# DEPARTMENT OF TAXATION
# 2012 Fiscal Impact Statement

**1. Patron** R. Lee Ware, Jr.

**2. Bill Number** HB 154

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

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

**3. Committee** Senate Finance

**4. Title** Corporate Income Tax; Apportionment for Retail Companies

**5. Summary/Purpose:**

This bill would modify the corporate apportionment formula by requiring retail companies to use a single factor apportionment based on sales to determine their Virginia taxable income. This modification would be phased in as follows: for taxable years beginning on or after July 1, 2012, but before July 1, 2014, qualifying corporations may elect to use a triple-weighted sales factor; for taxable years beginning on or after July 1, 2014, but before July 1, 2015, qualifying corporations may elect to use a quadruple-weighted sales factor; and for taxable years beginning on or after July 1, 2015, and thereafter, qualifying corporations may elect to use the single sales factor method to apportion Virginia taxable income.

This bill would be effective for taxable years beginning on and after July 1, 2012.

**6. Budget amendment necessary:** No.

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

**8. Fiscal implications:**

Administrative Impact

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

Revenue Impact

A single sales factor method of apportionment mandated for all retailers would reduce the tax for taxpayers with substantial operations in Virginia, while increasing it for other taxpayers. The net impact is expected to be revenue neutral for the Commonwealth.

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

Department of Taxation

Retailers

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

**11. Other comments:**

<u>Other States</u>

According to the Federation of Tax Administrators, as of January 1, 2011, at least fourteen other states also have a sales factor of 50%. Twelve states still utilize the standard three factor formula, and three states have a sales factor between 50% and 100%. An additional seventeen 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, Colorado, Georgia, Illinois, Indiana, Iowa, Louisiana, Maine, Maryland, Michigan, Minnesota, Nebraska, New York, Oregon, South Carolina, Texas, and Wisconsin.

<u>Virginia</u>

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.

Prior to 1999, the property, payroll, and sales factors were weighted equally. In 1999, the formula was changed so that the sales factor was double counted.

Corporate Apportionment for Manufacturers

In 2009, legislation was enacted (2009 *Acts of Assembly*, Chapter 821, House Bill 2437) that modified the corporate apportionment formula to allow manufacturing companies to elect a single factor apportionment based on sales to determine their Virginia taxable income. This modification is phased in as follows: for taxable years beginning on or after July 1, 2011, but before July 1, 2013, qualifying corporations may elect to use a triple-weighted sales factor; for taxable years beginning on or after July 1, 2013, but before July 1, 2014, qualifying corporations may elect to use a quadruple-weighted sales factor; and for taxable years beginning on or after July 1, 2014, and thereafter, qualifying corporations may elect to use the single sales factor method to apportion Virginia taxable income.

Once a manufacturing company elects to use these methods, it may not change the method of apportionment for three taxable years. In addition, a taxpayer making this election is required to certify to the Department that the average weekly wages of its full-time employees was greater than the lower of the state or local average weekly wages for the taxpayer's industry.

The manufacturing company is also required to maintain a base year level of employment in the Commonwealth for the first three taxable years after electing to use the single sales factor method apportionment. If a corporation does not satisfy this criterion, the Department is directed to assess the corporation the difference between taxes calculated under the standard apportionment in which sales are double-weighted and sales-only apportionment. In addition, a ten percent penalty would be assessed; and interest would accrue.

This legislative change was recommended by a joint subcommittee studying the benefits of adopting a single sales factor. This subcommittee was created as a result of House Joint Resolution 177 and Senate Joint Resolution 101, which were passed during the 2008 General Assembly session.

Proposal

This bill would modify the corporate apportionment formula by requiring retail companies to use a single factor apportionment based on sales to determine their Virginia taxable income. This modification would be phased in as follows: for taxable years beginning on or after July 1, 2012, but before July 1, 2014, qualifying corporations may elect to use a triple-weighted sales factor; for taxable years beginning on or after July 1, 2014, but before July 1, 2015, qualifying corporations may elect to use a quadruple-weighted sales factor; and for taxable years beginning on or after July 1, 2015, and thereafter, qualifying corporations may elect to use the single sales factor method to apportion Virginia taxable income.

"Retail company" would mean a domestic or foreign corporation primarily engaged in activities that, in accordance with the North American Industry Classification System (NAICS), United States Manual, United States Office of Management and Budget, 1997 Edition, would be included in Sectors 44-45.

This bill would be effective for taxable years beginning on and after July 1, 2012.

Similar Bills

**Senate Bill 49** is identical to this bill.

**House Bill 460** would eliminate the requirement that a manufacturer electing to use the single sales factor apportionment method maintain a base year level of employment in the Commonwealth for the first three taxable years after making the election, and the provisions assessing additional taxes, penalties and interest for failing to meet this requirement.

cc : Secretary of Finance

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