JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION
Fiscal Impact Review
2010 Session

Bill Number: HB 119 as Introduced
Review Requested By: Delegate Purkey

JLARC Staff Fiscal Estimates

Fund Source	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Dollars						
General Fund	($138.7)	($1299.7)	($838.0)	($872.4)	($918.4)	($955.4)
Non-General Fund	$0	$0	$0	$0	$0	$0
Positions						
General Fund	0	0	-2.5	-2.5	-2.5	-2.5
Non-General Fund	0	0	0	0	0	0

JLARC staff concur with the Department of Taxation's estimate of the impact that House Bill (HB) 119 would have on State revenues in fiscal years 2010 through 2016. It should be noted that although the estimate is based on the official State forecast for corporate income tax revenues in each of these fiscal years, several assumptions had to be made to determine the proportion of projected revenues attributable to returns filed after the bill would go into effect in tax year 2010. JLARC staff find that the Department used a sound methodology to estimate the timing of the impact of this bill on the General Fund.

JLARC staff also find that HB 119 would repeal sections of the *Code* of *Virginia* that affect non-corporate taxpayers. As currently written, this bill would eliminate several tax credits that can be claimed by individuals as well as many businesses organized as pass-through entities (i.e. S-corporations, LLCs, etc.). As a result, certain individuals and pass-through entities would likely pay more taxes, totaling between $5.7 and $10.3 million annually based on the amount of tax credits claimed in tax years 2005 through 2007. JLARC staff did not adjust the estimated fiscal impact of HB 119 to reflect the elimination of these credits because insufficient data are available to forecast their magnitude in future years. In addition, this bill repeals sections of the *Code* that set forth how the tax liability of pass-through entities must be calculated, which could create great uncertainty among these taxpayers.

Additional information about the State's corporate income tax will be available in November 2010, when JLARC staff conclude their review pursuant to House Joint Resolution 681 (2009).

An explanation of the JLARC staff review is included on the following pages.

Authorized for Release: 

Philip A. Leone
Director

Background

Bill Summary:
This bill would eliminate Virginia's corporate income tax for taxable years beginning on or after January 1, 2010 by repealing §§ 58.1-400 through 58.1-422, 58.1-432 through 58.1-439.12:02, and 58.1-500 through 58.1-504 of the *Code of Virginia*. The repeal of these *Code* sections would also result in the termination of certain tax credits that can currently be claimed by non-corporate taxpayers, and the elimination of technical guidance on the calculation of income tax liability for pass-through entities.

Discussion of Fiscal Implications:
Under House Bill (HB) 119, corporations would no longer be liable for State income taxes beginning in tax year 2010. The Department of Taxation (TAX) used figures from the State's official forecast (released December 18, 2009) to create a fiscal impact statement for this bill. Using these figures is a sound approach, as the official forecast reflects the best available assumptions about the economic climate that may affect the level of corporate income taxes collected in future years.

(A) Differences in Estimated Corporate Income Tax Receipts Between the Department of Taxation's Fiscal Impact Statement and Virginia's Official Forecast

While the Department of Taxation's fiscal impact statement mirrors the official forecast almost exactly in fiscal years (FY) 2012 and beyond, the estimates for FY 2010 and 2011 are substantially different as shown in the table below. However, JLARC staff find that this is warranted because it more accurately reflects the timing of the impact of HB 119 on the General Fund. Two factors largely explain the apparent disconnect: (1) State revenues will continue to be impacted by the corporate income tax until FY 2012 as returns from prior tax years are finalized, and (2) the retroactive nature of this bill could create uncertainty among corporations about whether to file their tax year 2010 return and pay any taxes owed at that time.

	Estimated Corporate Income Tax Receipts in Official Forecast (A)			**Estimated Corporate Income Tax Receipts if HB 119 Is Enacted (B)**			**Change in Corporate Income Tax Receipts if HB 119 Is Enacted (B) – (A)**
State Fiscal Year	For Tax Years Prior to 2010	For Tax Years 2010 and After	Total (Official Forecast)	For Tax Years Prior to 2010	For Tax Years 2010 and After	Total	Total
2010	286.1	419.1	705.2	286.1	279.4	565.4	-139.7
2011	-282.9	1,020.3	737.4	-282.9	-279.4	-562.3	-1,299.7
2012	-24.6	837.9	813.3	-24.6	0.0	-24.6	-837.9
2013	0.0	872.2	872.2*	0.0	0.0	0.0	-872.2
2014	0.0	918.2	918.2**	0.0	0.0	0.0	-918.2
2015	0.0	955.2	955.2**	0.0	0.0	0.0	-955.2

* Includes $30 million additional collections resulting from compliance audits, not included in the State's official forecast
** Includes $60 million additional collections resulting from compliance audits, not included in the State's official forecast

(1) Corporate income tax returns may take several years to be finalized

The revenue impact of corporate income taxes owed for a given tax year is realized over the course of several State fiscal years. This lag occurs largely because (1) the State fiscal year (July 1 through June 30) ends earlier than the tax year (January 1 through December 31), such that a portion of the corporations' payments made during the tax year will be reflected in the State's next fiscal year; (2) corporations can file for an extension that may delay a portion of their payment for up to two fiscal years; (3) tax refunds pertaining to a tax year are generally issued after final tax returns have been filed, which is generally during the following fiscal year or thereafter; and (4) several provisions allow corporations to apply losses incurred in a given tax year against their tax liability from prior years.

To illustrate, a corporation that owes Virginia income taxes for tax year 2009 could

- Remit the first two of its four estimated tax payments to the State in FY 2009,
- Pay the last two estimated tax payments in FY 2010 as well as any underpayment identified when its 2009 tax return is filed,
- Receive a refund in FY 2011 if it files a six-month extension and its final tax return indicates an overpayment,
- Receive another refund in FY 2012 if it applies a portion of net operating losses incurred in 2012 against its tax year 2009 liability.

To estimate in which fiscal year corporate income tax payments are likely to be collected, TAX analyzed the composition of corporate income tax receipts in fiscal years 1991 through 2005. During this 14-year period, there was little change in the proportion of corporate income taxes collected in a given fiscal year and attributable to prior tax years. Therefore, it is reasonable to assume that this trend will continue in FY 2010 and 2011. As shown in the table above, corporate income taxes from tax years prior to 2010 are expected to increase State revenues by $286.1 million in FY 2010 and reduce the General Fund by $282.9 million in FY 2011 and $24.6 million in FY 2012, as final payments are made and refunds are processed.

(2) Some corporations may pay their 2010 tax liability due to uncertainty over the passage of HB 119

In addition to corporate income tax payments related to tax years prior to 2010, certain corporations may remit income tax payments against their 2010 tax liability in FY 2010. While HB 119 would eliminate the corporate income tax starting on January 1, 2010, it is unclear whether the bill could be signed into law before corporations are required to file their 2010 return in April. Consequently, some corporations may adopt a conservative approach and remit their payment at that time. If the bill were subsequently passed, these corporations would receive a full refund that would likely be processed during the following fiscal year as shown in the table above. The Department of Taxation assumed in its fiscal impact statement that two-thirds of corporations would choose to make a payment, while the other one-third would abstain under the assumption that the bill would pass. In the absence of data that would indicate how many corporations are likely to make a payment, these assumptions appear reasonable.

(B) Impact of HB 119 on Non-Corporate Taxpayers

While HB 119 eliminates the taxation of corporations in the State, most other Virginia businesses would remain subject to income taxes. As indicated in TAX's fiscal impact statement, there are approximately 535,000 sole proprietorships and 170,000 pass-through entities in Virginia, compared

to 71,000 corporations based on the number of returns filed in 2007. Yet, HB 119 would eliminate sections of the *Code of Virginia* that pertain not only to corporations, but also to other types of businesses as well as individuals. In particular, the bill would eliminate 12 tax credits currently available to non-corporate taxpayers and repeal sections that describe how their tax liability must be calculated.

As shown in the table below, many non-corporate taxpayers claimed these credits in recent years and reduced their Virginia income tax liability by a total of $5.7 million in the most recent tax year for which data are available, in large part due to coal employment-related tax credits. Non-corporate taxpayers that are eligible to claim these credits include individuals, sole proprietorships, and pass-through entities such as S-corporations, limited liability companies (LLCs), and limited liability partnerships (LLPs). Unlike corporations, these taxpayers would still be subject to State income taxes if HB 119 were enacted. Therefore, eliminating the tax credits listed in the table below could in effect increase the tax liability of these taxpayers by at least $5.7 million per year, assuming that the amount claimed by individuals and pass-through entities in tax year 2007 is indicative of future claims.

Tax Credits Repealed by HB 119 (*Code of Virginia* §58.1-)	**Tax Year 2005**		**Tax Year 2006**		**Tax Year 2007**	
	# Non-Corporate Returns Where Claimed	**Amount Claimed ($M)**	**# Non-Corporate Returns Where Claimed**	**Amount Claimed ($M)**	**# Non-Corporate Returns Where Claimed**	**Amount Claimed ($M)**
Coal Employment and Production Incentive (433.1) Coalfield Employment Enhancement (439.2)	45	$8.4	44	$9.2	31	$5.1
Low Income Housing (435)	32	0.3	42	0.5	41	0.3
Waste Motor Oil Credits (439.10)	98	0.2	87	0.2	67	0.1
Vehicle Emissions Testing Equipment (438.1)	60	0.0	17	0.0	37	0.0
Clean Fuel Vehicles* (438.1)	3,665	0.9	280	0.2	41	0.0
Major Business Facility Jobs (439)	73	0.0	86	0.0	90	0.0
Worker Retraining (439.6)	5	0.0	6	0.0	4	0.0
Recyclable Materials Processing Equipment (439.7)	59	0.5	31	0.2	11	0.0
Day Care Facility Investment (439.4)	0	-	0	-	0	-
TANF Employee Credits (439.9)	0	-	0	-	0	-
Biodiesel Fuel Credits** (439.12:02)	0	-	0	-	0	-
Total	**4,037**	**$10.3**	**593**	**$10.3**	**322**	**$5.7**

Note: The amounts reported for a taxable year represent 12 months of processing. For example, amounts reported for TY 2005 represent credits filed on returns processed.
* Expired Dec 31, 2006. Only carry-forward amounts are being claimed.
** Began January 1, 2008.

HB 119 would also eliminate sections of the *Code* that provide technical guidance not only to corporations but also to pass-through entities. In particular, the bill would repeal sections that set forth how businesses that operate in multiple states should apportion their income to Virginia (§58.1-406 through 414), and how those rules vary based by industry (§58.1-415 through 422).

(C) Additional Information Expected From JLARC Review of Virginia's Corporate Income Tax

Additional information about the impact of HB 119 should be available in November 2010, when JLARC staff conclude their review of Virginia's corporate income tax as directed by House Joint Resolution 681 (2009). In particular, JLARC staff plan to examine the impact of lowering or repealing the State corporate income tax on job creation and the State's economy, and the extent to which this might offset the decrease in corporate income tax collections. The potential "dynamic" effects of changes in tax policy are not reflected in the Department of Taxation's fiscal impact estimates, which focus on the direct or "static" impact of proposed legislation. While more subjective than a static estimate, a dynamic estimate may offer some insight into the magnitude of additional revenues that could be expected as a result of changing Virginia's corporate income tax rate.

In addition, JLARC staff plan to conduct a more in-depth analysis of taxes paid by pass-through entities, which are twice as prevalent as corporations in Virginia. Due to data constraints, little is known about the nature of these businesses, their size, or the tax burden they experience. Because job creation has been cited as an important objective of eliminating the corporate income tax, it may be useful to better understand the extent to which Virginia jobs exist in corporations rather than in other types of businesses.

Budget Amendment Necessary

Yes. Revenues would need to be adjusted downward beginning in fiscal year 2010, and the Department of Taxation's budget would be reduced by $186,000 per year beginning in fiscal year 2012. Unless the introduced bill is amended, the revenue impact estimated by TAX would need to be partially offset by the positive fiscal impact resulting from the elimination of certain tax credits available to non-corporate taxpayers.

Agencies Affected

Department of Taxation

Date Released, Prepared By: 02/02/2010; Nathalie Molliet-Ribet