

DEPARTMENT OF TAXATION

2002 Fiscal Impact Statement

1. **Patron** Miller, Y.B.

3. **Committee** Senate Finance

4. **Title** Local Income Tax for Cities

2. **Bill Number** SB 37

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would allow cities to impose an income tax on individuals and estates or trusts. The tax would be levied in increments of one-quarter percent up to one percent on the Virginia taxable income of the individual or estate or trust. Each city may levy the tax upon adopting an ordinance authorizing such levy. Each city would only be allowed to impose such tax for a period of ten years. All revenues from such income tax would be used for education and transportation purposes.

The effective date of this bill is not specified.

6. **Fiscal Impact Estimates are:** Not available. (See Line 8.)

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

8. **Fiscal implications:**

Administrative Costs

There would be no administrative costs related to this bill unless a city imposes the local income tax authorized by this bill. If a city enacts the local income tax as a result of the passage of this bill, the department would be substantially impacted.

There would be 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. Therefore, the department would incur administrative costs for systems development of \$929,160 in FY 2003 and \$602,210 in FY 2004. In addition, the department would incur costs of \$675,990 in FY 2003 and \$641,740 in FY 2004 and all fiscal years thereafter for processing costs, forms development, and for three additional customer services positions. All of these administrative costs total \$1,605,150 in FY 2003, \$1,243,950 in FY 2004, and \$641,740 in FY 2005 and fiscal years thereafter.

It is assumed that the tax authorized by this bill would qualify as a local income tax under Item 281 of the Budget Bill. Under Item 281 of the Budget Bill, the department is permitted to borrow from the Transportation Trust Fund the necessary start-up costs associated with the implementation of the local income tax. Repayment of the start-up costs to the fund would come from revenues generated by the local income tax.

Revenue Impact

If all of the cities impose the local income tax authorized by this bill at the maximum rate, the combined revenues collected are estimated to be \$289.8 million based on 1999 return data.

9. Specific agency or political subdivisions affected:

Department of Taxation
All Virginia Cities

10. Technical amendment necessary: Yes.

If the intent of this bill is to tax all residents of a city and not just those who are residents of the city and have income from sources within such city, then the following technical amendment would be necessary:

Page 1, Line 20, At the beginning of the line
Strike: having income from sources within such city

11. Other comments:

Background

Local Income Tax

Legislation enacted during the 1989 General 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 $\frac{1}{4}\%$ 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 Legislation

This bill would allow cities to impose an income tax on individuals and estates or trusts. The tax would be levied in increments of one-quarter percent up to one percent on the Virginia taxable income of the individual or estate or trust. Each city may levy the tax upon adopting an ordinance authorizing such levy. A voter referendum would not be required for a city to impose the tax.

Each city would only be allowed to impose such tax for a period of ten years. All revenues from such income tax would be used for education and transportation purposes. Any city that would authorize an income tax under this bill would be prohibited from levying the local option income tax under current law. This tax would be administered by the Department of Taxation under the existing local option income tax provisions.

Other Legislation

House Bill 575, House Bill 961, and Senate Bill 380 would establish the Localities' Share of Individual Income Tax Revenue Fund (the "Fund"). A portion of individual income tax revenues would be deposited into the Fund for distribution to localities. The percentage of individual income taxes deposited into the Fund would increase 2% each year from 2% in 2003 until it reaches 10% in 2007.

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.

House Bill 1238 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.

cc : Secretary of Finance

Date: 01/29/02 CT

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