DEPARTMENT OF TAXATION
2017 Fiscal Impact Statement

1. Patron Amanda F. Chase

2. Bill Number SB 836

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

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

3. Committee Senate Finance

4. Title Business, Professional, Occupational, and License Tax: Local License Taxes Must be Based on Virginia Taxable income

5. Summary/Purpose:

This bill would provide that, beginning with the 2018 license year, if a locality imposes a Business, Professional, Occupational, and License (BPOL) tax upon a business, the tax shall be based upon the Virginia taxable income of the business.

Current law allows a locality the option to impose the tax upon gross receipts or Virginia taxable income.

6. Budget amendment necessary: No.

7. Fiscal Impact Not Available. (See Line 8.)

8. Fiscal implications:

The BPOL tax is imposed in all 39 cities, 48 of the 95 counties, and many of the towns of the Commonwealth. In 2015, $683.9 million in BPOL taxes were collected by local governments. However, as federal taxable income is determined by taking deductions from gross receipts, this proposal would likely lead to a substantial reduction in BPOL tax revenues for localities.

A 2013 Joint Legislative Audit and Review Commission report studying the impact of changing the basis of the BPOL tax concluded that changing the basis of the BPOL tax from gross receipts to net income could reduce local revenue from the tax by about 95 percent compared to actual 2012 collections.

This bill would have no impact on state revenues.

9. Specific agency or political subdivisions affected:

All localities that impose the local BPOL tax.

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 generally is the gross receipts of the business. However, current law allows localities to assess the BPOL tax on either gross receipts or the Virginia taxable income of a 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 or 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.

The intent of the different rate limitation on different classes of businesses was to try and account for the different profitability levels of different types of businesses. Localities that imposed a higher rate structure on January 1, 1978 are allowed to continue to impose the tax at those rates.

Situs Rules

Where a business has a definite place of business or office in more than one locality, for the purposes of the BPOL tax the situs of the gross receipts is generally determined as follows:

- Contracting - The definite place of business where the services are performed. If the services are not performed at any definite place of business, then the gross receipts are attributed to the definite place of business where the services are directed or controlled. However, if the amount of business that a contractor has done in a locality exceeds $25,000 in any year, the locality may impose the BPOL tax on such amount of business even if the contractor does not have a definite place of business in the locality. That portion of the contractor's gross receipts would not be subject to the BPOL tax in any other locality.

- Retail sales - The definite place of business where the sales solicitations occurred. If the sales solicitations do not occur at any definite place of business, then the gross receipts are attributed to the definite place of business where the sales solicitations are directed or controlled.

- Rentals of tangible personal property – The definite place of business where the tangible personal property is rented. If the property is not rented from any definite place of business, then the gross receipts are attributed to the definite place of business where the rental is managed.

- Performance of services - The definite place of business where the services are performed. If the services are not performed at any definite place of business, then the gross receipts are attributed to the definite place of business where the services are directed or controlled.

If it is impractical or impossible to determine which definite place of business the gross receipts of a business should be attributed to under the general rules, then the gross receipts are apportioned between the definite places of business on the basis of payroll. In order for gross receipts to be apportioned to a definite place of business, activities applicable under the general rule must have occurred at or have been controlled from such definite place of business.

Basis of the BPOL Tax

The measure or basis of the BPOL tax is generally the gross receipts of the business. As the BPOL tax is a tax on gross receipts, not net income, the BPOL tax has been the subject of criticism for many years. Opponents of the tax point out that the gross receipts of a business have little or no relation to the profitability of the business, and that different types of businesses have different levels of profitability compared to their gross receipts.

In 2011, House Bill 1437 (*Acts of Assembly*, Chapter 685) gave localities the option of imposing the BPOL tax on either the gross receipts or the Virginia taxable income of a business.

Taxable Income

A corporation's federal taxable income is its net income calculated as a result of taking various deductions from its gross receipts such as salaries paid, maintenance costs, bad debts, rent, interest expenses, advertising costs, depreciation, and other employee and business related costs.

A corporation's Virginia taxable income is its federal taxable income for the taxable year with numerous modifications, some of which are unrelated to a business, including, but not limited to, i) the addition of interest or dividends on obligations of any state other than Virginia, ii) the subtraction of dividends upon stock in any domestic international corporation, and iii) the subtraction of the amount contributed in funds to the Virginia Public School Construction Grants Program and Fund, etc.

Additionally, a corporation is subject to tax in Virginia only on the apportioned share of its Virginia taxable income, which can be considerably lower than the corporation's gross receipts or Virginia taxable income in the case of multi-state corporations.

While Virginia taxable income may resemble net income for certain businesses, the additions, subtractions, and deductions used to determine an individual's or corporation's Virginia taxable income may not be appropriate in the determination of a business' profitability or as a measure of its activities in a locality. Virginia taxable income, for both individuals and corporations, includes income from all sources, not just from business activities, and not just from the operations of the business in a particular locality. Additionally, Virginia allows deductions from taxable income for personal items that a sole proprietor may legitimately take on his individual income tax return that have no bearing on his business activities. For example, deductions for prepaid tuition contracts, and the Virginia Age Deduction.

JLARC Report

The 2013 Joint Legislative Audit and Review Commission ("JLARC") report entitled "Technical Report: Impact of Changing the Basis of the BPOL Tax from Gross Receipts to Income" made the following findings regarding changing the basis of the BPOL tax:

- Changing the basis of the Business, Professional, and Occupational License (BPOL) tax from gross receipts to net income could have reduced local revenue from the tax by about 95 percent, compared to actual 2012 collections.

- Using net income as the basis for the BPOL tax would considerably reduce the tax burden of businesses that currently pay the tax, but to varying degrees. Retailers, unprofitable or low-profitability businesses, and large businesses would benefit from the largest reduction in taxes owed.

- To maintain revenue at 2012 levels, localities would have had to impose an average tax rate of approximately five percent, which would be an average tax increase of 40 percent on profitable businesses still subject to the tax.

- Changing the basis of the BPOL tax to net income would make the tax more difficult for businesses to understand and comply with, and would require more resources for local governments to administer.

Proposal

This bill would mandate that localities that impose license taxes impose them only on the Virginia taxable income of a business.

The effective date of this bill is not specified.

cc : Secretary of Finance

Date: 1/14/2017 VB
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