DEPARTMENT OF TAXATION
2004 Fiscal Impact Statement

1. Patron Clifford L. Athey, Jr.

2. Bill Number HB 811

House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

Second House:
_____ **In Committee**
_____ **Substitute**
_____ **Enrolled**

3. Committee House Finance

4. Title Flat 5.5% income tax and sales tax increase

5. Summary/Purpose:

This bill would provide a flat rate of 5.5 percent for both the individual and corporate income taxes. The sales and use tax rate would be increased to 5.5 percent. This bill would make a number of other changes to income and sales tax as follows:

- Increase the standard deduction for individual income tax purposes to $24,000 for couples and $12,000 for individuals.
- Replace the statutory sales tax bracket system with a directive for the Department of Taxation to promulgate a bracket system by regulation.
- Eliminate the requirement that large sales tax dealers make July payments in June.

The bill has a reenactment clause so it would be effective in 2006 if it passes during this session and is reenacted in 2005.

6. Fiscal Impact Estimates are: None. (See Line 8.)

7. Budget amendment necessary: No.

8. Fiscal implications:

Administrative Costs

The Department would not incur any administrative costs as a result of this bill. If this bill is reenacted in 2005, the Department would incur administrative costs of $11,667 in FY 2005, $532,450 in FY 2006, $550,663 in FY 2007, $135,648 in FY 2008, $121,692 in FY 2009, and $125,343 in FY 2010. These administrative costs would be for issuing sales tax regulations setting forth the bracket system for calculating sales tax, distributing new bracket sheets to all sales tax dealers, and distributing new withholding tables to all employers and the hiring of three full-time employees to respond to taxpayer questions and process returns with errors.

Revenue Impact

Enactment of this bill would have no impact on General Fund revenues as it must be reenacted during the 2005 session to become effective. If this bill is reenacted in 2005, it is estimated to decrease General Fund revenues by $237.4 million in FY 2006, and then increase it by $90.1 million in FY 2007 and $159.6 million in FY 2008.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary:

To ensure that the changes in the individual standard deduction are not deemed retroactive to 1989 (and to eliminate obsolete language), the following amendments are suggested:

Page 4, Line 201 after b.
Strike: all of lines 201 through 204
Insert: Five thousand dollars for married persons (one-half of such amount in the case of a married individual filing a separate return), and $3,000 for single individuals; and for taxable years beginning on and after January 1, 2006, $24,000 for married couples (one-half of such amount in the case of a married individual filing a separate return), and $12,000 for single individuals;

11. Other comments:

Income Tax Provisions

Current Law

Individuals are allowed a standard deduction of $3,000 for single individuals and $5,000 for married couples ($2,500 each if separate returns are filed). The tax rates are 2% on income not in excess of $3,000, 3% on income in excess of $3,000 but not in excess of $5,000, 5% on income in excess of $5,000 but not in excess of $17,000, and 5.75% on income in excess of $17,000. Individuals receive a standard deduction in the amount of $5,000 for married couples (one-half that amount to each spouse if separate returns are filed), and $3,000 for single individuals. Corporations are subject to a tax rate of 6% on all taxable income.

Proposal

This bill would eliminate the graduated income tax rates and impose a flat 5.5% income tax on all individuals. This is ¼ of 1% lower than the existing maximum individual income tax rate. The corporate income tax would be reduced from 6% to 5.5%. This bill would also increase the standard deduction to $12,000 for single individuals, and to $24,000 for married couples ($12,000 each if separate returns are filed).

Sales Tax Rate

Current Law

The state imposes a 3.5% tax on sales of tangible personal property. Localities impose another 1% sales tax that is collected by the Department and distributed to the localities. For sales of less than $5.00 the statute provides a table of the tax to be collected for various brackets of prices.

Proposal

This bill would increase the state sales tax rate 3.5% to 4.5% (the combined state and local tax rate would be 5.5%). A corresponding increase would be made to the rate imposed on vending machine sales. The bill would also eliminate the bracket tax collection tables from the statute and require the Tax Commissioner to promulgate regulations setting out the appropriate brackets.

Accelerated Sales Tax Payment

Current Law

Sales tax dealers with annualized sales of $1.3 million or more must accelerate the payment of tax normally due July 20 and pay it on or before June 25 (June 30 if made by electronic funds transfer).

Proposal

The requirement for sales tax dealers with annual gross receipts greater than $1.3 million accelerate their July sales tax payment to June each year would eliminated effective in 2006, after this bill is reenacted.

cc : Secretary of Finance

Date: 1/27/04 JPJ