Commission on Local Government

Estimate of Local Fiscal Impact

2015 General Assembly Session

Bill: HB1352 **Patron:** Ramadan **Date:** 1/26/2015

In accordance with the provisions of §30-19.03 of the Code of Virginia, the staff of the Commission on Local Government offers the following analysis of the above-referenced legislation:

Bill Summary:

Allows a deduction from gross receipts for amounts paid by the licensee to persons who are not employees pursuant to a subcontract between the licensee and such other persons. The deduction would become effective beginning with the 2016 license year.

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Executive Summary:

HB 1352 would allow business licensees to make deductions from gross receipts for amounts pursuant to a subcontractor. This provision would begin in license year 2016.

Localities that do not charge a business license fee will not be affected by the provisions of HB 1352. For those jurisdictions that levy the BPOL fee, potential exists for a significant negative impact to local revenues. Responding localities estimated a loss of revenue of $5,000-18,800,000.

Localities with a large amount of business activity will likely be more affected than others by the provisions of HB 1352. Regions with a larger amount of new construction are also likely to be impacted the most by the legislation.

One local government noted that HB 1352 could bring about new business practices for contractors, who stand to benefit if they hire more subcontractors. In such a scenario, contractors may not need to keep as many employees on its books. It is also possible that other businesses will opt to use subcontracts to complete more work in order to reduce their tax burden. Auditing for these exemptions could also become challenging.

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Local Analysis:

Locality: City of Chesapeake **Estimated Fiscal Impact:** $950,000.00

Contractors, builders and developers all use subcontractors. We surmise that under this bill, receipts would only be assessed at one level rather than multiple levels. We estimate a 50% drop in revenues or a loss between $900,000 and $1,000,000 annually.

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Locality: City of Danville **Estimated Fiscal Impact:** $5,000.00

The City's Commissioner of Revenue provided a negative fiscal estimate of at least $5,000. Currently, data (gross receipts and subcontractor deductions) is not readily available to provide a better estimate, and the total gross receipts would be impacted by the level of new development.

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Locality: City of Falls Church **Estimated Fiscal Impact:** $212,000.00

An estimated loss $212,000.00 annually would equate to approximately 7% of the City's BPOL revenue. Since most general construction contractors “sub out” up to 70% of the work on larger jobs, the City of Falls Church could stand to lose that percentage of the BPOL licensing fees currently being paid. This also might encourage other business types to subcontract work normally performed by employees to outside companies. The percentage there would be lower than general construction contractors but even 5% would affect the gross receipt taxes collected within Falls Church.

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Locality: City of Roanoke

The precise impact could not be quantified, but an example was developed. This would result in an estimated 15% reduction in potential revenue to the organization.

Current tax process:

example: Leaning Tower Job - General Contractor $850,000.00 gross
plumber (sub) $100,000.00 gross
Electrician (sub) $ 50,000.00 gross

Total gross 1,000,000.00 gross x .0016 rate = $1,600.00 total tax revenue

Proposed tax process

example Leaning Tower Job General Contractor $700,000.00 gross
plumber (sub) $100,000.00 gross
electrician (sub) $ 50,000.00 gross

Total Gross $850,000.00 gross x .0016 rate = $1,360.00 total tax revenue

This current HB proposal will reduce revenue to the City.

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Locality: City of Winchester **Estimated Fiscal Impact:** $100,000.00

The impact from HB 1352 could be significant, as the provisions allow for the deduction from gross receipts but does not require corresponding documentation regarding the subcontractors involved. The unintended negative effects could be:
• Loss of BPOL revenue at the local level;
• Increase in local resources required to properly identify and license all parties; and
• Degradation of the principle of fair and equitable taxation

Localities should argue that this bill is unnecessary. The City conducts an interview process with contractors upon license issuance to identify any subcontractors involved and ensure proper licensure of all involved. This is standard practice amongst Commissioners of the Revenue and works well. This bill jeopardizes a current process which is efficient, effective and equitable.

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Locality: Henrico County **Estimated Fiscal Impact:** $18,800,000.00

This bill would exempt over 60 percent of the County's BPOL tax base, if approved. The fiscal impact provided was developed by looking at non-payroll expenses for industry benchmarks. From there, that percentage was compared to the County's current BPOL tax base and had the County's rate applied to it to determine the amount of lost revenue for this bill, if approved. As a note, the County collected $29,827,991 in BPOL taxes in FY14.

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Locality: Richmond County

Richmond County does not levy a BPOL fee.

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Locality: Rockingham County

No fiscal impact for Rockingham County.

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Locality: Spotsylvania County

Spotsylvania does not have the data that would be necessary to provide an estimated impact of this bill.

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Professional Organization Analysis:
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Organization: VGFOA

This would reduce revenues for localities. Since rates are capped by State Code, localities would have to look to other taxes (real estate, meals) to make up for the lost revenue or reduce services and expenditures.

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Organization: Virginia Commissioners of Revenue

This bill would have a very adverse impact on BPOL collections.

First, the tax impact on BPOL localities would be substantial, as any business licensee who outsources or "subcontracts" anything would be able to deduct it from their own gross receipts. The bill does not limit this deduction to contractors as defined in §58.1-3714, so its application and thus BPOL effect have the potential to be broad-ranging. For example, a car dealer who is paid to repair a car but who uses subcontractors to install a stereo, perform the alignment, and replace the transmission could deduct those contract amounts from his total gross receipts. The loss is substantial even if isolated to traditional contractors as defined in §58.1-3714. In that case at least one suburban locality has estimated at least a $1,000,000 one-year tax loss alone, before recognizing other types of "subcontractor" exclusions.

Second, this amendment would make it nearly impossible to ensure compliance for any licensee claiming the exemption. It would make auditing very difficult and complex. In the case of a landscaper who used subs for fencing/mowing/tree work, etc., the subs may not generate enough revenue for a license, or may have situs in another state or locality – whereby not only does the revenue go out the window, but the process of auditing or getting proof may entail more work than the revenue generated by licensing the subs or creating the additional assessment. This audit confusion is furthered by the fact that the bill leaves intact §58.1-3715, which allows a locality to license an outside contractor when "the amount of business done… exceeds the sum of $25,000." Without updating this also, confusion for both localities would result. Further audit confusion would come from not being able to compare BPOL gross receipts to gross receipts reported on federal documents or to gross sales on sales tax documents.

This bill will also elevate the interpretative powers of the Tax Department over BPOL, by allowing it to promulgate guidelines without following the Administrative Policy Act, a process of public involvement in policy that it currently has to follow for such guidelines, as required by §58.1-3701 (Department to promulgate guidelines).

Finally, perhaps most long-ranging, this legislation would likely encourage more employers to shed "employees" in place of "subcontractors."

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