

**DEPARTMENT OF TAXATION
2003 Fiscal Impact Statement**

1. **Patron** Phillips (By Request)

2. **Bill Number** HB 2161

3. **Committee** Senate Finance

House of Origin:
 Introduced
 Substitute
 Engrossed

4. **Title** Claims Bill for Rocky McCowan,
Michael and Patricia Owens, Jimmy L. Lee,
Roger S. Farmer, and Robert A. Hicks

Second House:
 In Committee
 Substitute
 Enrolled

5. **Summary/Purpose:**

This bill would provide Rocky McCowan, Michael Owens, Steve Farmer, James Lee, and Robert Hicks (the "Taxpayers") with refunds for Virginia individual income taxes paid for the 1992 through 1996 taxable years that are otherwise barred by the statute of limitations.

The Department would be directed to review the amended income tax returns submitted by Rocky McCowan, Michael Owens, Steve Farmer, James Lee, and Robert Hicks for taxable years 1992 through 1996 notwithstanding the statute of limitations and provide the appropriate tax credit for income tax paid to another state.

The effective date of this bill is not specified.

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

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

8. **Fiscal implications:**

The Department would incur minimal administrative costs to implement this bill.

The credit for tax paid to another state is limited to (1) the tax actually paid to another state on non-Virginia source income or (2) an amount equivalent to the portion of the Virginia income tax liability attributable to the proportion of income taxable in such other state to Virginia taxable income. Assuming the suggested amendment eliminating interest on these refund claims is adopted, the General Fund revenue impact of this bill would be less than \$177,541 in Fiscal Year 2004.

If the amendment is not adopted, the revenue impact of this bill would be significantly higher. If the taxpayers received a full credit for taxes paid to Kentucky, it is estimated that the total interest added to these refund claims could exceed \$130,000.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

If it is the intent of this bill to limit the refunds resulting from this bill to the amount of the out of state tax credit, the following amendment is suggested:

Page 1, line 49 After: 58.1-332.

Insert: Any amount refunded by the Department of Taxation to Rocky McCowan, Michael Owens, Steve Farmer, James Lee, and Robert Hicks for taxable years 1992 through 1996 shall be without interest as provided by § 58.1-1833.

To insure that the claim for refunds authorized by this bill would not be left available for an indefinite period of time, the following amendment is requested.

Page 1, line 49 After: 58.1-332.

Insert: All amended tax returns shall be submitted to the Department of Taxation no later than October 1, 2003.

11. Other comments:

Statues of limitations are a set period in time in which an action must be started. Traditionally, such limitations are considered to promote fairness and efficiency in the administration of law.

Under Virginia law, an individual may file an amended return for claiming a refund within the later of: (1) three years from the due date or extended due date of such return; (2) one year from a final determination of a change in tax liability by the Internal Revenue Service; (3) two years from the date an amended return resulting in additional tax was filed (such an amended return may only address issues relating to the prior amended return); or (4) two years from the payment of an assessment (such an amended return may only address issues relating to the assessment). Based on the provisions in the bill, the Department does not have the authority to allow the out-of-state tax credit on any of the Taxpayers' returns for 1992 through 1996 taxable years.

According to the bill, the Taxpayers are Virginia residents who were shareholders in an S corporation that operated in Kentucky. The Taxpayers reported income from the S corporation on their Virginia individual income tax returns for the 1992 through 1996 taxable years. The bill indicates that, as a result of a tax audit, Kentucky issued individual income tax assessments against the Taxpayers in the following amounts:

Rocky	Michael	Steve	James	Robert
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	McCowan	Owens	Farmer	Lee	Hicks
1992				\$64,314.00	\$34,428.00
1993				\$23,560.00	\$14,560.00
1994	\$394.00	\$1,719.00		\$3,041.00	\$3,487.00
1995	\$5,753.00	\$4,865.00		\$5,852.00	\$8,168.00
1996	\$1,030.00	\$1,406.00	\$2,560.00	\$1,032.00	\$1,372.00
Total	\$7,177.00	\$7,990.00	\$2,560.00	\$97,799.00	\$62,015.00

Kentucky imposes a tax on the income of resident individuals, and the proportion of nonresident income reasonably attributable to property owned and business done in the state.

The Kentucky individual income tax is a graduated tax on net income. The net income of individuals is taxed at 2% from \$0 to \$3,000, 3% from \$3,000.01 to \$4,000, 4% from \$4,000.01 to \$5,000, 5% from \$5,000.01 to \$8,000, and 6% of net income exceeding \$8,000.

Virginia provides an income tax credit to Virginia residents for tax paid to another state on earned or business income subject to taxation in both states. The amount of the out-of-state tax credit is limited to the lesser of: (1) the tax actually paid to another state on non-Virginia source income; or (2) an amount equivalent to the portion of the Virginia income tax liability attributable to the proportion of income taxable in such other state to Virginia taxable income.

Because Kentucky's highest income tax bracket has a higher tax rate and lower threshold, a Virginia resident would most often be limited to an out-of-state tax credit that is less than the amount of income tax paid to Kentucky. As such, it is likely the actual amounts of credit available to the Taxpayers would be less than the amounts included in this bill.

This bill would direct the Department to review amended income tax returns submitted by Rocky McCowan, Michael Owens, Steve Farmer, James Lee, and Robert Hicks for taxable years 1992 through 1996 notwithstanding the statute of limitations and provide the appropriate tax credit for income tax paid to another state.

cc : Secretary of Finance