DEPARTMENT OF TAXATION
2005 Fiscal Impact Statement

1. Patron Allen L. Louderback

2. Bill Number HB 2494

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

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

3. Committee House Finance

4. Title Tax Reform

5. Summary/Purpose:

This bill would make the following changes to Virginia's tax code:

- The individual income tax brackets would be changed. For single filers, the rate for the first $12,000 of taxable income would be 0%, above $12,000 to $24,000 of taxable income would be 3.5%, above $24,000 to $30,000 of taxable income would be 4%, above $30,000 up to $45,000 of taxable income would be 5.5%, and above $45,000 would be 6.25%. For married filers, the rate for the first $24,000 of taxable income would be 0%, above $24,000 up to $30,000 of taxable income would be 4%, above $30,000 up to $45,000 of taxable income would be 5.5%, and above $45,000 would be 6.25%.

- The filing threshold would increase to $12,000 for single taxpayers and married taxpayers filing separately, and $24,000 for married taxpayers filing jointly.

- All individual income additions, subtractions, exemptions, and deductions would be repealed with the exception of the addition for interest on obligations of other states and the subtractions for federal obligations, obligations of the Commonwealth, taxable social security income, and the amount of any refund or credit for overpayment of income taxes.

- Tax credits would no longer be applicable to the individual income tax.

- Counties and cities with a personal property tax rate on motor vehicles no greater than $0.01 per $100 of assessed value would be entitled to a share of 1.5% of taxable individual income, based on each county's and city's share of the total income.

- The sales tax on food would be repealed.

- Most services would be subject to the sales and use tax.

- Industrial materials, materials temporarily stored in Virginia by contractors, meals furnished to restaurant employees, lodging rentals of more than 90 days, services purchased by a business for business purposes, services provided by an employer for his employee, and medical services would be exempt from the sales tax. In addition, raw materials, fuel, power, energy, supplies, and machinery or tools used in the drilling, extraction, refining or processing of natural gas or oil would be exempt from the sales tax.

- Agricultural, commercial and industrial, service, media-related, and nonprofit exemptions would be repealed. In addition, the exemptions for fuel used for domestic consumption, tangible personal property used for maintenance or repair services at nuclear power plants outside the Commonwealth, the provision of legal documents, school textbooks, charitable donations, and tangible personal property purchased by nonprofit churches would be repealed.

- 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 sales and use tax on motor vehicles, including manufactured homes, sold in Virginia or used or stored for use in Virginia would be increased from 3% to 4%. In addition, the sales and use tax on mobile offices sold in Virginia or used or stored for use in Virginia would increase from 2% to 3%.

- The amount of Virginia estate tax due from an estate would conform to the maximum amount of the federal tax credit for state death taxes as permitted under federal estate tax law.

- The Personal Property Tax Relief Act of 1998 would be repealed.

- The Business, Professional and Occupation License (BPOL) tax would be repealed.

- The Gas Severance Tax would be repealed.

The effective date for the individual income tax changes of this bill is taxable year 2006, while the requirement for payments to localities would be effective January 1, 2005. The effective date of all sales tax changes made by this bill is July 1, 2005. The repeal of the Personal Property Tax Relief Act of 1998, the gas severance tax, and the BPOL tax would be effective January 1, 2006. The change to the estate tax would be effective for the estates of persons dying after June 30, 2005.

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

6b. Revenue Impact:

Fiscal Year	***Dollars***	***Fund***
2004-05	$0	GF
2005-06	$992.8 million	GF
	$218.6 million	TTF
	$77.5 million	NGF
	($140.8 million)	Local
2006-07	$1,041.8 million	GF
	$243.5 million	TTF
	$89.2 million	NGF
	$723.1 million	Local
2007-08	$1,063.1 million	GF
	$247.8 million	TTF
	$91.9 million	NGF
	$2,091.9 million	Local
2008-09	$1,079.1 million	GF
	$251.7 million	TTF
	$92.8 million	NGF
	$2,279.9 million	Local
2009-10	$1,081.7 million	GF
	$258.0 million	TTF
	$97.4 million	NGF
	$2,442.6 million	Local
2010-11	$1,089.0 million	GF
	$262.7 million	TTF
	$97.4 million	NGF
	$2,629.9 million	Local

7. Budget amendment necessary: Yes.
ITEM(S): Page 1, Revenue Estimates

8. Fiscal implications:

Administrative Impact

Because this bill would make so many changes to the tax code, the Department would be unable to implement all of the changes required unless the effective dates were pushed back one year. Assuming that the dates were pushed back, the first year costs would be $230,450, the second year costs would be $1,288,330, the third year costs would be $1,175,206, and there would be continuing costs thereafter of approximately $400,000 annually.

Revenue Impact

This bill would result in an increase in state revenue of $1.29 billion in FY 2006, $1.37 billion in FY 2007, $1.40 billion in FY 2008, $1.42 billion FY 2009, $1.44 billion in FY 2010, and $1.45 billion in FY 2011. This bill would result in a decrease in local revenue of $140.8 million in FY 2006, and an increase of $723.1 million in FY 2007, $2.09 billion in

FY 2008, $2.28 billion in FY 2009, $2.44 billion in FY 2010, and $2.63 billion in FY 2011. 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.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

The following technical amendment is suggested to retain a provision that clarifies and coordinates a credit with domicile changes:

Page 5, Line 264 after jurisdiction
Unstrike: ~~, notwithstanding the provisions of § 58.1-332~~

In order to correct the lettering of § 58.1-321, the following technical amendment is suggested:

Page 6, Line 351 at the beginning of the line
Strike: B
Insert: C

Because this bill would eliminate the existing definitions of services specifically taxable, the following technical amendment is suggested:

Page 19, Line 1108 after property or services
Strike: taxable under this chapter

If the intent of this bill is to prohibit all income tax credits from being applied against the individual income tax, then the reference to the individual income tax should be removed from the following tax credits: the Enterprise Zone Act (§§ 59.1-271 and 59.1-280.1) and the Neighborhood Assistance Act (§§ 63.2-2000 and 63.2-2006).

11. Other comments:

<u>Income Tax Brackets</u>

<u>Current Law</u>

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, 2006.

Single Taxpayers	
Virginia Taxable Income Range	**Rate**
$12,000 or less	0%
$12,001 to $24,000	3.5%
$24,001 to $30,000	4%
$30,001 to $45,000	5.5%
$45,001 or more	6.25%

Married Taxpayers Filing Jointly	
Virginia Taxable Income Range	**Rate**
$24,000 or less	0%
$24,001 to $30,000	4%
$30,001 to $45,000	5.5%
$45,001 or more	6.25%

Individual Income Tax Additions, Subtractions, Exemptions, Deductions, Credits

Current Law

Virginia currently allows a variety of additions, subtractions, deductions and credits for Virginia taxpayers.

Proposed Change

This bill would repeal all additions, subtractions, exemptions, deductions, and credits with the exception of one addition and four subtractions. Virginia taxpayers would still be required to add the interest on obligations of any state other than Virginia. In addition, taxpayers would continue to receive a subtraction for federal or Virginia obligations such as stocks, bonds, and treasury notes, Social Security benefits provided under Title II of the Social Security Act, or the amount of any refund or credit for overpayment of income taxes.

Payments to Localities

Current Law

Tangible personal property, including motor vehicles, is taxed at the local level based on the assessed value. Under the Personal Property Tax Relief Act of 1998, the Commonwealth makes payments towards the first $20,000 of the assessed value of a motor vehicle. However, beginning in 2006, the distributions from the Commonwealth will be limited to $950 million.

Proposed Change

This bill would provide a personal property tax reimbursement to counties and cities that have a personal property tax rate on motor vehicles that is no greater than $0.01 per $100 of assessed value. The total amount of the reimbursement would be 1.5% of the taxable individual income reported annually by the Department of Taxation. This amount would be divided among the qualifying counties and cities based on their share of total Virginia taxable income. This distribution would be made no later than September 1 of the year in which the taxes are collected for the immediately preceding year.

Sales and Use Tax

Current Law

Virginia's combined state and local sales tax rate is 5%. This 5% rate is composed of a 4% state sales tax rate and a 1% sales tax rate that is imposed at the local level. Most services are exempt from the sales and use tax.

Virginia imposes a different sales tax rate on food. Currently, the state sales tax rate for food is 3.5%. However, this rate is scheduled to decrease to 2.5% on July 1, 2005, 2% on July 1, 2006, and 1.5% on July 1, 2007. "Food" is defined as any food or food product for home consumption except alcoholic beverages, tobacco, and hot foods or hot food products ready for immediate consumption.

Finally, Virginia imposes a separate state sales and use tax on motor vehicles. The rate is 3% for motor vehicles, including manufacture homes, and 2% for mobile offices sold, used or stored for use in the Commonwealth.

Proposed Change

This bill would subject most services to the sales and use tax and the agricultural, commercial and industrial, service, media-related, and nonprofit exemptions would be repealed. In addition, the exemptions for fuel used for domestic consumption, tangible personal property used for maintenance or repair services at nuclear power plants outside the Commonwealth, the provision of legal documents, school textbooks, charitable donations, and tangible personal property purchased by nonprofit churches would be repealed.

This bill would continue to exempt from sales tax industrial materials, materials temporarily stored in Virginia by contractors, meals furnished to restaurant employees, lodging rentals of more than 90 days, services purchased by a business for business purposes, services provided by an employer for his employee, and medical services from the sales tax. In addition, raw materials, fuel, power, energy, supplies, and machinery or tools used in the drilling, extraction, refining or processing of natural gas or oil would be exempt. This bill would also retain some of the miscellaneous exemptions and the exemption for government and commodities.

This bill would repeal the sales tax on food for human consumption. The definition of "food for human consumption" would include substances, whether in liquid, concentrated, solid, frozen, dried, or dehydrated form, that are sold for ingestion or chewing by humans and are consumed for their taste or nutritional value. It would not include alcoholic beverages or tobacco.

The sales and use tax rate for motor vehicles, including manufactured homes, would increase to 4%, while the rate for mobile offices would increase to 3%. In addition, the definition of the sale price of the vehicle would be changed to allow for a subtraction of any allowance given by the seller for a motor vehicle taken in trade as a partial payment for the purchased motor vehicle.

Accelerated Sales Tax Payments

Current Law

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 July 1, 2005.

Estate Tax

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 had 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 fully repealed in 2005. For 2005 and years thereafter, a deduction from the taxable estate is allowed for any state death taxes actually paid.

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 allow the Virginia estate tax to be eliminated at the same time as the elimination of the federal credit upon which the Virginia tax is based. It would accomplish this by conforming the amount of Virginia estate tax due from an estate to the maximum amount of the federal tax credit for state death taxes as permitted under federal estate tax law. This change would be effective for the estates of persons who die after June 30, 2005.

Personal Property Tax Relief Act of 1998

Current Law

The PPTRA originally was intended to eliminate the tangible personal property tax imposed on the first $20,000 of value on passenger cars, pickup or panel trucks, and motorcycles owned or leased by natural persons and used for nonbusiness purposes.

The tax was originally scheduled to be eliminated over five years with 12.5% of the tax eliminated in 1998, 27.5% in 1999, 47.5% in 2000, 70% in 2001, and 100% in 2002 and thereafter. However, the level of tax relief never exceeded 70%.

In 2004, the General Assembly changed the personal property tax relief program for motor vehicles. Beginning in 2006, the state will distribute $950 million annually to localities as reimbursement for the personal property tax relief provided by each locality. Each locality's share of the $950 million state reimbursement for tax year 2006 and subsequent tax years will be based upon its share of the total state reimbursement for tax year 2005.

Proposed Change

This bill would repeal the Personal Property Tax Relief Act of 1998 effective January 1, 2006.

Business, Professional and Occupation License Tax

Current Law

The Business, Professional and Occupational License (BPOL) tax is a tax on businesses for the privilege of engaging in business at a definite place of business within a Virginia locality. The BPOL tax is a tax on gross receipts, not net income.

Under current BPOL law, any locality may charge a license fee in an amount not to exceed:

- $100 for any locality with a population greater than 50,000
- $50 for any locality with a population of 25,000 but no more than 50,000
- $30 for any locality with a population smaller than 25,000

A locality may not assess a license tax on gross receipts when it charges a license fee.

Under current BPOL law, localities may not impose a license tax on a business with gross receipts:

- Less than $100,000 in any locality with a population greater than 50,000
- Less than $50,000 in any locality with a population of 25,000 but no more than 50,000.

Any business with gross receipts in excess of these thresholds may be subject to a license tax at a rate not to exceed the rates set forth below:

- Contracting - sixteen cents per $100 of gross receipts
- Retail sales - twenty cents per $100 of gross receipts
- Financial, real estate, and professional services - fifty-eight cents per $100 of gross receipts
- Repair, personal and business services, and all other businesses - thirty-six cents per $100 of gross receipts.

Localities that imposed a higher rate structure on January 1, 1978 are allowed to continue to impose the tax at those rates.

Proposed Change

This bill would repeal the business, professional and occupation license (BPOL) tax effective January 1, 2006.

Gas Severance Tax

Current Law

Under current law, counties and cities may impose the 1% gas severance tax authorized under *Code of Virginia* § 58.1-3712, the 1% Local Coal and Gas Road Improvement and Virginia Coalfield Economic Development Authority tax authorized in *Code of Virginia* § 58.1-3713, and the additional 1% gas severance tax authorized under *Code of Virginia* §

58.1-3713.4. The maximum allowable local tax rate on gases is 3%. Seven counties currently receive revenues from the gas severance tax: Buchanan, Dickenson, Lee, Russell, Scott, Tazewell, and Wise.

Proposed Change

This bill would repeal the Gas Severance tax effective January 1, 2006.

cc : Secretary of Finance

Date: 1/29/2005 AMS
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