Commission on Local Government

Estimate of Local Fiscal Impact

2002 General Assembly Session

Bill: **<u>SB 173</u>** **Patron:** **<u>Sen. Colgan</u>** **Date:** **<u>February 14, 2002</u>**

In accordance with the provisions of §§ 30–19.03 through 30–19.03:1.1 of the Code of Virginia, the staff of the Commission on Local Government offers the following analysis of the above-referenced bill:

I. Bill Summary

SB 173 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%, raising the combined State and local sales and use tax rate from 4.5% to 6%; distribute revenues generated by the sales tax increase to localities on the basis of a specified formula rather than the existing funding mechanism; and create a reserve fund to be used for State distributions to localities. For this bill to take effect, a constitutional amendment exempting motor vehicles and boats from local tangible personal property taxation would be required in November 2004. The sales and use tax increase and the exemption for motor vehicles and boats would then become effective on January 1, 2005.

II. Fiscal Impact Analysis

The tangible personal property tax provides approximately 15% of localities' revenue and is the second largest revenue source for localities after local real property taxes. The motor vehicles and boats classifications constitute the largest of portion of taxable personal property, approximately 85%. Under current law, the Personal Property Tax Relief Act of 1998 (PPTRA) provides for a five-year phase-out of that tax based on local tax rates in effect in 1997. As part of this plan, the tax on the first $20,000 of value of personal passenger cars, motorcycles, and certain pick-up or panel trucks will have been completely phased out in calendar year 2002, and the Commonwealth is scheduled to reimburse localities for foregone revenues. Currently, the Commonwealth reimburses localities for 70% of the tax on the first $20,000 of value for qualified vehicles.

The Virginia Retail Sales and Use Tax is currently imposed at a combined rate of 4.5%, of which the State's portion is 3.5% and the local share is 1%. This bill would increase the State portion of the tax by 1.5% to 5%, for a combined rate of 6%. Revenues generated by this increase would be distributed to localities in lieu of the current reimbursement mechanism under the PPTRA.

In general, the SB 173 formula provides for annual reimbursement to localities based on an amount equal to the total funded to the locality in the preceding calendar year plus a percentage of any increase in the certified sales and use tax revenue over the preceding fiscal year calculated at a rate of (1) 15% for a county; (2) 11% for a city; and (3) 5% for a town. Calendar year 1997 is the base year for computing the initial funding amount. Certified sales and use tax revenues do not include local option sales and use tax revenues. The bill is silent with respect to the distribution of losses from any decrease in sales and use tax revenue.

The Department of Taxation (DTAX) estimates that SB 173 will increase both State and local revenues and views the bill as a revenue-sharing program. Specifically, DTAX expects revenues from the increased State sales tax and transfer to localities, as well as savings realized from the elimination of local responsibilities under the PPTRA, to more than offset the amount of funds localities will lose through the elimination of the personal property tax on motor vehicles and boats under SB 173. DTAX predicts that the State's transfer of funds to localities will total approximately $1,023.0 million in FY 2005 and $2,279.9 million in FY 2006, and $2,577.7 million in FY 2007, resulting in a net gain for localities overall of $377.3 million in FY 2005, $353.9 million in FY 2006, and $565.0 million in FY 2007.

The Commission on Local Government did not receive any local fiscal impact estimates for SB 173. However, its impact for localities will depend on how effectively the new sales and use tax formula that SB 173 calls for replaces revenues currently derived from the personal property tax. Due to the wide range of tax rates, license fees, permit fees, charges for services, and interest income from one locality to another that are included in the base year, it seems reasonable to conclude that the bill is likely to affect each locality differently. Local estimates for similar legislation proposed in 2001 indicated that the impact for some localities could be significant (City of Chesapeake, $19,187,000; City of Waynesboro, $580,000; Frederick County, $6,661,443 total first-year revenue loss). In addition, localities whose retail bases are not growing are likely to find that increases in the personal property tax outdistance growth in the sales and use tax. It is also worth noting that sales and use tax revenues would probably be more susceptible than the personal property tax collections to an economic downturn, since sales would decrease immediately whereas property would be less likely to lose its value rapidly.

III. Conclusion

SB 173 is expected to affect localities differentially resulting in net revenue increases for some localities but net reductions of revenue for others, some of which may be significant.