DEPARTMENT OF TAXATION
2008 Fiscal Impact Statement

1. Patron Kathy J. Byron

2. Bill Number HB 1514

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

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

3. Committee House Finance

4. Title Corporate Income Tax; Apportionment for Manufacturers

5. Summary/Purpose:

This bill would modify the corporate apportionment formula by allowing manufacturing companies to use a single sales factor to determine their Virginia taxable income. Such companies would still have the option of using the current apportionment formula, which is one fourth property, one fourth payroll, and one half sales.

This bill would be effective for taxable years beginning on and after July 1, 2009.

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

7. Budget amendment necessary: Yes. (See Line 8.)
Page 1, Revenue Estimates

8. Fiscal implications:

Administrative Costs

TAX has not assigned any administrative costs to this bill because the changes required by a single bill such as this can be implemented as part of the annual changes to our systems and forms. As stand-alone legislation, TAX considers implementation of this bill as “routine,” and does not require additional funding.

TAX will provide specific administrative costs on any legislation that is not “routine.” Additionally, TAX will review all state tax legislation likely to be enacted prior to the passage by each house. If the aggregate number of routine bills likely to pass either house is unusually large, it is possible that additional resources will be required. If so, TAX will identify the costs at that time.

Revenue Impact

TAX examined a sample of corporations for taxable year 2003, which is the latest year for which the detail of data necessary is readily available. TAX then compared the tax liability on the return to the tax liability that would result under an optional single sales factor, first for all returns and then only for those corporations deemed to be a manufacturer. Of the 293 corporations in the sample, 68 were classified as manufacturers. Assuming that corporations would only elect a single sales factor if the resulting tax liability was lower, 42 of the manufacturers would benefit from a single sales factor. Using this analysis, the total negative revenue impact for TY 2003 would have been $36 million.

Forecasts of the impact on future fiscal year revenues have not been provided because corporate tax revenue is so volatile. For example, total corporate income tax collections totaled $426 million in FY 2004 and grew to $879 million in FY 2007, but are expected to range between $750 million and $810 million per year in the period FY 2008-2014. These estimates are often revised. Therefore, the $36 million revenue loss for TY 2003 may not be representative of the true future revenue impact.

In order to complete this revenue impact, TAX estimated which corporations would be deemed "manufacturers" by examining the nature of the business and by making reference to the definitions in 23 VAC 10-210-920, which concerns industrial manufacturers and processors for the purposes of the retail sales and use tax.

To implement this change, a reduction of an equal amount of general fund support from other areas in the introduced budget would be required. Given the magnitude of funding involved, funding would need to be transferred from areas with significant general fund support.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

In order to clarify the meaning of "manufacturing company," the following technical amendment is suggested:

Page 1, Line 28, after § 58.1-408.
Insert: For the purposes of this section, "manufacturing company" means a domestic or foreign corporation which is primarily engaged in activities that, in accordance with the North American Industrial Classification System (NAICS), United States Manual, United States Office of Management and Budget, 1997 Edition, would be included in Sector 11, 31, 32, or 33.

11. Other comments:

Background

In Virginia, multistate corporations are generally required to use a three-factor formula of property, payroll and double-weighted sales. The sum of the property factor, payroll factor and twice the sales factor is divided by four to arrive at the final apportionment factor. This amount is then multiplied by Virginia taxable income.

The property factor is a fraction, the numerator of which is the average value of the corporation's real and tangible personal property owned and used or rented and used in Virginia during the taxable year, and the denominator of which is the average value of all the corporation's real and tangible property owned and used or rented and used during the taxable year and located everywhere; to the extent that such property is used to produce Virginia taxable income and is effectively connected with the conduct of a trade or business within the United States and income derived is includible in federal taxable income.

The payroll factor is a fraction, the numerator of which is the total amount paid or accrued in Virginia during the tax period by the corporation for compensation, and the denominator of which is the total compensation paid or accrued everywhere during the tax period; to the extent that such payroll is used to produce Virginia taxable income and is effectively connected with the conduct of a trade or business within the United States and income derived is includible in federal taxable income.

The sales factor is a fraction, the numerator of which is the total sales of the corporation in Virginia during the tax period, and the denominator of which is the total sales of the corporation everywhere during the tax period, to the extent that such sales are used to produce Virginia taxable income and are effectively connected with the conduct of a trade or business within the United States and income derived is includible in federal taxable income.

Initially, the property, payroll, and sales factors were weighted equally. In 1999, the formula was changed so that the sales factor was counted twice. According to the Federation of Tax Administrators, as of January 1, 2007, at least sixteen other states also have a sales factor of 50%. Nine states still utilize the standard three factor formula, and four states have a sales factor between 50% and 100%. An additional sixteen states either currently have, or will have within the next five years, a sales factor of 100% for either all taxpayers or for specified industries. These states are Connecticut, Georgia, Illinois, Indiana, Iowa, Kentucky, Maryland, Massachusetts, Minnesota, Missouri, Nebraska, New York, Oregon, South Carolina, Texas, and Wisconsin.

Proposal

This bill would modify the corporate apportionment formula by allowing manufacturing companies to use a single sales factor to determine their Virginia taxable income. Such companies would still have the option of using the current apportionment formula, which is one fourth property, one fourth payroll, and one half sales. In addition, corporations with no sales factor would be allowed to use the current formula.

This bill does not define the term “manufacturing company.” A technical amendment has been suggested that would provide such a definition.

This bill would be effective for taxable years beginning on and after July 1, 2009.

Similar Legislation

House Joint Resolution 177 would establish a joint subcommittee to study the benefits of adopting a single sales factor to apportion the income of multistate corporations for purposes of the corporation income tax.

Senate Joint Resolution 101 would provide for a joint committee of the Senate Committee on Finance and the House Committee on Finance to study the benefits, economic impact, and fiscal impact of adopting a single sales factor to apportion the income of multistate corporations for purposes of the corporation income tax.

cc : Secretary of Finance

Date: 1/28/2008 AMS
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