DEPARTMENT OF TAXATION
2002 Fiscal Impact Statement

1. Patron Parrish

2. Bill Number HB 1238

House of Origin:
X Introduced
_____ Substitute
_____ Engrossed

3. Committee House Finance

4. Title Income and Personal Property Taxes: Imposition and Administration

Second House:
_____ In Committee
_____ Substitute
_____ Enrolled

5. Summary/Purpose:

This bill 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). This bill would also limit the tax rate localities could levy on personal property at $0.01 per $100 of assessed value.

This bill would be effective for taxable years beginning on or after January 1, 2003.

6. Fiscal Impact Estimates are:

6a. Expenditure Impact:

Fiscal Year	***Dollars***	***Positions***	***Fund***
2001-02	$0	0	GF
2002-03	$125,750	0	GF
2003-04	$1,412,251	9	GF

6b. Revenue Impact:

State Revenues

Fiscal Year	***General Fund***	***Special Fund***
2001-02	$0	$0
2002-03	$0	$418.4 million
2003-04	$0	$142.6 million
2004-05	$0	$13.8 million

Local Revenues

Fiscal Year	***Distribution from Special Fund***	***Tangible Personal Property Tax***	***Net***
2001-02	$0	$0	$0
2002-03	$363.5 million	<$760.9 million>	<$397.4 million>
2003-04	$1.52 billion	<$2.32 billion>	<$801.5 million>
2004-05	$1.66 billion	<$2.51 billion>	<$851.3 million>

7. **Budget amendment necessary:** Yes.
Items: Page 1, Revenue Estimates
283 and 285, Department of Taxation

8. **Fiscal implications:**

Administrative Costs

The department would be reimbursed for any direct costs associated with the administration of this bill from the additional income tax revenues.

There are costs associated with modifying the system to implement this legislation. TAX is currently in the process of replacing its automated systems as part of a partnership with AMS. As a result, TAX will be maintaining two systems – the current STARS system and the new IRMS system – for a period of time as a contingency. The contract with AMS generally provides for the costs of implementing routine legislation. However, changes attributable to major legislation are not within the scope of the contract.

Because the scope of this legislation is significant, systems changes will not be paid through the AMS contract. If the suggested amendments are adopted, the department would incur systems development of $547,351 FY 2004. In addition, the department would incur costs of $125,750 in FY 2003, $864,900 in FY 2004, and $803,900 in FY 2005 and all fiscal years thereafter for processing costs, forms development, and for nine additional customer services positions. All of these administrative costs total $125,750 in FY 2003, $1,412,251 in FY 2004, and $803,900 in FY 2005 and fiscal years thereafter.

Revenue Estimate

While this bill would not effect General Fund revenue, the additional income tax revenue generated as a result of this bill would be deposited into the General Fund and transferred monthly to a special fund called the Collections of Local Income Tax Revenues (the "Fund"). Revenues deposited into the Fund would be designated for distribution to localities to replace revenue lost from the reduction in tangible personal property tax rates. 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 increases of an estimated $418.4 million for Fiscal Year 2003, $142.6 million for Fiscal Year 2004, and $13.8 million for Fiscal Year 2004.

It is estimated that the reduction in the rate at which localities could impose the tangible personal property tax would reduce local revenues by an estimated $760.9 million in lost personal property tax revenues for Fiscal Year 2003, $2.32 billion for Fiscal Year 2004, and $2.5 billion for Fiscal Year 2005. Because of the lag time explained above, the net effect on local revenues would be an estimated decrease of $397.4 million for Fiscal Year 2003, $801.5 million for Fiscal Year 2004, and $851.3 million for Fiscal Year 2005. Also, because income tax revenues would not be distributed to localities in proportion to lost revenues, some localities will experience net revenue losses and some net revenue increases regardless of the net effect for all localities.

9. Specific agency or political subdivisions affected:

State Comptroller
Localities
Department of Taxation

10. Technical amendment necessary: Yes.

The department believes that the intent of this legislation is to effectively repeal the local personal property tax along with the reimbursements under the Personal Property Relief Act of 1998 and replace them with the additional revenues from the income tax increases under this bill. If this assumption is correct, then an amendment striking § 58.1-320.1(E) in this bill would be necessary. In addition, it would be necessary to repeal Chapter 35.1 (§§ 58.1-3523 through 58.1-3536) of Title 58.1, §§ 15.2-1636.20 and 58.1-3916.01 of the Code of Virginia as well as references to the Personal Property Tax Relief Act of 1998 in §§ 3.1-1111, 30-133, 46.2-623, 58.1-611.1 and 58.1-3912 of the Code of Virginia. In order to make this amendment, an amendment in the nature of a substitute would be necessary.

In order to correct a reference, the following technical amendment is suggested:

Page 1, Line 47, After: enacted by the
Strike: 2001
Insert: 2002

In order for the department to administer the distributions to localities proposed in this bill (see discussion on line 11 below), the following amendments are suggested:

Page 1, Line 48, After: based on
Strike: on each taxpayer's residence
Insert: the relative share of the total individual income tax paid by taxpayers filing returns in each locality

Page 1, Line 49, After: § 58.1-320.1.
Strike: For purposes of this article, an individual shall be deemed to be a resident of any county or city in which the individual is domiciled at any time during the taxable year or has maintained his place of abode for an aggregate of more than 183 days of the taxable year.

Page 2, Line 88, After: based on
Strike: each locality's share of total full-time employees, as determined by the Tax Commissioner.
Insert: where wages are earned. The amount of each locality's relative share of the total statewide wages earned according to the most recent Bureau of Labor Statistics ES202 data obtained from the Virginia Employment Commission annually shall be used to calculate this part of the formula.

11. Other comments:

This bill would effectively eliminate the tangible personal property tax by capping the rate that localities may impose at 1 cent per $100 of assessed value. In order to replace the lost local revenue, this bill would increase the corporate income tax rate by 1% (from 6% to 7%), and increase the rates for each of the individual income tax brackets by 1%. The following table shows how the individual income tax rates would change as a result this bill.

Individual Income Tax Rates

Income Brackets	Current Rates	Proposed Rates
Less than $3,000	2%	3%
$3,000 to $5,000	3%	4%
$5,000 to $17,000	5%	6%
More than $17,000	5.75%	6.75%

The added individual and corporate income tax revenue would be earmarked for distribution to localities. Distribution would take place in the first month after the end of each calendar quarter. Additional individual income tax revenue would be distributed to each locality to the extent generated by residents of that locality. Additional corporate income tax revenue would be distributed to localities according to their share of the state's full-time workforce.

Proposed Amendments

Residency: The additional individual income tax revenue would be distributed based residency of individual taxpayers. For the purposes of this bill, an individual would be considered to be a resident of any county or city in which that individual is domiciled at any time during the taxable year or has maintained his place of abode for an aggregate of more than 183 days of the taxable year. It would be extremely difficult to verify the residency of an individual who moves from a locality to another during a taxable year or even after a taxable year but before the filing deadline. As such, the department has recommended amendments that would allow for the distribution of the additional individual income tax based on residency information provided on individual income taxpayers' returns for the taxable year being distributed. The department already captures this data.

Employment: The additional corporate income tax revenue would be distributed based on each locality's "share of total full-time employees." The Department of Taxation does not currently maintain employment data by locality. Such data is collected by the Virginia Employment Commission ("VEC") is based on wage reports submitted by employers. As such, the department has recommended an amendment that would allow for the distribution of the additional corporate income tax based on VEC wage reports. Employers that operate in more than one location are allowed to report all of their wages in the locality in which their operations are based. As a result, this data would include wages reported in one locality, but actually earned in another.

Other Legislation

House Bill 575, House Bill 961, and **Senate Bill 380** 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 699 would distribute to each county or city the greater of (i) the county or city's share of fifteen percent of the individual income tax revenues for the prior fiscal year or (ii) the indexed revenue the county or city received in 2004 from the tangible personal property tax on nonbusiness use motor vehicles.

House Bill 770 would amend the local option income tax to allow any county or city to impose the tax at a rate of either one-half or one percent with the adoption of an ordinance.

House Bill 1018 would require eligible Northern Virginia localities that enact a local income tax to use the proceeds from the tax for transportation projects approved by the Transportation Coordinating Council of Northern Virginia in December 1999.

Senate Bill 37 would allow cities to impose an income tax on individuals and estates or trusts in increments of one-quarter percent up to one percent on the Virginia taxable income of the individual or estate or trust.

cc: Secretary of Finance

Date: 1/29/02/CT
Document: S:\2002leg\WorkInProcess\OTPwork\House Bills\HB1238F161.doc