DEPARTMENT OF TAXATION
2014 Fiscal Impact Statement

1. **Patron** Christopher T. Head

2. **Bill Number** HB 371
   House of Origin:
   _____ **Introduced**
   __X__ **Substitute**
   _____ **Engrossed**

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

3. **Committee** House Finance

4. **Title** Business, Professional, and Occupational License Tax; Income of Businesses

5. **Summary/Purpose:**

   The Department understands that the patron plans to introduce a substitute bill. This impact statement addresses the substitute bill.

   This bill would exclude amounts paid by a taxpayer to another person, who is not an employee of the taxpayer, pursuant to a subcontract between the taxpayer and such person from the gross receipts of the taxpayer for the purposes of the Business, Professional, and Occupational License ("BPOL") Tax.

   Under current law, exclusions from gross receipts are provided for i) commissions paid by real estate brokers to their agents that have BPOL licenses, ii) commissions paid by a security broker or security dealer to an independent registered representative on any sale or purchase of a security, iii) amounts collected by funeral services providers and paid to another person providing goods or services in connection with a funeral.

   The effective date of this bill is not specified.

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

7. **Fiscal Impact Estimates are:** Not available. (See Line 8.)

8. **Fiscal implications:**

   To the extent that the gross receipts of taxpayers are lowered by amounts paid pursuant to subcontracts, this bill would have an unknown negative impact on local revenues. In Fiscal Year 2012, the BPOL tax generated approximately $683.1 million for the counties, cities, and towns that imposed the tax. The BPOL tax is imposed in all 39 cities, 48 of the 95 counties, and many of the towns of the Commonwealth. The potential local revenue loss from this bill could be substantial. This bill would have no impact on state revenues.

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

   All localities

10. Technical amendment necessary: No.

11. Other comments:

BPOL Tax

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 may either be the gross receipts or the Virginia taxable income of the 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.

Localities that imposed a higher rate structure on January 1, 1978 are allowed to continue to impose the tax at those rates.

Taxability of Pass Through Costs

For purposes of the BPOL tax, *Va. Code* § 58.1-3700.1 provides that gross receipts means "the whole, entire, total receipts, without deduction." Additionally, a business that is not the legal agent of its customer may not exclude from its BPOL taxable gross receipts monies it receives from its customer as payment for costs incurred by the business with others who have no contractual relationship with the customer.

In some instances, an agency relationship meeting specific criteria enables a taxpayer to exclude certain receipts from the calculation of his gross receipts. Ruling of the Tax Commissioner, Public Document 01-38 (4/12/2001), establishes the following criteria: (1) there must be a contractual relationship between a taxpayer and both the client and the contracted third party; (2) the taxpayer cannot commingle its funds with all other sources; it must have a separate accounting system or a fiduciary account where the pass through receipts are recorded; and (3) the taxpayer does not report these "pass through costs" on its federal income tax return.

The BPOL law allows taxpayers to deduct pass through costs in very limited situations, including the exclusion of commissions paid by real estate brokers to their agents that have BPOL licenses. Under current law, without a specific exemption, taxpayers are not allowed to deduct receipts subsequently paid over to an independent representative unless the taxpayer is acting as an agent in the transactions. Exemptions are provided for i) commissions paid by real estate brokers to their agents that have BPOL licenses, ii) commissions paid by a security broker or security dealer to an independent registered representative on any sale or purchase of a security, iii) amounts collected by funeral services providers and paid to another person providing goods or services in connection with a funeral. In all other situations, there is no deduction allowed for amounts paid to subcontractors.

Proposal

This bill would exclude amounts paid by a taxpayer to another person, who is not an employee of the taxpayer, pursuant to a subcontract between the taxpayer and such person from the gross receipts of the taxpayer for the purposes of the Business, Professional, and Occupational License ("BPOL") Tax.

The effective date of this bill is not specified.

Similar Legislation

House Bill 434 would prohibit a locality from increasing the rate of its business machinery and tools tax, merchants' capital tax, and BPOL tax and fees above the locality's rates in effect as of January 1, 2014.

House Bill 435 would prohibit a locality from increasing the rate of its business machinery and tools tax, merchants' capital tax, and BPOL tax and fees above the locality's rates in effect as of January 1, 2014. The bill would also establish refundable income tax credits equal to 33 percent of such taxes paid during the taxable year beginning with taxable year 2014.

House Bill 497 would allow taxpayers to appeal or request a written ruling from the Tax Commissioner regarding the classification of his business for BPOL tax purposes, regardless of whether the locality has conducted an audit or issued an assessment.

Senate Bill 112 would require the General Assembly to appropriate an amount sufficient to pay on behalf of taxpayers the total amount of BPOL Tax and Machinery and Tools Tax owed to a locality beginning in any calendar year in which the unemployment rate of the locality in the most recent calendar year for which data is available is equal to or greater than twice the statewide average unemployment rate.

cc : Secretary of Finance

Date: 1/20/2014 AM
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