

DEPARTMENT OF TAXATION

2008 Fiscal Impact Statement

1. **Patron** Kathy J. Byron

2. **Bill Number** HB 1514

3. **Committee** Senate Finance

House of Origin:

☐ Introduced

☐ Substitute

☐ Engrossed

4. **Title** Corporate Income Tax; Apportionment for
Manufacturers

Second House:

☒ In Committee

☐ Substitute

☐ Enrolled

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, 2010.

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 considers implementation of this bill as routine, and does not require additional funding.

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: No.

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 would define a "manufacturing company" as 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. This would include the sectors of agriculture, forestry, fishing, and hunting and manufacturing.

This bill would be effective for taxable years beginning on and after July 1, 2010.

Impact of This Proposal

In general, the single sales factor would reduce the tax liability of manufacturers whose property and payroll ratios are on average greater than the sales factor. This would, generally, be manufacturers with headquarters and major production facilities located in Virginia. However, because the single sales factor would be optional, manufacturers whose sales ratio is the dominant factor, or those with few or no facilities in Virginia, would not have any increase in taxable income apportioned to Virginia.

Thus, while this proposal would provide a benefit to some manufacturers located in Virginia, those manufacturers that are not located in Virginia would not be negatively affected in any way. This would result in a much higher negative revenue impact, because the lower tax liability of the manufacturers benefiting from this bill would not be offset by other taxpayers.

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 and related issues for purposes of the corporation income tax.

Senate Joint Resolution 101 would provide for a joint committee 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.

If HB 1514 is enacted, there is little value in also completing these studies.

cc : Secretary of Finance

Date: 2/22/2008 AMS
HB1514FE161