DEPARTMENT OF TAXATION
2002 Fiscal Impact Statement

1. Patron Colgan

2. Bill Number SB 173

House of Origin:
X Introduced
_____ Substitute
_____ Engrossed

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

Second House:
_____ In Committee
_____ Substitute
_____ Enrolled

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 motor vehicles and boats is ratified in November 2004.

The sales and use tax increase and the exemption for motor vehicles and boats would become effective on January 1, 2005.

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

6a. **Expenditure Impact:**

Fiscal Year	***Dollars***	***Fund***
2004-05	$199,500	GF
2004-05	$20,000	NGF

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)
2005	$ 658.5	$ 645.7	$1,023.0	$ 377.3
2006	1,397.9	1,925.9	2,279.9	353.9
2007	1,460.9	2,012.7	2,577.7	565.0

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)
2005	$ 658.5	$1,023.0	$1,265.5	$ 901.0
2006	1,397.9	2,279.9	1,329.0	447.0
2007	1,460.9	2,577.7	1,382.2	265.3

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

8. **Fiscal implications:**

Administrative

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, system changes will not be paid through the AMS contract. TAX would incur $85,500 in fiscal year 2005 in costs for system changes and other administrative costs of $114,000 for personnel costs, forms development, printing and postage.

This bill would relieve DMV from the administrative responsibilities of tracking local reimbursements associated with the PPTRA. Programming costs to dismantle the PPTRA at DMV are estimated to be $20,000 in fiscal year 2005. Currently, personal property tax information is pulled from nightly automated system runs. Programming changes would be required to back out the PPTRA data from these runs.

Currently, localities receive estimates from DMV regarding the reimbursement they should receive under the PPTRA. If these programming changes were made under the provisions of this bill, DMV would no longer be able to provide this forecast information to localities.

Revenue

The bill provides that the tangible personal property tax exemption for motor vehicles and boats and the sales tax increase provisions would become effective January 1, 2005. Therefore, the revenue estimates for fiscal year 2005 represent the period January through June 2005. The estimates for fiscal year 2006 represent a full year period.

Sales and Use Tax

It is estimated that the sales and use tax increase provided in this bill would generate additional revenues of $658.5 million in fiscal year 2005 and $1,397.9 million in fiscal year 2006. 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 $645.7 million in fiscal year 2005 and $1,925.9 million in fiscal year 2006.

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 $1,023 million in fiscal year 2005 and $2,279.9 million in fiscal year 2006. As a result, the localities would realize a net gain of $377.3 million in fiscal year 2005 and $353.9 million in fiscal year 2006. 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 $901 million in fiscal year 2005 and $447 million in fiscal year 2006. 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 and use 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 and use 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 2004. The constitutional amendment for this bill is provided in Senate Joint Resolution No 51.

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 and use tax rate would be distributed to the localities to replace the current reimbursement to the localities under the PPTRA.

Of the 46 states (including the District of Columbia) which impose a sales and use tax, 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, 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 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 this year. Under the PPTRA, the Commonwealth reimburses the localities for the revenues forgone under the phase-out of the tax. Currently, the Commonwealth reimburses 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 2005. The total local tax revenues are assumed to include the local option sales and use 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 2005. 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 51 provides the constitutional amendment that would exempt motor vehicles and boats from the tangible personal property tax.

House Joint Resolution 117 and House Joint Resolution 126 provide the constitutional amendment that would exempt motor vehicles used for non-business purposes from the tangible personal property tax.

cc: Secretary of Finance

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