DEPARTMENT OF TAXATION
2013 Fiscal Impact Statement

1. Patron L. Scott Lingamfelter

2. Bill Number HB 1831

House of Origin:
X Introduced
_____ Substitute
_____ Engrossed

Second House:
_____ In Committee
_____ Substitute
_____ Enrolled

3. Committee

4. Title Exemptions from certain SCC fees, from the BPOL tax, and state tax credits for local personal property.

5. Summary/Purpose:

This bill would provide businesses owned by disabled veterans, whose disabilities are service-connected, with an exemption from certain State Corporation Commission ("SCC") fees for the first two years such businesses are engaged in business in Virginia; would provide all new businesses with an exemption from the local Business, Professional and Occupational License ("BPOL") Tax for the first two full calendar years after they locate in a county, city, or town for the first time; and would provide all beginning businesses with a refundable state tax credit for local tangible personal property, machinery and tools, and merchants' capital taxes paid by such businesses up through their first two full tax years.

The exemption from SCC fees would only apply to businesses that were first engaged in business in Virginia on or after July 1, 2013. The BPOL exemption would only apply to businesses that locate in a Virginia county, city, or town for the first time on or after July 1, 2013. The refundable state tax credit would be effective for taxable years beginning on or after January 1, 2013, but before January 1, 2018.

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

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

Fiscal Year	*Dollars*	*Positions*	*Fund*
2012-13	$0	0	GF
2012-13	$0	0	Local
2013-14	($3.5 million)	0	GF
2013-14	($13.4 million)	0	Local
2014-15	($2.5 million)	0	GF
2014-15	($13.4 million)	0	Local

Fiscal Year	*Dollars*	*Positions*	*Fund*
2015-16	($2.6 million)	0	GF
2015-16	($13.5 million)	0	Local
2016-17	($2.6 million)	0	GF
2016-17	($13.6 million)	0	Local
2017-18	($1.5 million)	0	GF
2017-18	($13.6 million)	0	Local
2018-19	($0.2 million)	0	GF
2018-19	($13.6 million)	0	Local

8. Fiscal implications:

Administrative Costs

Department of Taxation Administrative Costs

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

The Department will provide specific administrative costs on any legislation that is not "routine." Additionally, the Department 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, the Department will identify the costs at that time.

SCC Administrative Costs

This bill would require computer system modifications for the SCC Clerk's Office. The extent of such modifications and the related costs are unknown at this time. The Clerk's Office would have to develop procedures to ascertain the ownership of new businesses because the information is not currently reported to them. In fact, newly organized entities do not have owners until after the fees are paid, the SCC issues the charter, and an organizational meeting of the entity is held at which ownership interests can be purchased. Therefore, the SCC may have to implement the fee waiver through a refund mechanism. While some of the fees are deposited to the General Fund, most of the fees collected affected by this bill are retained by the SCC and fund the Clerk's Office. The number of new businesses owned by disabled veterans is unknown, so the impact of the exemption from SCC fees on the ability of the Clerk's Office to absorb the increased administrative costs cannot be determined.

Revenue Impact

This bill would have an unknown General Fund and local revenue impact because the number of new businesses and the amount of local property taxes they pay that would qualify for the tax credit is unknown. However, a speculative revenue estimate can provide an order of magnitude for the revenue loss.

Provision (amounts in $ millions)	**FY 2014**	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**
Exempt businesses owned by disabled veterans from SCC fees	($0.2)	($0.2)	($0.2)	($0.2)	($0.2)	($0.2)
New business income tax credit for local machinery & tools tax and merchants' capital tax	($3.3)	($2.3)	($2.4)	($2.4)	($1.3)	0
Total General Fund Loss	**($3.5)**	**($2.5)**	**($2.6)**	**($2.6)**	**($1.5)**	**($0.2)**
New Business exemption from local BPOL tax	($13.4)	($13.4)	($13.5)	($13.5)	($13.6)	($13.6)

SCC Fees: The fees collected by the SCC from limited liability companies are transferred to the General Fund. According to the Clerk's Office, the SCC deposited $49.3 million to the General Fund from annual registration, charter and entrance fees in Fiscal Year 2012. According to the Service Disabled Veteran Owned Small Business Council, there are approximately 2,000 businesses in Virginia owned by veterans with a service connected disability. According to the Census Bureau, in 2007 there were about 638,643 businesses in Virginia. The estimate assumes that the ratio of disabled veteran business to all business is the same for new businesses, and is grown by the average annual change in individual and corporate income tax forecasts.

Income tax credit: Between Fiscal Year 2007 and 2011, the local Merchants' Capital and Machinery and Tools tax averaged about $223.4 million in revenue to Virginia localities. This five year average was multiplied by the number of start-up businesses in 2007 (13,110) from the Virginia Employment Commission and divided by the total number of Virginia firms (638,643) to yield a preliminary revenue impact of about $13.4 million. This figure was grown by the four year average of the annual percentage change in M&T and Merchants' Capital revenue from FY 2007 to FY 2011 (1.28%). This estimate does not include existing companies that would relocate here from outside of Virginia or change localities in Virginia. It also assumes that the tax base (gross receipts) is the same for start-up businesses as it is for all businesses. In addition, the estimate was modified to adjust for changes to estimated payments.

Local BPOL Revenue:

The BPOL tax is imposed in all 39 cities, 46 of the 95 counties, and many of the towns of the Commonwealth. Between Fiscal Year 2007 and 2011, the local BPOL tax averaged about $653.0 million in revenue to these localities. This five year average was multiplied by the estimated number of start-up businesses in 2007 (13,110) from the Virginia Employment Commission and divided by the total number of Virginia firms (638,643) to yield a preliminary revenue impact of about $13.4 million. This figure was grown by the four year average of the annual percentage change in BPOL revenue from FY 2007 to FY

2011 (0.3%). This estimate does not include existing companies that would relocate here from outside of Virginia or change localities in Virginia. It also assumes that the tax base (gross receipts) is the same for start-up businesses as it is for all businesses subject to the BPOL tax.

9. Specific agency or political subdivisions affected:

State Corporation Commission
All localities that impose the BPOL Tax
Department of Taxation

10. Technical amendment necessary: Yes.

It is unclear whether the SCC fees exemption is intended to apply to a business that has existed for several years in another state and moves to Virginia after July 1, 2013. Further, it is unclear whether the SCC fees exemption is intended to apply to inactive corporations, which do not begin engaging in business activities for a number of years after formation.

The stricken language at line 116 “for beginning businesses” should be restored. The procedures for taxing a new business based on estimated receipts will still be needed for certain types of business reorganizations excluded from the new business exemption. See, also, 1988 Op. Va. Att'y Gen. 578 stating that a broker who had been in business for several years, but ceased doing business for an entire year, was treated as a beginner when he resumed business the following year.

The following references should also be corrected:

Line 19, after 13.1-1005
Strike: 13.1-1061
Insert: 13.1-1062

Line 19, after 13.1-1204
Strike: 13.1-1251
Insert: 13.1-1252

Line 19, after 50-73.17
Strike: 50-73.66
Insert: 50-73.67

Line 21, after in
Strike: a

11. Other comments:

Current Law

Exemption From SCC Fees

The SCC assesses and collects charter and entry fees, fees for filing documents or issuing certificates, and annual registration fees from stock and nonstock corporations. Further, the SCC assesses and collects fees for filing documents or issuing certificates and annual registration fees from limited liability corporations, business trusts, and limited partnerships.

BPOL Tax Exemption

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 measure or basis of the BPOL tax generally is the gross receipts of the business. Localities may impose the tax on the gross receipts or the Virginia taxable income of the business, except the basis of the BPOL Tax on certain public service corporations must be gross receipts. Currently, no locality imposes the tax on Virginia taxable income of businesses. For purposes of the provision in the Constitution of Virginia that requires all property to be taxed, the BPOL tax is deemed to be in lieu of the property tax on merchants' capital, the locality cannot impose both taxes on the same business.

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

- $50 for any locality with a population of 25,000 and greater
- $30 for any locality with a population smaller than 25,000

The locality may not assess a license tax on gross receipts upon which it charges a license fee. Additionally, the locality 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 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

Proposed Legislation

Exemption From SCC Fees

This bill would not allow the SCC to assess or collect certain fees against service disabled veteran businesses for the first two years that such enterprises were engaged in business in Virginia. Service disabled veteran businesses that are stock corporations or nonstock corporations would be exempt from charter and entry fees, fees for filing documents, or issuing certificates and annual registration fees. Service disabled veteran businesses that are limited liability companies, business trusts, or limited partnerships would be exempt from fees for filing documents or issuing certificates and annual registration fees.

"Service disabled veteran business" means a business concern that is at least 51 percent owned by one or more service disabled veterans or, in the case of a corporation, partnership, or limited liability company or other entity, at least 51 percent of the equity ownership interest in the corporation, partnership, or limited liability company or other entity is owned by one or more individuals who are service disabled veterans and both the management and daily business operations are controlled by one or more individuals who are service disabled veterans.

“Service disabled veteran” is defined as a veteran who (i) served on active duty in the United States military ground, naval, or air service, (ii) was discharged or released under conditions other than dishonorable, and (iii) has a service-connected disability rating fixed by the United States Department of Veterans Affairs.

The exemption would only apply to service disabled veteran businesses that were first engaged in business in Virginia on or after July 1, 2013. Further, a merger, acquisition, similar business combination, name change, or a change in business form would not affect the date on which a service disabled veteran business first engaged in business in Virginia.

SCC fees apply to both domestic and foreign stock and nonstock corporations, limited liability companies, business trusts, and limited partnerships. Charter and entry fees for corporations and, fees for filing documents or issuing certificates and annual registration fees for limited liability companies, business trusts, and limited partnerships are required to be paid as a prerequisite to incorporating or organizing a new Virginia business entity.

Equity interests in a business entity cannot issued until after the business entity has been created. This presents a procedural dilemma for the SCC because at the time it collects various fees in connection with the organization of a new business entity there are no owners. While ownership interests should have been issued before subsequent fees are collected, e.g., annual registration fees, the ownership information of a business entity is not required to be reported to the Clerk’s Office. Therefore, the Clerk’s Office has no way of knowing the identities of the equity owners of a given business entity or the percentage of equity that each individual owns. The Clerk’s Office would have to devise a procedure to obtain and verify ownership, perhaps by refunding fees after ownership interests are created and certified to the SCC.

The proposed exemption applies to any "service disabled veteran business," a term defined in the *Code of Virginia* to mean, in part, a business concern at least 51% of whose equity is owned by one or more service disabled veterans. The definition appears to embrace established business entities. Further, the definition does not specify whether the service disabled veteran must be the registered owner of the equity or if he can be a beneficial owner of the equity.

The proposed bill provides no requirement that the person submitting an organizational document for a new business entity provide proof, or merely a statement, that he is a service disabled veteran. Furthermore, it provides no requirement that the person submitting the document provide a statement that states that service disabled veterans own or, after formation, will own at least 51% of the equity interests in the business entity. Therefore, the Clerk's Office would not know whether the to-be-formed or existing entity would be exempt from the fees specified in this bill.

This bill would prohibit the SCC from imposing the specified fees for the first two years that a service disabled veteran business is engaged in business in Virginia. Charter and entry fees for corporations and fees for filing documents or issuing certificates and annual registration fees for limited liability companies, business trusts, and limited partnerships are usually one-time fees paid in connection with the formation of a business entity or, in the case of a foreign business entity, with the application for authority to transact business in Virginia. Therefore, the two-year prohibition on the imposition of these fees appears to be inapposite. In addition, the quoted language does not proscribe the collection of these fees in conjunction with the formation of a new domestic entity or with a foreign corporation's entry into Virginia. If the intent is to exempt service disabled veteran businesses from paying charter, entry, and other fees, then this concept should be clearly stated.

Further, a new business entity can postpone engaging in a business for years. It is common for persons to form "shelf" corporations with the intention that they not begin engaging in business activity for a number of years. The SCC has no way of knowing if, and when, a newly formed entity engages in business. Moreover, this information is irrelevant to the purpose of annual registration fees. These fees are imposed for the privilege of doing business in Virginia, not for actually carrying on business in Virginia. Similar to the determination of ownership status, the relevant statutes provide no mechanism for the SCC to ascertain whether a business entity is engaged in business within or without Virginia.

<u>BPOL Tax Exemption</u>

This bill would exempt all businesses from the BPOL Tax for the first two full calendar years after they locate in a county, city, or town for the first time on or after July 1, 2013. Thus, the localities in which the BPOL tax is imposed would suffer a revenue loss, while localities that impose the merchants' capital tax instead of BPOL tax would continue receiving the merchants' capital tax revenue while the state gives businesses an income tax credit.

Income Tax Credits

This bill would allow a beginning business that first engaged in business in Virginia on or after January, 1 2013, but before, January 1, 2018, a nonrefundable credit against Virginia's individual income tax, corporate income tax, bank franchise tax, insurance premiums license tax, or the license tax on telegraph, telephone, water, heat, light, power, and pipeline companies, in an amount equal to the sum of the business tangible personal property tax, machinery and tools tax, or merchants' capital tax paid by the beginning business during the taxable year. The credit would be allowed for the amount of such taxes imposed on the beginning business up through the first two full tax years of the beginning business. No credit would be allowed for any penalties or interest. Further, a merger, acquisition, similar business combination, name change, or a change in business form would not affect the date on which a business first engaged in business in Virginia.

"Beginning business" would be defined as a business that first engaged in business in Virginia on or after January 1, 2013.

"Engaged in business" would be defined as undertaking a course of dealing that requires the time, attention, and labor of the person so engaged for the purpose of earning a livelihood or profit. It implies a continuous and regular course of dealing, rather than an irregular or isolated transaction. The following acts shall create a rebuttable presumption that a person is engaged in a business: (i) advertising or otherwise holding oneself out to the public as being engaged in a particular business or (ii) filing tax returns, schedules, and documents that are required only of persons engaged in a trade or business.

"Tax year" would be defined as the 12-month period beginning in the calendar year for which business tangible personal property tax, machinery and tools tax, or merchants' capital tax was imposed by a locality on a beginning business for the full 12-month period.

In order to claim the credit, this bill would require the beginning business to attach evidence of the payment of the business tangible personal property tax, machinery and tools tax, or merchants' capital tax to the tax return it files with the Department or the SCC.

The amount of the tax credit claimed would not be allowed to exceed the total amount of the individual income tax, corporate income tax, bank franchise tax, insurance premiums license tax, and license tax on telegraph, telephone, water, heat, light, power, and pipeline companies, imposed on the beginning business for the taxable year. If the amount of the tax credit exceeds the total amount of such taxes imposed on the beginning business for the taxable year, then the unused tax credits may be carried over for five taxable years or until the total amount of the tax credit has been taken, whichever is sooner.

Under this bill, the tax credits granted to a partnership, limited liability company, or electing small business corporation (S corporation) would be allocated to the individual partners, members, or shareholders in proportion to their ownership or interest in such business entities.

This bill would require the Tax Commissioner to develop guidelines implementing the bill's provisions. Such guidelines would be exempt from the Administrative Process Act.

cc : Secretary of Finance

Date: 1/24/2013 MTH
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