DEPARTMENT OF TAXATION
2011 Fiscal Impact Statement

REVISED 1/23

1. Patron L. Scott Lingamfelter

2. Bill Number HB 729

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

3. Committee House Finance

4. Title Individual Income Tax; Retail Sales and Use Tax; Restructuring

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

5. Summary/Purpose:

This bill would reduce the individual income tax rates for taxable years beginning on and after January 1, 2015. The individual income tax would be imposed at the following rates: (i) 2.95 percent on income in excess of $3,000, but not in excess of $5,000; (ii) 4.9 percent on income in excess of $5,000 but not in excess of $17,000; and (iii) 5.5 percent on income in excess of $17,000.

Additionally, this bill would increase the threshold for filing a Virginia individual income tax return. This bill would increase the filing threshold for single individuals and married taxpayers filing separately to a Virginia adjusted gross income of $15,000, after taking into account the age deduction, if applicable. This bill would increase the filing threshold for married taxpayers filing jointly to a combined Virginia adjusted gross income of $30,000, after taking into account the age deduction, if applicable. This portion of the bill would be effective for taxable years beginning on and after January 1, 2015.

The bill would increase the state Retail Sales and Use Tax rate by 0.7 percent effective January 1, 2015, and would repeal the state and local retail sales and use tax on food purchased for human consumption beginning June 1, 2015. The bill also would repeal the 0.7 percent additional state Retail Sales and Use Tax imposed in the Planning District 8, the Northern Virginia region, and Planning District 23, the Hampton Roads region effective January 1, 2015. The revenues generated by the 0.7 percent state Retail Sales and Use Tax would be dedicated to the General Fund, except that Planning Districts 8 and 23 would continue to receive the revenue generated by a 0.7 percent state sales and use tax from each county and city located within the respective Planning District.

The bill would establish funds for each planning district of the Commonwealth as of January 1, 2014, with the exception of Planning District 8 and Planning District 23, and would dedicate Transportation Trust Fund revenues to each Planning District, other than Planning Districts 8 and 23, in the amount of revenue generated by a 0.7 percent state sales and use tax from each county and city located within the respective Planning District (as the boundaries were determined or drawn by the Department of Housing and Community Development as of January 1, 2014). The revenues would be required to be used solely for new construction projects on new or existing roads, bridges, and tunnels or mass transit projects within the geographical boundaries of the Planning District (as the boundaries were determined or drawn by the Department of Housing and Community Development as of January 1, 2014). The Commonwealth Transportation Board ("Board"), in consultation with the planning district commission, would be required to approve the projects to be funded or financed with money in the planning district funds. The Board would be required to ensure that the moneys are used for projects in each county or city within the planning district. Projects approved by the Board must be located i) only in the counties and cities within geographical boundaries of the planning district to which the funds relate, or ii) in localities adjacent to such planning district but only to the extent that such extension is an insubstantial part of the project and is essential to the viability of the project within such planning district.

This bill would also limit the sales and use tax exemption available to nonprofit organizations on their purchases of tangible personal property to those organizations that had less than $1 million in gross revenue in their previous fiscal year effective January 1, 2015.

This bill would impose the Retail Sales and Use Tax upon the sale of certain specified services, events, and other such transactions, regardless of whether charges for the services or events are separately stated on the invoice or whether the true object of the charge is a service. The bill would also specify that, for purposes of determining which locality is entitled to the one percent local option sales and use tax, the sales taxes collected from admissions would be sourced to the county or city where admission is gained. Sales taxes generated from membership fees and dues would be sourced to the county or city of the facility used by the dues-paying members. The local option taxes for all other services would be distributed in the same manner as the Department currently distributes its local sales and use taxes. The Department would be required to publish guidelines implementing the provisions of this bill.

The effective date of this bill is not specified.

6. Budget amendment necessary: Yes.
ITEM(S): Page 1, Revenue Estimates
273 and 275, Department of Taxation

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

Fiscal Year	***Dollars***	***Positions***	***Fund***
2013-14	$3,000	0	GF
2014-15	$360,000	0	GF
2015-16	$0	0	GF
2016-17	$230,000	4	GF
2017-18	$230,000	4	GF
2018-19	$240,000	4	GF
2019-20	$240,000	4	GF

8. Fiscal implications:

Administrative Costs

The Department would incur administrative costs of approximately $3,000 in Fiscal Year 2014 and $480,000 in Fiscal Year 2015 for forms and systems changes, and $230,000 in Fiscal Year 2017, $230,000 in Fiscal Year 2018, $240,000 in Fiscal Year 2019, and $240,000 in Fiscal Year 2020 for 4 full time employees to administer the audit program for service businesses now subject to the Retail Sales and Use Tax.

Revenue Impact

Income Tax

The following chart shows the estimated revenue impact of the provisions reducing the income tax rates and increasing the filing thresholds effective for taxable years beginning on and after January 1, 2015:

$ Millions

Fiscal Year	General Fund
2015	($282)
2016	($586)
2017	($607)
2018	($636)
2019	($663)
2020	($691)

Retail Sales and Use Tax

House Bill 2313, enacted by the 2013 General Assembly, committed discretionary General Fund revenue to the Highway Maintenance and Operating Fund ("HMOF") in an amount equal to the revenue generated by a 0.05% sales and use tax, such as that paid to the Transportation Trust Fund, for Fiscal Year 2014. The dedication increases to 0.10% for Fiscal Year 2015, and 0.15% for Fiscal Year 2016. For Fiscal Year 2017 and each fiscal year thereafter, the revenue dedicated to the HMOF will be an amount equal to the revenue generated by a 0.175% sales and use tax. If the collection of sales and use tax from remote sellers is not authorized by January 1, 2015, the revenue dedicated to the HMOF will remain at the Fiscal Year 2015 rate of 0.10%.

Under the Marketplace Fairness Act (S. 743), states would not be able to require remote collection of sales and use tax until the first day of the calendar quarter (January, April, July, October) that is at least 6 months after the date the state enacts legislation to exercise the authority granted by the bill. As Virginia has already passed legislation exercising the authority, if Congress were to grant states the authority to collect retail sales and use taxes from remote sellers by December 31, 2014, remote seller collections of sales and use tax could begin as early as April 1, 2015. For purposes of this bill, it is assumed that remote collections would begin July 1, 2015 if Congress were to enact the Marketplace Fairness Act.

Retail Sales and Use Tax Increase

The bill would increase the Retail Sales and Use Tax by 0.7 percent effective January 1, 2015. The following chart shows the estimated revenue impact of the increase, assuming that Congress does enact legislation and remote collections begin July 1, 2015 and assuming that Congress does not enact the Marketplace Fairness Act:

$ Millions – Retail Sales and Use Tax Increase

Fiscal Year	With Remote Collections	Without Remote Collections
2015	$133.8	$133.8
2016	$349.3	$332.4
2017	$364.2	$345.0
2018	$376.5	$356.8
2019	$389.3	$368.9
2020	$402.6	$381.4

Repeal Retail Sales and Use Tax on Food

This bill would repeal the Retail Sales and Use Tax on food purchased for human consumption beginning June 1, 2015. Passage of the Marketplace Fairness Act would have no impact on this provision of the bill. The following chart shows the estimated revenue impact to Retail Sales and Use Tax revenues of the repeal of the sales and use tax on food:

$ Millions – Repeal of Sales Tax on Food

Fund	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
School-age	$0	($176.9)	($183.7)	($189.9)	($196.4)	($203.0)
TTF	$0	($89.4)	($92.8)	($95.9)	($99.2)	($102.5)
Local	$0	($178.7)	($185.5)	($191.8)	($198.3)	($205.1)
Total	**$0**	**($445.0)**	**($461.9)**	**($477.6)**	**($493.9)**	**($510.7)**

Taxation of Nonprofits with Gross Revenue of Over $1 Million

This bill would repeal the Retail Sales and Use Tax exemption for purchases of tangible personal property by nonprofit organizations that had $1 million or more in gross revenue effective January 1, 2015. Passage of the Marketplace Fairness Act would not impact the total revenue estimate for this provision. The effect of the passage of the Marketplace Fairness Act on particular funds is shown in the section "Net State and Local Impact" below.

The following chart shows the estimated revenue impact to Retail Sales and Use Tax revenues of the repeal of the exemption for large nonprofits assuming a 6 percent Retail Sales and Use Tax rate:

$ Millions – Nonprofit Exemption ($1 Million+)

Fiscal Year	Retail Sales and Use Tax Revenues
2015	$64.7
2016	$160.7
2017	$163.9
2018	$167.0
2019	$170.4
2020	$170.4

Taxation of Personal Services

This bill would repeal the Retail Sales and Use Tax exemption for certain personal services effective January 1, 2015. Passage of the Marketplace Fairness Act would not impact the total revenue estimate for this provision. The effect of the passage of the Marketplace Fairness Act on particular funds is shown in the section "Net State and Local Impact" below. The following chart shows the estimated revenue impact to Retail Sales and Use Tax revenues of the repeal of the exemption for personal services assuming a 6 percent Retail Sales and Use Tax rate:

$ Millions – Personal Services

Fiscal Year	Retail Sales and Use Tax Revenues
2015	$254.3
2016	$620.6
2017	$632.9
2018	$644.9
2019	$657.9
2020	$666.2

Net State and Local Impact

The following chart shows the estimated net state and local revenue impact of the income tax and sales tax provisions, assuming that Congress does enact legislation and remote collections begin July 1, 2015:

With MFA
($ millions)

Fund	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2020**
Sales Tax Provisions	$120.8	$289.4	$291.8	$297.4	$303.3	$306.4
Income Tax Provisions	($281.7)	($585.8)	($607.3)	($635.8)	($663.0)	($690.7)
GF-Unrestricted	($160.9)	($296.4)	($315.5)	($338.5)	($359.6)	($384.3)
GF-Restricted	$59.5	($31.3)	($35.1)	($38.5)	($41.9)	($47.1)
Transportation	$42.7	$15.2	$13.8	$12.7	$11.6	$9.4
Local Option	$53.3	($48.1)	($52.3)	($56.0)	($59.8)	($65.2)
HMOF (GF transfer)	$5.3	$19.6	$23.3	$23.8	$24.2	$24.5
0.7% increase, excluding No. Va. and H.R. planning districts	$151.4	$392.5	$408.2	$421.4	$435.1	$448.8
Transfer from TTF to Planning Districts, excluding No. Va. and H.R.	($151.4)	($392.5)	($408.2)	($421.4)	($435.1)	($448.8)
Net Fiscal Impact, State and Local	**$0**	**($340.9)**	**($365.7)**	**($396.6)**	**($425.5)**	**($462.7)**

The following chart shows the estimated net state and local revenue impact of the income tax and sales tax provisions, assuming that Congress does not enact the Marketplace Fairness Act:

Without MFA
($ millions)

Fund	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
Sales Tax Provisions	$120.8	$296.0	$301.8	$307.5	$313.7	$316.9
Income Tax Provisions	($281.7)	($585.8)	($607.3)	($635.8)	($663.0)	($690.7)
GF-Unrestricted	($160.9)	($289.8)	($305.5)	($328.3)	($349.2)	($373.8)
GF-Restricted	$59.5	($31.3)	($35.1)	($38.5)	($41.9)	($47.1)
Transportation	$42.7	$15.2	$13.8	$12.7	$11.6	$9.4
Local Option	$53.3	($48.1)	($52.3)	($56.0)	($59.8)	($65.2)
HMOF (GF transfer)	$5.3	$13.1	$13.3	$13.6	$13.9	$14.0
0.7% increase, excluding No. Va. and H.R. planning districts	$151.4	$375.6	$389.1	$401.6	$414.7	$427.7
Transfer from TTF to Planning Districts, excluding No. Va. and H.R.	($151.4)	($375.6)	($389.1)	($401.6)	($414.7)	($427.7)
Net Fiscal Impact, State and Local	**$0**	**($340.9)**	**($365.7)**	**($396.6)**	**($425.5)**	**($462.7)**

Net Planning Districts Impact

The bill would transfer to the planning districts an amount generated by a 0.7 percent sales and use tax in each planning district, other than Planning Districts 8 and 23 (Northern Virginia and Hampton Roads regions), from the Transportation Trust Fund. The bill also would transfer Retail Sales and Use Tax revenues to Planning Districts 8 and 23 in an amount generated by a 0.7 percent sales and use tax in each planning district.

The following chart shows the revenue impact to the planning districts, assuming that Congress does enact the legislation and remote collections begin July 1, 2015:

With MFA
($ millions)

Fund	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2020**
Hampton Roads P.D.	$6.8	$23.1	$24.2	$24.8	$25.3	$25.8
Northern Va. P.D.	$13.0	$44.1	$46.5	$47.5	$48.6	$49.5
P.D. Sales Tax Distribution	$19.8	$67.2	$70.7	$72.3	$73.9	$75.3
Transfer from TTF to Planning Districts, excluding No. Va. and H.R.	$151.4	$392.5	$408.2	$421.4	$435.1	$448.8
Net Fiscal Impact, Planning Districts	**$171.2**	**$459.7**	**$478.9**	**$493.7**	**$509.0**	**$524.1**

The following chart shows the revenue impact to the planning districts, assuming that Congress does not enact the Marketplace Fairness Act:

Without MFA
($ millions)

Fund	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2020**
Hampton Roads P.D.	$6.8	$16.6	$16.9	$17.2	$17.5	$17.7
Northern Va. P.D.	$13.0	$31.7	$32.4	$33.0	$33.6	$34.0
P.D. Sales Tax Distribution	$19.8	$48.3	$49.3	$50.2	$51.1	$51.7
Transfer from TTF to Planning Districts, excluding No. Va. and H.R.	$151.4	$375.6	$389.1	$401.6	$414.7	$427.7
Net Fiscal Impact, Planning Districts	**$171.2**	**$440.8**	**$457.4**	**$471.6**	**$486.3**	**$500.5**

9. Specific agency or political subdivisions affected:

Department of Taxation
Planning Districts

10. Technical amendment necessary: No.

11. Other comments:

Individual Income Tax Rate Structure

Under current law, the Virginia taxable income of an individual is taxed at the following rates: 2 percent on income not exceeding $3,000; 3 percent on income in excess of $3,000, but not in excess of $5,000; 5 percent on income in excess of $5,000, but not in excess of $17,000; and 5.75 percent on income in excess of $17,000.

An individual is not required to file a Virginia income tax return under current law if his Virginia adjusted gross income after taking into account the age deduction, if applicable, is less than $11,950. This threshold amount is $23,900 for married individuals filing joint returns.

Retail Sales and Use Tax

House Bill 2313, enacted by the 2013 General Assembly, increased the state portion of the Retail Sales and Use Tax from 4 percent to 4.3 percent effective July 1, 2013. In addition to the 4.3 percent state sales and use tax imposed upon the retail sale and use of tangible personal property in Virginia, localities are permitted to impose a general retail sales tax at the rate of one percent to provide revenue for the general fund of that locality, for a total rate of 5.3 percent. House Bill 2313 also imposed an additional state sales and use tax at a rate of 0.7% in the counties and cities embraced by the Northern Virginia and the Hampton Roads Regions, for a total Retail Sales and Use Tax rate of 6.0 percent in those localities. The Northern Virginia Region embraces the Counties of Arlington, Fairfax, Loudoun, and Prince William and the Cities of Alexandria, Fairfax, Falls Church, Manassas, and Manassas Park. The Hampton Roads Region embraces the Counties of Isle of Wight, James City, Southampton, and York and the Cities of Chesapeake, Franklin, Hampton, Newport News, Norfolk, Poquoson, Portsmouth, Suffolk, Virginia Beach, and Williamsburg.

Currently, dealers engaging in the sale of items through vending machines, or other means that make the collection of the sales tax impractical, may remit the sales tax on the wholesale cost of products being sold at the rate of 5.3 percent. Dealers must still remit the additional one percent local sales and use tax, for a total state and local sales and use tax rate of 6.3 percent (7.0 percent in the Northern Virginia and Hampton Roads Regions).

Food purchased for human consumption is subject to a different state sales tax rate than other tangible personal property. *Va. Code* § 58.1-611.1 provides that the state tax rate on food purchased for human consumption is 1½ percent. The local sales tax rate remains at one percent. Thus the combined state and local sales and use tax rate on food purchased for human consumption is 2½ percent. Food purchased for human consumption includes most staple grocery food items and cold prepared foods packaged for home consumption. Specifically excluded from the definition of food for human consumption are alcoholic beverages, tobacco, and prepared hot foods sold for immediate consumption on and off the premises.

Services

Charges for services generally are exempt from the Retail Sales and Use Tax. However, a number of services are subject to the tax, including: services in connection with the fabrication of tangible personal property; services in connection with the furnishing, preparing or serving of meals or other tangible personal property; charges for lodging or accommodations furnished to transients for less than 90 continuous days; and services provided in connection with sales of tangible personal property. These services are subject to tax in Virginia based upon the definition of sales price, set forth in the *Code of Virginia*, which is defined as the "total amount for which tangible personal property or services are sold, including any services that are a part of the sale…without any deduction on account of the cost of the property sold, the cost of materials used, labor or service costs, losses or any other expenses whatsoever." The Retail Sales and Use Tax does not apply to purely service transactions, which do not involve a sale or transfer of tangible personal property.

Currently, where a transaction involves both the rendering of a service and the provision of tangible personal property, the "true object test" must be utilized to determine the taxability of the transaction. If the "true object" of the transaction is to secure a service, and the tangible personal property which is transferred to the customer is not critical to the transaction, then the transaction may constitute an exempt service. However, if the "true object" of the transaction is to secure the property which it produces, then the entire charge, including the charge for any services provided, is taxable.

The *Code of Virginia* specifies a number of personal services that are exempt from the Retail Sales and Use Tax, even where tangible personal property may be provided in connection with the sale of the service. Among these exempt services are separately stated labor charges for the repair, installation, application or remodeling of tangible personal property; separately stated transportation charges, and separately stated charges for alterations to apparel, clothing and garments.

Nonprofit Organizations

Virginia allows nonprofit organizations that meet certain requirements to apply to the Department to obtain a certificate of exemption, exempting their purchases of tangible personal property from the Retail Sales and Use Tax. Nonprofit organizations must meet the following criteria to be eligible for exemption:

- Be exempt under I.R.C. § 501(c)(3) or § 501(c)(4) or have annual gross receipts of less than $5,000 and be organized for a charitable purpose;
- Have annual administrative costs that are 40% or less of annual gross receipts;
- Be in compliance with state solicitation laws;
- Provide the Department with an estimate of its total taxable purchases;
- Provide the Department with a copy of its Form 990 or a list of its board of directors;
- Provide the Department with a copy of a full financial audit if its gross annual revenues was $1 million or greater in the previous year. Nonprofits with gross annual revenues in the previous year ranging between $750,000 and $1 million

may provide either a financial audit or financial review performed by an independent certified public accountant.

Proposal

Income Tax

This bill would reduce the individual income tax rates for taxable years beginning on and after January 1, 2015. The individual income tax would be imposed at the following rates: (i) 2.95 percent on income in excess of $3,000, but not in excess of $5,000; (ii) 4.9 percent on income in excess of $5,000 but not in excess of $17,000; and (iii) 5.5 percent on income in excess of $17,000.

Additionally, this bill would increase the threshold for filing a Virginia individual income tax return. This bill would increase the filing threshold for single individuals and married taxpayers filing separately to a Virginia adjusted gross income of $15,000, after taking into account the age deduction, if applicable. This bill would increase the filing threshold for married taxpayers filing jointly to a combined Virginia adjusted gross income of $30,000, after taking into account the age deduction, if applicable. This portion of the bill would be effective for taxable years beginning on and after January 1, 2015.

Retail Sales and Use Tax

The bill would increase the state Retail Sales and Use Tax rate by 0.7 percent effective January 1, 2015, and would repeal the state and local retail sales and use tax on food purchased for human consumption beginning June 1, 2015. The bill also would repeal the 0.7 percent additional state Retail Sales and Use Tax imposed in the Planning District 8, the Northern Virginia region, and Planning District 23, the Hampton Roads region effective January 1, 2015. The revenues generated by the 0.7 percent state Retail Sales and Use Tax would be dedicated to the General Fund, except that Planning Districts 8 and 23 would continue to receive the revenue generated by a 0.7 percent state sales and use tax from each county and city located within the respective Planning District.

The bill would establish funds for each planning district of the Commonwealth as of January 1, 2014, with the exception of Planning District 8 and Planning District 23, and would dedicate Transportation Trust Fund revenues to each Planning District, other than Planning Districts 8 and 23, in the amount of revenue generated by a 0.7 percent state sales and use tax from each county and city located within the respective Planning District (as the boundaries were determined or drawn by the Department of Housing and Community Development as of January 1, 2014). The revenues would be required to be used solely for new construction projects on new or existing roads, bridges, and tunnels or mass transit projects within the geographical boundaries of the Planning District (as the boundaries were determined or drawn by the Department of Housing and Community Development as of January 1, 2014). The Commonwealth Transportation Board ("Board"), in consultation with the planning district commission, would be required to approve the projects to be funded or financed with money in the planning district funds. The Board would be required to ensure that the moneys are used for projects in each county or city within the planning district. Projects approved by the Board must be located i) only in the counties and cities within geographical boundaries of the planning district to which the funds relate, or ii) in localities adjacent to such planning district but only to the extent that such extension is an insubstantial part of the project and is essential to the viability of the project within such planning district.

This bill would also limit the sales and use tax exemption available to nonprofit organizations on their purchases of tangible personal property to those organizations that had less than $1 million in gross revenue in their previous fiscal year effective January 1, 2015.

Services

This bill would impose the Retail Sales and Use Tax upon the sale of certain specified services, events, and other such transactions, regardless of whether charges for the services or events are separately stated on the invoice or whether the true object of the charge is a service. The specific services, events, and other transactions that would be subject to state and local sales and use taxes would include:

- Admissions to cultural institutions and museums, amusement parks, entertainment facilities, fitness and sports centers, film and art exhibitions, live sporting events, live performing art performances, dance halls and clubs;
- Charges for bowling, ice skating, roller skating, and paint ball;
- Charges for carpet, rug and upholstery cleaning and repair;
- Charges for delivering or shipping tangible personal property, parking (excluding parking meters), taxi and limousine services, armored car services, and other charges for travel;
- Funeral, cremation, and cemetery services;
- Charges for golfing, including cart charges;
- Hairdressing, nail care, personal exercise programs, and diet and weight-reducing services (excluding surgical procedures or services performed by a licensed doctor);
- Motor vehicle repairs, including painting and remodeling of motor vehicles;
- Car and motor vehicle washes and cleanings;
- Jewelry repairs
- Laundry and linen cleanings
- Docking charges, slip charges, and other charges for the use of a marina;
- Membership fees and dues;
- Pet care;
- Refrigerated storage, mini-warehouse storage, and self-storage units; and
- Labor, maintenance, or repair work performed on machinery, equipment, appliances, electronics and all other tangible personal property.

The Department would be required to publish guidelines implementing the provisions of this bill.

The effective date of this bill is not specified.

Similar Legislation

House Bill 433 would phase out the state and local retail sales and use tax on food purchased for human consumption beginning July 1, 2014 and dedicate General Fund revenues to the Transportation Trust Fund and localities.

cc : Secretary of Finance

Date: 1/23/2014 AM
DLAS File Name: HB729F161