasurers, as they may no longer be responsible for assessing and collecting the tangible personal property tax on motor vehicles and boats. In addition, the local Commissioners of Revenue and Treasurers would no longer be responsible for tracking the assessment, billing, and collection of the reimbursements provided under the PPTRA.

Proposed Funding to the Localities

The bill provides a formula for computing the distributions to the localities by the state. Each locality will have a base funding amount equal to: (1) for a county, 15% of its certified total local tax revenues collected in fiscal year 1997; (2) for a city, 11% of its total local tax revenues collected in fiscal year 1997; and (3) for a town, 5% of its total local tax revenues collected in fiscal year 1997. The base year amounts would be used for purposes of determining the initial funding amounts to counties, cities, and towns in calendar year 2003. The total local tax revenues are assumed to include the local option sales tax revenues and revenue remitted directly to the localities by the taxpayers.

The bill provides that each locality's base amount would be increased annually by the percentage growth increase of the certified sales and use tax revenues for the fiscal year ending during the calendar year for which the funding would be provided. Certified sales and use tax revenues are defined to mean the amount of sales and use tax revenues collected for the fiscal year pursuant to Code of Virginia § 58.1-600 et seq., but excluding local option sales and use tax revenues.
This bill requires that the state commence distributing funds to the localities beginning in calendar year 2003. The funding would be made in monthly increments for twelve-month periods on a calendar year basis.

Tangible Personal Property Reimbursement Fund

This bill would create a reserve fund on the books of the Comptroller to be used for payment of the funding amounts to the localities as provided in this bill. Moneys in the fund shall be used exclusively for making payments to the localities.

Food Tax Reduction Program

The safeguards that applied to the PPTRA have been deleted from the Food Tax Reduction Program. Future scheduled rate reductions would not be conditioned upon the next level of the PPTRA taking effect. The remaining safeguard in the Food Tax Reduction Program would be the revenue growth requirement, *i.e.*, actual GF revenues for the fiscal year preceding a fiscal year in which a rate reduction is contemplated must exceed the official revenue estimates for that preceding fiscal year by at least 1 percent.

Similar Legislation

Senate Joint Resolution 418 provides the constitutional amendment that would exempt motor vehicles and boats from the tangible personal property tax.

House Joint Resolution 609 and House Joint Resolution 811 provide the constitutional amendment that would exempt motor vehicles used for non-business purposes from the tangible personal property tax.

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 the 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.

cc: Secretary of Finance

Date: 1/26/01/VHM,SLR
Document: S:\2001leg\WorkInProcess\OTPwork\Senate Bills\SB1083F161.DOC