# DEPARTMENT OF TAXATION
# 2004 Fiscal Impact Statement

1. **Patron** John H. Chichester

2. **Bill Number** SB 635

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

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

3. **Committee** House Finance

4. **Title** Omnibus Tax Bill

5. **Summary/Purpose:**

This bill would make numerous changes to the taxes and fees of the Commonwealth as follows:

Individual Income Tax

- The individual income tax brackets would be changed by adding new tax brackets of 6.25% for income between $100,000 and $150,000 and 6.5% for income above $150,000.
- The standard deduction for single taxpayers would be increased to $3,500 and to $7,000 for married couples.
- The personal and dependent exemption amount would be increased to $1,000.
- The filing threshold would be increased to $9,000 for married taxpayers filing jointly, $4,500 for married taxpayers filing separate returns, and $5,000 for single taxpayers.
- The age deduction would be reduced for taxpayers whose modified federal adjusted gross income exceeds $40,000 for single individuals and $64,000 for married taxpayers. The $6,000 age deduction would be eliminated for those born after December 31, 1941.
- A nonrefundable Virginia earned income tax credit for low-income taxpayers would be allowed equal to 20% of the federal earned income tax credit.
- A "two-earner" credit would be available to married taxpayers whose combined taxable income exceeds $100,000 in lieu of the existing adjustment for married couples.

Retail Sales & Use Tax

- The state sales tax rate would be increased from 3.5% to 4.5%.

- The state sales tax rate on food for human consumption would be reduced to 1%.

- A portion of the additional sales tax revenue would be dedicated as follows: $30 million to the new Virginia Natural and Historic Resources Fund for redistribution, $15 million to the Virginia Water Quality Improvement Fund and $15 million to the Virginia Land Conservation Fund.

- Sales tax dealers with annual sales of $1.3 million or more would no longer be required to make a prepayment of their June sales tax collections.

- The exemption for common carriers of property or passengers by motor vehicle would be repealed.

<u>Motor Vehicle Taxes</u>

- The sales tax on motor vehicles would be increased from 3 percent to 4.5 percent.

- The tax on daily rental motor vehicles would be increased from 4% to 6%, with the additional revenue dedicated to the General Fund.

- Motor vehicle registration fees would be increased by $10 annually.

- The gasoline tax would be increased by three cents per gallon.

- The tax on diesel fuel and alternative fuel would be increased by 4.5 cents per gallon.

- An additional 5.5 percent wholesale tax would be imposed on gasoline, gasohol, diesel fuel, blended fuel and alternative fuel.

- The revenues from these increases would be dedicated to the Transportation Trust Fund.

<u>Other Taxes, Fees, and Distributions</u>

- The following two corporate income tax provisions will be changed:

  - The effects of transactions with intangible holding companies would be eliminated from the Virginia corporate income tax computation.

  - A sales throwback rule would be used to eliminate the effect of nowhere income by ensuring that profits on goods shipped from Virginia are taxed in Virginia, unless they are taxed in another state.

- Pass-through entities doing business in Virginia would be required to file an annual informational return with the Department listing its income and owners.

- The Virginia estate tax would be eliminated on all estates of $10 million or less and on estates valued at greater than $10 million provided the majority of the value of the estate's assets are made up of a closely held business or working farm.

- This bill would repeal the requirement that one-third of the revenues from the state license tax on insurance companies be dedicated to the Priority Transportation Fund.

- The recordation tax would be increased from 15 cents to 30 cents per $100 and the revenues from the increase would be dedicated to the Revenue Stabilization Fund through June 30, 2006, and to the General Fund thereafter.

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

**6a. Expenditure Impact:**

| *Fiscal Year* | *Dollars* | *Positions* | *Fund* |
|---|---|---|---|
| 2003-04 | $1,375,281 | 0 | GF |
| 2004-05 | $2,516,833 | 4 | GF |
| 2005-06 | $1,432,254 | 7 | GF |
| 2006-07 | $711,603 | 7 | GF |
| 2007-08 | $684,703 | 7 | GF |
| 2008-09 | $687,003 | 7 | GF |
| 2009-10 | $689,503 | 7 | GF |

**6b. Revenue Impact:**

| *Fiscal* | *FUNDS* | *(amounts in millions)* | |
|---|---|---|---|
| *Year* | *GF* | *TTF* | *NGF* |
| 2003-04 | $0 | $0 | $0 |
| 2004-05 | $884.6 | $751.1 | $110.9 |
| 2005-06 | $949.2 | $793.5 | $110.9 |
| 2006-07 | $1,134.0 | $818.7 | $30.9 |
| 2007-08 | $1,224.6 | $832.0 | $30.9 |
| 2008-09 | $1,303.2 | $861.2 | $30.8 |
| 2009-10 | $1,398.1 | $892.3 | $30.8 |

7. **Budget amendment necessary:** Yes.
Item(s): Page 1, Revenue Estimates
284 and 286, Department of Taxation

8. **Fiscal implications:**

Administrative

The Department would incur administrative costs to implement this bill in the amount of $1,375,281 for FY 2004, $2,516,833 for FY 2005, $1,432,254 for FY 2006, $711,603 for FY 2007, $684,703 for FY 2008, $687,003 for FY 2009, and $689,503 for FY 2010. These administrative costs would be for systems development, forms revisions, and 7 additional employees.

Some of the administrative costs that the Department would incur as a result of this bill are similar to the costs for some of the changes in the Governor's tax reform plan that are assumed in the Executive Budget. Assumed in the Executive Budget are costs of $493,724 for Fiscal Year 2004, $3,017,970 for Fiscal Year 2005, and $1,835,206 for Fiscal Year 2006 to implement the changes proposed in the Governor's tax reform plan.

The Department of Motor Vehicles would incur minimal costs to implement the increase in the motor fuel tax.

Revenue

This bill would result in an increase in state revenue of $1,746.6 in Fiscal Year 2005, $1,853.6 in Fiscal Year 2006, $1,983.6 in Fiscal Year 2007, $2,087.5 in Fiscal Year 2008, $2,195.2 in Fiscal Year 2009, and $2,321.2 in Fiscal Year 2010. These estimates do not include the revenue gain from repeal of the exemption for motor vehicle common carriers. With the number of structural changes made to the tax system under this bill, the responses of taxpayers and the resultant impacts on their tax liability are difficult to predict. Therefore, the revenue estimates should be considered highly tentative.

This estimate is made assuming that the income tax changes proposed by this bill are implemented as specified in the bill for the 2004 taxable year or July 1, 2004. It would be nearly, if not actually, impossible for the Department to properly implement all of these changes for 2004. As an alternative for some of the provisions that require extensive systems modifications, such as the age deduction and income tax brackets, a 2005 effective date would allow the Department an adequate timeframe to implement the changes proposed by this bill.

The Executive Budget assumes the passage of the Governor’s tax reform proposal. The Governor’s tax reform proposal contains provisions that would amend the individual income tax, sales tax, corporate income taxes, cigarette tax, estate tax, and personal property tax. The following chart compares the General Fund revenue effects of this bill on current law with the changes to the General Fund revenue forecast, assumed in the Executive Budget, caused by the provisions in the Governor’s tax reform proposal.

(Amounts in millions)

| Fiscal Year | Effect of SB 635 on General Fund Revenue* | GF revenue effect of Governor’s tax reform proposal | Difference between SB 635 and Governor’s tax reform proposal* |
|---|---|---|---|
| 2005 | $884.6 | $495.2 | $389.4 |
| 2006 | $949.2 | $553.8 | $395.4 |
| 2007 | $1,134.0 | $511.9 | $622.1 |
| 2008 | $1,224.6 | $448.3 | $776.3 |
| 2009 | $1,303.2 | $407.6 | $895.6 |
| 2010 | $1,398.1 | $462.6 | $935.5 |

* Estimates do not include the gain from repeal of the motor vehicle common carrier sales and use tax exemption.

In addition to the revenue impact discussed above, this bill would dedicate some of the revenue to particular funds, and change the funds to which existing revenue is dedicated. The major changes are described in Line 11.

The table below shows the state revenue impact of the proposed bill broken down by its major components.

| State Revenue Impact of SB 635 by Component | | | | | | |
|---|---|---|---|---|---|---|
| **($ millions)** | **FY 2005** | **FY 2006** | **FY 2007** | **FY 2008** | **FY 2009** | **FY 2010** |
| **Individual Income Tax** | $419.2 | $231.6 | $279.3 | $322.8 | $353.7 | $384.4 |
| **Business Tax Provisions** | ($134.4) | $35.7 | $38.6 | $39.7 | $40.8 | $41.9 |
| **Sales Tax** | $523.1 | $604.2 | $635.2 | $668.6 | $705.5 | $744.3 |
| **Recordation Tax** | $171.9 | $178.5 | $189.8 | $197.3 | $205.2 | $213.5 |
| **Estate Tax** | ($50.9) | ($63.3) | ($53.3) | ($50.3) | ($50.3) | ($35.9) |
| **Motor Vehicle & Fuel Taxes** | $817.7 | $866.9 | $894.0 | $909.4 | $940.3 | $973.0 |
| **Total** | $1,746.6 | $1,853.6 | $1,983.6 | $2,087.5 | $2,195.2 | $2,321.2 |

Local Revenue

This bill may increase local revenues to the extent that localities take advantage of the increase in state recordation tax to increase the local recordation tax.

**9. Specific agency or political subdivisions affected:**

Department of Motor Vehicles
Department of Taxation
Department of Treasury
Cities, Counties and Towns

**10. Technical amendment necessary:** No.

**11. Other comments:**

## Individual Income Tax Components

**Personal Exemptions**

Current Law

Virginia currently allows a deduction of $800 for each personal and dependent exemption allowed on a taxpayer's individual income tax return. An additional exemption amount of $800 is allowed for individuals who are blind or age 65 and over. The personal and dependent exemption amount was last increased by the General Assembly in 1987.

Proposed Change

This bill would increase the Virginia personal and dependent exemption amount from $800 to $1,000. The additional exemption for blind or age 65 and over individuals would remain at $800. This provision would be effective for taxable years beginning on or after January 1, 2005.

**Filing Threshold**

Current Law

A filing threshold is the amount of Virginia adjusted gross income for which a tax return is required to be filed. The current filing threshold amounts have not been changed since 1987. The current individual income tax filing thresholds are as follows:

| | |
|---|---|
| Single | $5,000 |
| Married Filing Jointly | $8,000 |
| Married Filing Separately | $4,000 |

Proposed Change

This bill would increase the filing thresholds for the Virginia individual income tax. The proposed filing thresholds would be as follows and would be effective for taxable years beginning on and after January 1, 2005.

| | |
|---|---|
| Single | $5,000 |
| Married Filing Jointly | $9,000 |
| Married Filing Separately | $4,500 |

**Standard Deduction**

Current Law

Currently, individuals are entitled to claim a standard deduction on their Virginia return if they claimed a standard deduction on their federal return. The deduction amounts are as follows: $3,000 for single individuals, $5,000 for individuals married filing jointly, and $2,500 for married individuals filing separately. These amounts have been in effect since the 1989 taxable year.

Proposed Change

This bill would increase the standard deduction amounts. The proposed standard deduction amounts are as follows: $3,500 for single and married filing separately individuals and $7,000 for married filing jointly individuals. The effective date of this provision would be January 1, 2005.

## Age Deduction

Current Law

Virginia currently allows an age deduction for individuals age 62 or older. The deduction amounts are $6,000 for individuals age 62 through 64 and $12,000 for individuals age 65 and over. These amounts have remained unchanged since the 1996 taxable year.

Proposed Change

For taxable years beginning on or after January 1, 2004, the age deduction would be reduced $1 for each $1 by which the taxpayer's modified federal adjusted gross income ("FAGI") exceeds $40,000 for single taxpayers and $64,000 for married taxpayers. However, if a married taxpayer files a separate return, then the age deduction would be reduced by $1 for each $2 that the combined modified FAGI exceeds $64,000. Modified FAGI would be defined as federal adjusted gross income minus taxable social security and taxable Railroad Retirement benefits.

For taxable years 2004 and after, the $6,000 age deduction would only be available to those born after December 31, 1941. Taxpayers born in 1941 would be 62 in 2003 and eligible to claim the $6,000 age deduction. They would continue to be eligible to claim the $6,000 age deduction in 2004 and subsequent years until they are 65 and eligible for the $12,000 age deduction.

For taxable years 2011 and after, the $12,000 age deduction would be allowed only if the taxpayer had reached the age that qualifies for full Social Security retirement benefits during the taxable year. Thus, someone born in 1945 would be 65 in 2010 and qualify for the Virginia age deduction, but would not qualify for social security benefits because the qualifying age would be 66. However, in 2011 that person would qualify for both social security and the Virginia age deduction.

Under federal law, the retirement age at which one is eligible for full Social Security benefits will increase until it reaches age 67 for those born after 1959 as follows:

| Year of Birth | Full Retirement Age | Year of Birth | Full Retirement Age |
|---|---|---|---|
| 1937 or earlier | 65 | 1943–1954 | 66 |
| 1938 | 65 and 2 months | 1955 | 66 and 2 months |
| 1939 | 65 and 4 months | 1956 | 66 and 4 months |
| 1940 | 65 and 6 months | 1957 | 66 and 6 months |
| 1941 | 65 and 8 months | 1958 | 66 and 8 months |
| 1942 | 65 and 10 months | 1959 | 66 and 10 months |
| | | 1960 and later | 67 |

## Income Tax Brackets

Current Law

The top two brackets have not been changed since 1987. The bottom two brackets have not been changed since 1926. The table below shows the current individual income rate and bracket structure.

| Virginia Taxable Income Range | Rate |
|---|---|
| $3,000 or less | 2% |
| $3,001 to $5,000 | 3% |
| $5,001 to $17,000 | 5% |
| $17,001 or more | 5.75% |

Proposed Change

Under this bill, the rates and brackets would be changed as shown below and would be effective for taxable years beginning January 1, 2004.

| Virginia Taxable Income Range | Rate |
|---|---|
| $3,000 or less | 2% |
| $3,001 to $5,000 | 3% |
| $5,001 to $17,000 | 5% |
| $17,001 to $100,000 | 5.75% |
| $100,001 to $150,000 | 6.25% |
| $150,001 or more | 6.5% |

**Earned Income Credit**

Current Law

Currently, a taxpayer whose family income does not exceed the poverty level may claim the Credit for Low Income Taxpayers. The credit is equal to $300 each for the taxpayer, spouse and dependent(s).

Proposed Change

In lieu of the $300 credit, taxpayers may elect to receive a nonrefundable credit against their Virginia income tax equal to 20% of the federal earned income tax credit. The effective date of this provision is taxable years beginning on or after January 1, 2005.

**Two-Earner Credit**

Current Law

Married taxpayers who file joint federal returns have the option of filing a joint Virginia return or they may separately compute their tax on a combined return. The separate computation gives each taxpayer the benefit of the graduated rates, and they may allocate their standard deduction and certain other items in the manner that best reduces the tax. The only area in which Virginia married taxpayers face a “marriage penalty” compared to a single taxpayer with the same income is the standard deduction, which is $500 less for a married taxpayer filing a separate return than for a single taxpayer.

Proposed Change

This bill would allow a credit when the family taxable income exceeds $100,000. Married taxpayers with income less than $100,000 would continue to compute their adjustment to give them the benefit of graduated tax rates on each spouse's separate income under existing law and procedures. Effective for taxable years beginning on or after January 1, 2004, couples with incomes greater than $100,000 would compute their tax on the combined income and then calculate a credit against the tax, not to exceed $1,132, as follows:

| Virginia Taxable Income Range | Credit Rate |
|---|---|
| $100,000 to 125,000 | 4.5% |
| $125,001 to $150,000 | 4% |
| $150,001 to $200,000 | 3% |
| $200,001 to $300,000 | 2% |
| $300,001 or more | 1% |

## Business Tax Components

### Nowhere Income

Current Law

A corporation that is doing business in multiple states and is subject to a corporate income tax in at least one other state apportions its income to the several states in which it makes sales based on a formula based upon the amount of property, payroll, and sales in each of those states. Currently, these corporations treat sales shipped out of Virginia as non-Virginia sales even if the corporation is not subject to an income tax in the destination state. (Foreign countries are "states" for this purpose.) Since these sales are not counted in assigning income to any state, they are commonly referred to as "nowhere income."

Proposed Change

The definition of Virginia sales would include the sales of products shipped from Virginia to a destination state (or foreign country) in which the corporation is not taxable. Because such sales are thrown back from the destination state to the shipping state, this provision is commonly referred to as a "throwback rule." This bill would restore a throwback rule that existed in Virginia's corporate income tax law until 1981.

For example, Corporation A is located in Virginia and New York. During the year, Corporation A ships all of its goods from Virginia to customers in Virginia, Maryland and New York. The goods shipped to New York increase the share of the corporation's income taxed by New York. Under current law, the goods shipped to Maryland reduce the share of the corporation's income taxed in Virginia even though no Maryland income tax is paid. With the proposed sales throwback rule, the goods shipped to Maryland would be treated as Virginia sales and correspondingly increase the share of the corporation's income taxed in Virginia.

## Intangible Holding Companies

Current Law

Corporations start with federal taxable income, which reflects deductions taken for royalties, interest and other expenses paid to an affiliated intangible holding company. If the corporation has done its planning correctly (i.e., established a nontax reason for the intangible holding company's existence and arm's length rates for their transactions), then Virginia cannot invoke its authority under existing law to correct transactions between related companies that improperly reflect income. In extreme cases, a corporation may contribute a valuable patent or trademark to an affiliated intangible holding company in a tax-free transaction, pay royalties for its use, then borrow the funds back from the intangible holding company and pay interest for the use of its own money.

Proposed Change

Corporations would be required to add back to federal taxable income any interest and intangible expenses directly or indirectly paid to one or more related members. A related member is defined by reference to the Internal Revenue Code. Two safe-harbors would be allowed:

- The add-back would not be required if in the same taxable year of the payment the item of income received by the related member is subject to a tax on or measured by the related member's net income in any state of the United States or a foreign country that has an income tax treaty in force with the United States.
- The add-back would not be required if the corporation can establish to the satisfaction of the Tax Commissioner both of the following:
  - The related member directly or indirectly incurred the same costs to a person who is not a related member (e.g., interest paid to a bank); and
  - The transaction did not have as a principal or primary purpose the avoidance of any state tax.

## Pass-Through Entities

Current Law

Pass-through entities are business entities, such as partnerships, limited liability companies and Subchapter S corporations, that are not subject to federal and state income taxes at the entity level. The partners, members or shareholders (the "owners") of the pass-through entity report their share of the income from the entity on their own income tax returns.

Under current law, the owners of pass-through entities are liable for Virginia income taxes on Virginia source income. However, the Department does not have an effective way of identifying these owners and verifying that they have properly paid tax on Virginia income. The revenue loss attributable to noncompliance on the part of the owners of pass-through entities has grown with the increased popularity of pass-through entities.

Pass-through entities are currently required to file informational returns with the IRS and most other states. Virginia formerly required partnerships to file such returns, but repealed the practice in 1988. New technology will enable the Department to utilize effectively the proposed informational returns to ensure that the owners of pass-through entities properly report and pay tax on Virginia income.

Proposal

This proposal would require every pass-through entity doing business in Virginia or having income from Virginia sources to file an annual informational return with the Department listing its income and owners. This proposal is effective January 1, 2004.

This proposal would authorize the Department to establish an income threshold for the filing requirement. Pass-through entities with income below this threshold would not be required to file returns. This proposal would also allow pass-through entities to apply to the Department to file a single composite return for all nonresident shareholders. These provisions would help reduce the compliance burden on affected individuals.

Under this proposal, entities would be required to file returns using an electronic medium prescribed by the Department. However, the Department would be authorized to waive this requirement for businesses with small numbers of owners.

**Accelerated Sales Tax Payments**

Current Law

Currently, sales tax dealers with annual sales of $1.3 million or more must make a prepayment in June of 90% of their June sales tax liability.

Proposed Change

This bill would repeal the accelerated sales tax payment requirement for dealers effective for the June payment of 2005.

## Sales Tax Components

**Sales and Use Tax**

Current Law

Virginia's combined state and local sales tax rate is 4.5%; the second lowest in the nation. The 4.5% sales tax rate is composed of a 3.5% state sales tax rate and a 1% sales tax rate imposed at the local level. Currently, one-half percent of the 3.5% sales and use tax rate is distributed to the Transportation Trust Fund. In addition, one percent of the 3.5% state sales and use tax rate is distributed among the counties and cities of the Commonwealth based on school age population. For sales of $5 or less the statute provides a bracket table to simplify collection of the tax for retail dealers. In certain cases, 2% of the 3.5% state tax collected at certain public facilities may be turned over to the locality while the bonds that financed the public facility remain outstanding.

Proposed Change

Effective July 1, 2004, the state portion of the retail sales and use tax rate would increase by 1% on all items except food (see below). This would result in a combined state and local rate of 5.5%. The revenues would be distributed as follows:

| Sales Tax Components | Under Current Law | Proposed Change |
|---|---|---|
| 1% Local Sales Tax | Distributed to localities based on point of sale | No Change |
| 1% of State Sales Tax | Distributed to localities based on school age population | No Change |
| 2% of State Sales Tax | General Fund (except for revenue from certain bond-financed public facilities) | No Change (except for impact of food tax reduction) |
| 0.5% of State Sales Tax | Transportation Trust Fund | No Change (except for impact of food tax reduction) |
| Additional 1% of State Sales Tax | *Not Applicable* | ▪ $30 million to Virginia Natural and Historic Resources Fund;<br>▪ Balance to General Fund |

**Sales and Use Tax on Food**

Current Law

As originally enacted, the Food Tax Reduction Program was to reduce the state sales and use tax rate on food products purchased for human consumption by 0.5% per year over a four year period. Beginning January 1, 2000, the state tax rate decreased to 3% for the period January 1, 2000 through March 31, 2001. Thereafter, the rate was scheduled to decrease to 2.5% for the period April 1, 2001 through March 31, 2002, 2% for the period April 1, 2002 through March 31, 2003, and to 1.5% effective April 1, 2003.

The tax rate reductions for April 1, 2001 and thereafter were to be effective provided two conditions were satisfied: (1) the next level of the phase-out of the tangible personal property tax under the Personal Property Tax Relief Act of 1998 was implemented for that fiscal year, and (2) actual General Fund revenues for the fiscal year preceding a fiscal year in which a rate reduction is contemplated exceeded the official revenue estimates for that second preceding fiscal year by at least 1 percent.

The current state sales and use tax rate on food products is frozen at 3%.

Proposed Change

This bill would reduce the rate on food to 1% effective July 1, 2004. The revenue from the 1% state tax on food would be distributed to localities in proportion to school-age population. The local 1% sales tax would continue to be applicable to food.

**Common Carrier Exemption**

Current Law

Currently, a retail sales and use tax exemption applies to common carriers of property or passengers by motor vehicle, allowing them make tax-free purchases of tangible personal property for use in the rendition of their public service.

Proposed Change

This bill would repeal the exemption.

## Recordation Tax Components

Current Law

A tax at the rate of 15¢ per $100 is imposed when deeds, deeds of trust, leases, and other contracts relating to real estate are recorded. The tax on deeds is measured by the consideration or actual value, whichever is greater. The tax on deeds of trust is measured by the amount of the obligation secured by the deed of trust, but not more than the actual value of the property. Reduced rates are imposed on deeds of trust securing more than $10 million. The tax on leases is measured by the total rent for the term of the lease, but not more than the actual value of the property. The tax on other types of contracts relating to real estate is measured by the consideration. Localities are authorized to impose a local recordation tax equal to one-third of the state tax.

Proposed Change

Effective July 1, 2004, the tax rate would increase to 30¢ per $100 for the various types of documents recorded. The additional revenue generated by this change, up to $80 million annually, would be deposited into the Revenue Stabilization Fund for Fiscal Years 2006 and 2007. Thereafter, the additional revenue would be deposited into the General Fund.

Local governments are authorized to impose a local recordation tax equal to one-third of the state tax. Because the state tax rate is increased, local tax revenues may also be increased to the extent that localities take advantage of the increased state tax rate.

## Estate Tax Components

Background

*Federal Estate Tax Credit for State Death Taxes*

A credit is allowed against the Federal estate tax for estate taxes paid to any state with respect to property included in the decedent's gross estate. The maximum amount of the credit allowable for state death taxes is determined under a graduated rate table, based on the size of the decedent's adjusted taxable estate.

*Virginia Estate Tax*

Virginia imposes a "pick-up" estate tax that is equal to the maximum amount of the federal credit for state death taxes as it existed on January 1, 1978. Prior to federal legislation enacted in 2001, the maximum federal credit amounts have not changed since 1978.

*2001 Federal Legislation*

Under the Economic Growth and Tax Relief Act of 2001 (EGTRRA) enacted by Congress, the state death tax credit is reduced incrementally beginning in 2002, and is fully repealed in 2005. For 2005 and years thereafter, a deduction from the taxable estate is allowed for any state death taxes actually paid.

| Year of Death | % Reduction of Federal Credit for State Death Taxes |
|---|---|
| 2002 | 25% |
| 2003 | 50% |
| 2004 | 75% |
| 2005 | Credit Repealed |

Current Law

The estate tax is imposed on the transfer of taxable estates in excess of $1.5 million. The federal estate tax is slowly being phased out until it is finally repealed in 2010. While most states automatically conform to the federal estate tax, Virginia bases its tax on a federal credit as it existed in 1978.

Proposed Change

This bill would eliminate the Virginia estate tax on all estates of $10 million or less and on estates valued at greater than $10 million provided the majority of the value of the estate's assets are made up of a closely held business or working farm. This provision would be effective for decedents dying on or after January 1, 2004.

## Motor Vehicle Tax Components

### Motor Vehicle Fuel Tax

Current Law

A state tax is imposed on motor fuels at the following rates: 17½ cents per gallon on gasoline and gasohol and 16 cents per gallon on diesel fuel and liquid alternative fuel. Motor carriers pay a road tax equivalent to 19½ cents per gallon with a credit of 16 cents per gallon for fuel purchased in Virginia.

Proposed Change

The tax on motor fuels would be increased to 20½ cents per gallon on gasoline and gasohol and 20½ cents per gallon on diesel fuel and liquid alternative fuel. An additional tax would be imposed on fuel on a cents-per-gallon rate set by the Department of Motor Vehicles that is equivalent to 5.5% of the statewide average retail price of self-serve regular unleaded gasoline. Motor carriers would pay a road tax on a cents-per-gallon basis equivalent to 3½ cents per gallon greater than the fuel tax and new additional fuel tax, with a credit for the taxes paid on fuel purchased in Virginia. The additional revenue would be deposited into the Transportation Trust Fund.

**Motor Vehicle Sales Tax**

Current Law

A sales tax on motor vehicles is imposed at the rate of 3% of the gross sales price; revenue is deposited to the Commonwealth Transportation Fund. In addition, a 4% tax is levied on the rental of any daily rental vehicle; revenue is distributed to locality in which the vehicle was delivered.

Proposed Change

The motor vehicle sales tax would be increased from 3% to 4.5% on the gross sales price. The additional revenue would be deposited into the Transportation Trust Fund. The tax on daily rental vehicles would be increased from 4% to 6%. The additional revenue would be deposited to the General fund.

**Motor Vehicle Insurance Premium Tax**

Current Law

A license tax is imposed on insurance companies based on their gross premiums. One-third of the revenue from the tax is deposited to the Transportation Trust Fund.

Proposed Change

The dedication of one-third of the revenue to the Transportation Trust Fund would be repealed.

**Other Legislation**

**House Bill 1361** contains provisions relating to intangible holding companies but has numerous safe-harbors.

**House Bill 1488** would eliminate numerous commercial and industrial exemptions, including the common carrier exemption.

cc : Secretary of Finance
Date: 2/24/2004 JPJ