# DEPARTMENT OF TAXATION
# 2018 Fiscal Impact Statement

**1. Patron** David W. Marsden

**2. Bill Number** SB 390

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

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

**3. Committee** Senate Finance

**4. Title** Taxation in the Commonwealth

**5. Summary/Purpose:**

This bill would create two new individual income tax brackets and would, thereby, impose tax at a rate equal to 6.25 percent on income in excess of $500,000, but not in excess of $1 million, and 6.75 percent on income in excess of $1 million.

This bill would make the Tax Credit for Low-Income Individuals refundable. This bill would prohibit a taxpayer from claiming the Neighborhood Assistance Act Tax Credit or the Education Improvement Scholarships Tax Credit using a donation that was eligible for the charitable deduction.

This bill would also reduce the corporate income tax rate from 6 percent to 5 percent for taxable years beginning on and after January 1, 2018.

This bill would effectively reinstate the Virginia estate tax for residents by requiring that the maximum amount of the federal credit for state estate taxes be treated as if it is equal to the federal credit as it existed on January 1, 1978. The Virginia estate tax would not be imposed on a gross estate if the majority of the assets of the total estate are an interest in a closely held business or working farm.

This bill would eliminate the Retail Sales and Use Tax on food for human consumption and impose the tax on certain enumerated services, including downloaded or streaming digital products. This bill would also make changes to the application of the Retail Sales and Use Tax and the local Transient Occupancy Tax to accommodations. This bill would also change the sales tax dealer registration criteria and would increase the rate of the state taxes on cigarettes and other tobacco products.

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

**7a. Expenditure Impact:**

| ***Fiscal Year*** | ***Dollars*** | ***Positions*** | ***Fund*** |
|---|---|---|---|
| 2017-18 | $387,779 | 2 | GF |
| 2018-19 | $329,725 | 4 | GF |
| 2019-20 | $404,306 | 4 | GF |
| 2020-21 | $395,899 | 4 | GF |
| 2021-22 | $406,510 | 4 | GF |
| 2022-23 | $417,140 | 4 | GF |
| 2023-24 | $427,788 | 4 | GF |

**7b. Revenue Impact:**

| ***Fiscal Year*** | ***Dollars*** | ***Fund*** |
|---|---|---|
| 2017-18 | ($8.1 million) | GF |
| 2018-19 | ($595.3 million) | GF |
| 2018-19 | $173.3 million | NGF |
| 2019-20 | ($351.1 million) | GF |
| 2019-20 | $188.3 million | NGF |
| 2020-21 | ($341.5 million) | GF |
| 2020-21 | $187.7 million | NGF |
| 2021-22 | ($340.3 million) | GF |
| 2021-22 | $186.9 million | NGF |
| 2022-23 | ($335.4 million) | GF |
| 2022-23 | $186.4 million | NGF |
| 2023-24 | ($331.5 million) | GF |
| 2023-24 | $186.9 million | NGF |

**8. Fiscal implications:**

Administrative Costs

This bill would result in administrative costs of $387,779 in Fiscal Year 2018; $329,725 in Fiscal Year 2019; $404,306 in Fiscal Year 2020; $395,899 in Fiscal Year 2021; $406,510 in Fiscal Year 2022; $417,410 in in Fiscal Year 2023; and $427,788 in Fiscal Year 2024. Such costs include hiring auditors to ensure compliance with the new Sales and Use Tax collection requirement that would be imposed on affected service providers, hiring customer services wage staff, updating the Department's systems and forms, and communicating with sales tax dealers about the changes to the Retail Sales and Use Tax.

Revenue Impact

This bill would have a negative General Fund revenue impact of $8.1 million in Fiscal Year 2018, $595.3 million in Fiscal Year 2019, $351.1 million in Fiscal Year 2020, $341.5 million in Fiscal Year 2021, $340.3 million in Fiscal Year 2022, $335.4 million in Fiscal Year 2023, and $331.5 million in Fiscal Year 2024. Non-General Fund revenues (Transportation Trust Fund, Local Option, HMOF, Regional Transportation Fund, Regional Transient Occupancy, Local Transient Occupancy, and Health Care Fund) would increase by a total of $173.3 million in Fiscal Year 2019, $188.3 million in Fiscal Year 2020, $187.7 million in Fiscal Year 2021, $186.9 million in Fiscal Year 2022, $186.4 million in Fiscal Year 2023, and $186.9 million in Fiscal Year 2024.

The table below shows the impact that each provision would have on General Fund revenues (in millions):

| Fiscal Year | Individual Tax Brackets | LITC | Corporate Rate Change | Credits for Char. Contr. | Digital Downloads (GF Restricted and Non-Restricted) | Tax on Services | Eliminate Sales Tax on Food (GF Restricted) | Estate Tax | Sales Tax on Accomm-odations | Cigarette and Tobacco Taxes (GF Restricted and Non-Restricted) | Total GF Impact |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2018 | - | - | ($8.1) | - | - | - | - | - | - | - | **($8.1)** |
| 2019 | $361.5 | ($645.1) | ($271.8) | $4.3 | $16.4 | $101.4 | ($181.8) | $17.3 | $2.2 | $0.2 | **($595.3)** |
| 2020 | $255.8 | ($443.7) | ($167.0) | $2.2 | $18.7 | $113.4 | ($202.4) | $69.3 | $2.5 | $0.2 | **($351.1)** |
| 2021 | $271.0 | ($451.7) | ($164.3) | $2.2 | $19.6 | $116.3 | ($206.7) | $69.3 | $2.6 | $0.2 | **($341.5)** |
| 2022 | $286.0 | ($459.9) | ($169.5) | $2.2 | $20.6 | $119.1 | ($211.0) | $69.3 | $2.7 | $0.2 | **($340.3)** |
| 2023 | $300.8 | ($468.2) | ($170.9) | $2.2 | $21.7 | $122.1 | ($215.5) | $69.3 | $2.9 | $0.2 | **($335.4)** |
| 2024 | $316.2 | ($475.4) | ($175.1) | $2.2 | $22.9 | $125.1 | ($220.0) | $69.3 | $3.0 | $0.2 | **($331.5)** |

The table below shows the impact that each provision would have on Non-General Fund revenues (in millions):

| Fiscal Year | Digital Downloads | Tax on Services | Eliminate Sales Tax on Food (TTF) | Sales Tax on Accomm-odations | Cigarette and Tobacco Taxes (Health Care Fund) | Total NGF Impact |
|---|---|---|---|---|---|---|
| 2019 | $11.0 | $68.1 | ($91.8) | $5.9 | $180.1 | **$173.3** |
| 2020 | $12.6 | $76.1 | ($102.2) | $6.7 | $195.1 | **$188.3** |
| 2021 | $13.2 | $78.1 | ($104.4) | $7.1 | $193.7 | **$187.7** |
| 2022 | $13.9 | $80.0 | ($106.6) | $7.4 | $192.2 | **$186.9** |
| 2023 | $14.6 | $82.0 | ($108.8) | $7.8 | $190.8 | **$186.4** |
| 2024 | $15.4 | $84.0 | ($111.1) | $8.2 | $189.4 | **$185.9** |

*Income Tax Provisions*

Imposing two new individual income tax brackets would have a positive General Fund revenue impact of $361.5 million in Fiscal Year 2019, $255.8 million in Fiscal Year 202, $271.0 million in Fiscal Year 2021, $286.0 million in Fiscal Year 2022, $300.8 million in Fiscal Year 2023, and $316.2 million in Fiscal Year 2024.

Limiting donations that may qualify for the Neighborhood Assistance Act Tax Credit and Education Improvement Scholarships Tax Credit would have a positive General Fund revenue impact of $4.3 million in Fiscal Year 2019 and $2.2 million annually for Fiscal Year 2020 and thereafter.

Allowing the Tax Credit for Low-Income Taxpayers to be refundable would have a negative General Fund revenue impact of $645.1 million in Fiscal Year 2019, $443.7 million in Fiscal Year 2020, $451.7 million in Fiscal Year 2021, $459.9 million in Fiscal Year 2022, $468.2 million in Fiscal Year 2023, and $475.4 million in Fiscal Year 2024.

Reducing the corporate income tax rate would have a negative General Fund revenue impact of $8.1 million for Fiscal Year 2018, $271.8 million for Fiscal Year 2019, $167.0 million for Fiscal Year 2020, $164.3 million for Fiscal Year 2021, $169.5 million for Fiscal Year 2022, $170.9 million for Fiscal Year 2023, and $175.1 million for Fiscal Year 2024.

The revenue estimates for the changes to Virginia's income structure are based on the most recently available Virginia individual income tax data.  Congress recently enacted Public Law 115-

97, known as the “Tax Cuts and Jobs Act” (“the TCJA”), which could significantly impact the computation of federal adjusted gross income, which is the starting point for calculating a taxpayer's Virginia income tax liability, as well as increase the number of taxpayers who choose to claim the federal standard deduction. As a result, the revenue impact of the income tax provisions of this bill, particularly the changes related to the individual income tax, could vary once the recent federal changes are taken into account.

*Reinstatement of the Estate Tax*

Reinstating Virginia’s estate tax would have a positive General Fund revenue impact. Because the federal estate tax is due nine months after the death of the decedent, it is assumed that revenue from the Virginia estate tax will be generated beginning nine months after the July 1, 2018 effective date of this bill. Based on the 2018 federal estate tax threshold of $10 million and Fiscal Year 2008 Virginia return information, it is estimated that the Virginia estate tax would have a positive revenue impact of $17.3 million for Fiscal Year 2019 and $69.3 million annually for Fiscal Year 2020 and thereafter.

*Expansion of the Sales Tax Base*

Imposing the Retail Sales and Use Tax on the services contained in this bill would have an estimated positive impact on state revenues of $169.5 million in Fiscal Year 2019, $189.5 million in Fiscal Year 2020, $194.4 million in Fiscal Year 2021, $199.1 million in Fiscal Year 2022, $204.1 million in Fiscal Year 2023, and $209.2 million in Fiscal Year 2024. Expanding the Retail Sales and Use Tax to include downloaded and streamed digital products would have an estimated positive impact on state revenues of $27.479 million in Fiscal Year 2019, $31.325 million in Fiscal Year 2020, $32.835 million in Fiscal Year 2021, $34.508 million in Fiscal Year 2022, $36.344 million in Fiscal Year 2023, and $38.35 million in Fiscal Year 2024.

*Elimination of Sales Tax for Food for Home Consumption*

Elimination of the state Retail Sales and Use Tax on food for home consumption would have a negative state revenue impact (General Fund Restricted for K-12 Education and Transportation Trust Fund) of $274 million in Fiscal Year 2019; $305 million in Fiscal Year 2020; $311 million in Fiscal Year 2021; $318 million in Fiscal Year 2022; $324 million in Fiscal Year 2023; and $331 million in Fiscal Year 2024.

*Sales Tax on Accommodations*

Applying the Retail Sales and Use Tax to the fees and charges levied by accommodation intermediaries would have an estimated positive state revenue impact of $8.04 million in Fiscal Year 2019, $9.19 million in Fiscal Year 2020, $9.66 million in Fiscal Year 2021, $10.14 million in Fiscal Year 2022, $10.67 million in Fiscal Year 2023, and $11.25 million in Fiscal Year 2024.

*Taxation of Tobacco*

Increasing the excise taxes on cigarettes, roll-your-own tobacco, distributors of loose leaf tobacco, any other unit, pouch, or package of loose leaf tobacco, and tobacco products other than moist snuff or loose leaf tobacco would have a positive revenue impact to the Health Care Fund of $180.1 million in Fiscal Year 2019, $195.1 million in Fiscal Year 2020, $193.7 million in Fiscal Year 2021, $192.2 million in Fiscal Year 2022, $190.8 million in Fiscal Year 2023, and $189.4 million in Fiscal Year 2024. The changes to the application of the Retail Sales and Use Tax to tobacco products proposed by this bill would result in an estimated increase to state revenues of $0.3 million in Fiscal Year 2019 and $0.4 million annually beginning in Fiscal Year 2020.

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

Department of Taxation

**10. Technical amendment necessary:** No.

**11. Other comments:**

Background

*Federal Tax Rates and the Federal Tax Cuts and Jobs Act*

On December 22, 2017, the President signed into law the TCJA. The TCJA modifies the current individual income tax rate structure. The current rate structure has seven rates: 10 percent, 15 percent, 25 percent, 28 percent, 33 percent, 35 percent, and 39.6 percent. Effective beginning in Taxable Year 2018, the TCJA maintains the seven-rate structure, but taxes a taxpayer's income at modified rates: 10 percent, 12 percent, 22 percent, 24 percent, 32 percent, 35 percent, and 37 percent.

The following table compares the tax brackets under prior law to those under the TCJA for married taxpayers filing a joint return:

| **Before the TCJA** | | **Under the TCJA** | |
|---|---|---|---|
| **Federal Taxable Income** | **Federal Tax Rates** | **Federal Taxable Income** | **Federal Tax Rates** |
| $0 to $19,050 | 10 percent | $0 to $19,050 | 10 percent |
| $19,051 to $77,400 | 15 percent | $19,051 to $77,400 | 12 percent |
| $77,401 to $156,150 | 25 percent | $77,401 to $165,000 | 22 percent |
| $156,151 to $237,950 | 28 percent | $165,001 to $315,000 | 24 percent |
| $237,951 to $424,950 | 33 percent | $315,001 to $400,000 | 32 percent |
| $424,951 to $480,050 | 35 percent | $400,001 to $600,000 | 35 percent |
| $480,051 or more | 39.6 percent | $600,001 or more | 37 percent |

Different rate tables apply for those married taxpayers filing a separate return, those filing as head of household, and those filing as individuals.

*Virginia Individual Income Tax Rates and Tax Brackets*

Under current law, the Virginia individual income tax is imposed at the following rates:

| **Virginia Taxable Income** | **Virginia Tax Rates** |
|---|---|
| $3,000 and less | 2 percent |
| $3,001 to $5,000 | 3 percent |
| $5,001 to $17,000 | 5 percent |
| $17,001 or more | 5.75 percent |

In 1971, when Virginia studied conforming to the federal income tax law, Virginia originally considered having on the first three tax brackets shown above. Therefore, the top marginal tax rate would have been 5 percent, applicable to Virginia taxable income of $5,001 or more.

However, by 1972, when the General Assembly voted to conform to federal income tax law, it enacted four tax brackets at the same tax rates as under current law.

The amount of Virginia taxable income subject to Virginia's top marginal tax rate was last modified during the 1987 Session, in response to the 1986 federal tax reform. The income threshold for the top marginal rage was increased from $12,001 to $14,001 for Taxable Year 1987 and from $14,001 to $17,001 over the next three years.

| Year | Taxable Income Subject to 5.75 percent Tax Rate |
|---|---|
| 1972—1986 | $12,001 or more |
| 1987 | $14,001 or more |
| 1988 | $15,001 or more |
| 1989 | $16,001 or more |
| 1990—Present | $17,001 or more |

Since 1990, the General Assembly has not enacted any legislation affecting Virginia individual income tax rates or brackets.

Several neighboring states have recently made structural changes to their individual income tax rates and bracket structures. For example, the District of Columbia enacted budget provisions that created individual income tax relief contingent upon meeting certain revenue goals. For Taxable Year 2017, this included reducing the rate on income between $40,000 and $60,000 from 6.75 percent to 6.5 percent.

North Carolina recently reformed its individual income tax by enacting a flat individual income tax rate and gradually decreasing this rate over a period of several years. Prior to Taxable Year 2014, North Carolina had three individual income tax rates of 6 percent, 7 percent, and 7.75 percent. For Taxable Year 2014, North Carolina replaced its tiered tax structure with a flat individual income tax rate of 5.8 percent. This rate decreased to 5.75 percent for Taxable Years 2015 and 2016, to 5.499 percent for Taxable Year 2017 and 2018, and is scheduled to decrease to 5.25 percent for Taxable Year 2019 and thereafter.

Tennessee only taxes individuals on interest and dividends. Tennessee enacted legislation that reduces the rate for this tax from six percent to five percent in Taxable Year 2016, and continues to reduce the rate by one percent annually, eventually eliminating the tax for the taxable years beginning on or after January 1, 2021.

*Virginia Low-Income Tax Credits*

Virginia allows an individual to claim either the Tax Credit for Low-Income Individuals or a credit equal to 20 percent of the federal earned income tax credit that was claimed for the taxable year:

- The Tax Credit for Low-Income Individuals is a nonrefundable individual income tax credit equal to $300 each for the individual, the individual's spouse, and any person claimed as a dependent on such individual's or married person's income tax return for the taxable year.

- Virginia also allows a nonrefundable individual income tax credit equal to 20 percent of the federal earned income tax credit claimed by an individual for the taxable year. The credit is for any individual or married persons that are eligible for the federal earned income tax credit for the taxable year and claimed such credit.

No household may claim both credits in the same taxable year. For purposes of these credits, “household” means an individual or married persons, regardless of whether such married persons file joint or separate Virginia individual income tax returns.

*Corporate Income Tax Rate*

Virginia’s corporate income tax is currently imposed at the rate of 6 percent on the Virginia taxable income of domestic and foreign corporations doing business in Virginia. A “corporation” is defined as any entity created as a corporation under the laws of any state or local domestic or foreign jurisdiction, and any association, joint stock company, or any other entity subject to corporate income tax under the Internal Revenue Code.

A corporation’s taxable income is determined by allocation and apportionment when the income is derived from sources both within and without Virginia. Multistate corporations allocate and apportion federal taxable income after Virginia modifications are made to determine the amount of income attributable to Virginia. No allocation or apportionment is necessary when the entire business of a corporation is conducted or transacted within Virginia. Instead, the Virginia corporate income tax is imposed upon the entire Virginia taxable income of the corporation for each taxable year.

Virginia’s corporate income tax rate has remained unchanged since 1972, when it was increased from 5 percent to 6 percent.

The TCJA reduced the federal corporate income tax rate from 35 percent to 21 percent.

*Virginia Neighborhood Assistance Act Tax Credit*

The Virginia Neighborhood Assistance Act provides an income tax credit to business firms and individuals that donate to neighborhood organizations for approved programs that benefit impoverished people. The Department of Social Services and the Department of Education are responsible for approving programs proposed by neighborhood organizations and allocating Neighborhood Assistance Act Tax Credits to neighborhood organizations with approved programs. A business firm or individual that makes a donation to a neighborhood organization for an approved program is then eligible to receive an income tax credit from that neighborhood organization.

The amount of the credit for a business firm or individual who donates professional services is equal to 65 percent of the value of the money, property, professional services, or contracting services donated by such taxpayer to a neighborhood organization for an approved program. No credit less than $400 may be granted to a business firm or individual who provides professional services for any donation. Therefore, a business firm or individual who provides professional services must make a donation with a value of at least $616 to meet the minimum credit threshold, and receive an allocation of credits.

The amount of the credit for an individual who makes a monetary donation or marketable securities donation to a neighborhood organization for an approved program is equal to 65 percent of the value of such donation. To receive an allocation of credits, an individual is required to make a donation of at least $500. For purposes of determining the amount of credits allocated to an individual, the value of the individual’s donation is limited to the lesser of the actual value of the donation or $125,000. The $125,000 cap on the value of donations caps the credit at $81,250 per taxpayer.

No provision of Virginia law prohibits a taxpayer from claiming this credit and the deduction for charitable contributions for the same donation.

*Education Improvement Scholarships Tax Credits*

Taxpayers are permitted to claim Education Improvement Scholarships Tax Credits in an amount equal to 65 percent of the monetary or marketable securities donation they made to a qualifying scholarship foundation. Tax credits are awarded to taxpayers on a first-come, first-served basis. No tax credit is allowed if the donation is less than $500. No more than $125,000 in tax credits may be issued to an individual in a taxable year. The $125,000 limitation does not apply to tax credits issued to any business entity, including a sole proprietorship. The Education Improvement Scholarships Tax Credit is subject to a $25 million per fiscal year cap.

No provision of Virginia law prohibits a taxpayer from claiming this credit and the deduction for charitable contributions for the same donation.

*Estate Tax*

The 2006 *Acts of Assembly*, Chapter 4, effectively suspended the Virginia estate tax by equating the Virginia estate tax to the current amount of the federal credit allowable for state estate taxes.

Prior to the 2006 legislation, Virginia imposed a “pick-up” estate tax that was equal to the maximum amount of the federal credit for state estate taxes as it existed on January 1, 1978. The federal credit for state estate taxes was eliminated in 2005 by the Economic Growth and Tax Relief Act of 2001, but the freeze to 1978 in Virginia law preserved the Virginia estate tax. By striking the language tying the tax to 1978, the 2006 Acts of Assembly, Chapter 4, effectively repealed the Virginia estate tax.

Under the Economic Growth and Tax Relief Act of 2001, the threshold amount of the federal taxable estate was increased over time. The amount was $1.5 million for 2004 and 2005, $2 million for 2006 through 2008, and $3.5 million for 2009. Any estate with a value less than the applicable amount is not subject to the federal estate tax.

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the federal estate tax through 2012 and increased the threshold amount from $3.5 million to $5 million. The threshold amount is indexed for inflation for 2012. The Act did not reinstate the federal credit for state estate taxes; therefore, the Virginia estate tax was not reinstated.

The Economic Growth and Tax Relief Act of 2001 was scheduled to sunset in 2010, which would have reinstated the federal tax rules and credits as of 2001. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the 2001 Act for two years, but the federal estate tax was scheduled to revert to 2001 rates and credits in 2013. The American Taxpayer Relief Act of 2012 continued the federal estate tax beyond 2012 and kept the estate tax exemption at $5 million (as indexed for inflation).

The TCJA increased the federal estate tax exemption amount to $10 million (indexed for inflation) for estates of persons dying after December 31, 2017, but before January 1, 2026.

*Retail Sales and Use Tax*

Under current law, the sales tax is levied on the sale or consumption of goods and a very limited number of services. The only services currently subject to the tax are transient accommodations and services provided in connection with the sales, fabrication, or furnishing of tangible personal property.

Digital products such as downloaded or streamed books, software and audio and visual content are exempt from the sales tax. Software is taxable only if there is a tangible, physical component to the product that the customer receives. Charges for modifying software or custom software are exempt, regardless of how delivered.

Under current law, the sales tax on food for home consumption is levied at 2.5 percent, consisting of a 1.5 percent state tax and a 1 percent local option tax.

Under current law, the sales tax is imposed on the "gross proceeds derived from the sale or charges for rooms, lodgings, or accommodations furnished to transients as set out in the definition of 'retail sale.'" The definition specifically includes "the sale or charges for any room or rooms, lodgings, or accommodations furnished to transients for less than 90 continuous days by any hotel, motel, inn, tourist camp, tourist cabin, camping grounds, club, or any other place in which rooms, lodging, space, or accommodations, are regularly furnished to transients for a consideration." However, the tax is not levied on the markup or commission charged by online travel companies and other accommodations intermediaries because the tax applies only to the provider of the accommodations. The provider of the accommodations would normally constitute a hotel or lodging owner.

*Local Transient Occupancy Tax*

Under current law, any county may levy a Transient Occupancy Tax upon the "amount of charge for the occupancy of any room or space occupied." The tax, however, does not apply to rooms rented on a continuous basis by the same individual or group for 30 or more continuous days. The tax applies to rooms intended or suitable for dwelling and sleeping. Therefore, the tax does not apply to such rooms used for alternative purposes, such as banquet rooms and meeting rooms. Cities or towns may impose excise taxes on transient room rentals of privately owned accommodations and travel campgrounds.

*State Taxes on Tobacco*

Under current law, the state excise tax on cigarettes is 1.5 cents per cigarette. The tax on roll-your-own tobacco is currently levied at 10 percent of the manufacturer's sales price. Loose-leaf tobacco is currently taxed at $0.21 per each single-unit, $0.40 per each half pound-unit, and $0.70 per each pound-unit. The current tax on any other unit, pouch, or package of loose leaf tobacco to $0.21 per unit, pouch, or package plus $0.21 for each increment of four ounces or portion thereof that the loose leaf tobacco exceeds 16 ounces. The current tax upon tobacco products other than moist snuff or loose leaf tobacco is 10 percent of the manufacturer's sales price.

*Sales Tax Dealer Registration Requirements*

In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the U.S. Supreme Court ruled that the Commerce Clause bars a state from requiring an out-of-state mail-order company to collect use tax on goods sold to customers located within the state when the company has no outlets, sales representatives, or significant property in the state. The Court determined that only Congress has the authority to require out-of-state vendors without a physical presence in a state to register and collect the state's tax.

Consistent with the *Quill* decision, Virginia law sets out specific criteria for evaluating whether dealers are required to collect the tax on their sales into the Commonwealth. Generally, the duty to register will arise when a dealer making sales in the Commonwealth owns or leases real property in Virginia; conducts certain activities through employees, agents, independent contractors, or representatives within Virginia; conducts certain advertising, solicitation, or delivery activities within Virginia; shares common ownership or business relationships with an in-state business; or owns tangible personal property leased or rented to Virginia consumers.

Generally, a physical presence by a dealer is required before a state may impose upon the dealer an obligation to collect sales tax. The imposition of dealer status based on one's provision of in-person services would not generally offend the Constitutional safeguards outlined by the Court in *Quill* because a physical presence of an employee or contractor is a necessary component of the transaction.

Proposed Legislation

*Income Tax Changes*

This bill would create two new individual income tax brackets, effectively increasing the number of brackets from four to six. As a result, for taxable years beginning on and after January 1, 2018, Virginia would have the following individual income tax rates and brackets:

| Virginia Taxable Income | Virginia Tax Rates |
|---|---|
| $3,000 and less | 2 percent |
| $3,001 to $5,000 | 3 percent |
| $5,001 to $17,000 | 5 percent |
| $17,001 to $500,000 | 5.75 percent |
| $500,001 to $1 million | 6.25 percent |
| Over $1 million | 6.75 percent |

For taxable years beginning on or after January 1, 2019, this bill would require that the 6.25 percent and 6.75 brackets be adjusted for inflation by an amount equal to the percentage change in the Consumer Price Index for All Urban Consumers (CPI-U), for all items, from September 1 through August 31 for the year immediately preceding the affected taxable year.

This bill would require the Department to calculate by December 15, 2018, the individual income tax brackets, after adjustment for inflation, that will be in effect for Taxable Year 2019. The Department would be required to report the income brackets and the percentage change from the previous year, to the Secretary of Finance and the Chairs of the House Committee on Appropriations, the House Committee on Finance, and the Senate Committee on Finance and post such income brackets prominently on the Department's website. Thereafter, the Department would continue to report on December 15 the individual income tax brackets that will be in effect for the next taxable year beginning after January 1.

This bill would make Virginia's Tax Credit for Low-Income Taxpayers refundable to the extent such credit exceeds their individual income tax liability for a taxable year. The effective date of this provision is not specified.

This bill would reduce the corporate income tax rate from 6 percent to 5 percent for taxable years beginning on and after January 1, 2018.

This bill would prohibit a taxpayer from claiming the Neighborhood Assistance Act Tax Credit or the Education Improvement Scholarships Tax Credit for a donation if such donation was eligible as a charitable contribution for purposes of computing the taxpayer's Virginia taxable income. These provisions would be effective for taxable years beginning on and after January 1, 2017.

*Estate Tax*

This bill would effectively reinstate the Virginia estate tax for residents by treating the maximum amount of the federal credit for state estate taxes as if it is equal to the federal credit as it existed on January 1, 1978. The Virginia estate tax would not be imposed on a gross estate if the majority of the assets of the total estate are an interest in a closely held business or working farm.

For the purposes of the Virginia estate tax, an "interest in a closely held business" would be defined as an interest as a proprietor in a trade or business carried on as a proprietorship or an interest as a partner in a partnership carrying on a trade or business, if 20 percent or more of the total capital interest in such partnership is included in determining the gross estate of the decedent, such partnership had 45 or fewer partners, or stock in a corporation carrying on a trade or business if 20 percent or more in value of the voting stock of such corporation is included in determining the gross estate of the decedent, or such corporation had 45 or fewer shareholders.

A "working farm" would be defined as an interest in a closely held business that operates as an active trade or business for agricultural purposes.

For the personal representative of any estate subject to the Virginia estate tax that is not required to file a federal estate tax return, a Virginia estate tax return would be required to be filed within the 270 days immediately following the death of the decedent. The Department would be allowed to grant an extension of time for filing the Virginia estate tax return or remitting the tax due. The Department would be required to establish procedures and conditions for an extension.

These provisions would be effective for deaths occurring on or after July 1, 2018.

*Retail Sales and Use Tax Provisions*

This bill would impose the Retail Sales and Use Tax on the following types of services:

- Carpet, rug, and upholstery cleaning and dyeing;
- Garment alteration, maintenance, modification, or repair;
- Hair care, including hairdressing, grooming, coloring, cutting, or styling;
- Commercial and residential landscaping;
- Laundering and dry-cleaning clothing with the exception of rental of clothing to commercial users when the essential part of the rental includes the recurring service of laundering or cleaning of the clothing;
- Nail care, including coloring, manicuring, pedicuring, and polishing;
- Pest control or extermination;
- Pet care including boarding, grooming, kenneling, pet sitting, walking, and the performance of veterinary medicine;
- Piercing, tattooing, and other cosmetic body modifications not required for medical reasons; and
- Spa services.

This bill would expand the definition of what constitutes taxable tangible personal property upon which the sales tax is levied to include digital products downloaded or streamed over the internet, including digital audio and visual content, books, applications, and computer games. This bill would not affect charges for modifying software or custom software. Those charges would remain exempt, regardless of how delivered.

This bill would eliminate the 1.5 percent state tax on food for home consumption beginning July 1, 2018. Food for home consumption would still be subject to the 1 percent local option tax.

*Taxation of Accommodations*

This bill would modify the application of the sales tax on the provision of accommodations in situations where an intermediary facilitates the sale. Accommodations providers would be responsible and liable for collecting and remitting the taxes due to the Department on transactions where there was no intermediary. The tax would be computed on the total charges for the accommodations charged to the customer.

For transactions utilizing an intermediary, the intermediary would be deemed the dealer making a retail sale of accommodations. The intermediary would be required to collect the sales tax computed on the whole room charge and the intermediary would be authorized to elect to remit the entire amount collected to the accommodations provider. The provider would then be responsible for remitting the entire amount properly. Alternatively, the intermediary could elect to remit the sales tax collected on the accommodation fee (intermediary's fee) to the Department directly and the remainder to the accommodations provider.

The bill would make similar changes to the local transient occupancy taxes.

*Dealer Registration Requirements*

The bill would specify the activities that constitute "sufficient activity" to require registration as a sales tax dealer for service providers and accommodations intermediaries. The bill would require that the furnishing of services valued at $5,000 or more during a calendar year constitutes sufficient activity to require dealer registration. Accommodation intermediaries who regularly facilitate the sale of accommodations in Virginia would have sufficient activity to require registration.

*Taxation of Tobacco*

The bill would increase the excise tax on cigarettes to $0.35 per cigarette sold, stored, or received in the Commonwealth. This bill would also increase the tax on roll-your-own tobacco to 23 percent of the manufacturer's sales price. The bill would increase the tax levied on distributors of loose leaf tobacco to $0.49 per each single-unit, $0.93 per each half pound-unit, and $1.63 per each pound-unit.

The bill would increase the tax on any other unit, pouch, or package of loose leaf tobacco to $0.49 per unit, pouch, or package plus $0.49 for each increment of four ounces or portion thereof that the loose leaf tobacco exceeds 16 ounces. The bill would increase the tax upon tobacco products other than moist snuff or loose leaf tobacco to 23 percent of the manufacturer's sales price.

<u>Similar Legislation</u>

**House Bill 966** would make numerous changes to Virginia's tax structure.

**House Bill 1189** would lower Virginia's top marginal individual income tax rate to five percent, effectively reducing the number of tax brackets from four to three.

**Senate Bill 759** would reduce the rate of taxation for each of Virginia's individual income tax brackets by up to ten percent of the current rate over a three-year period.

**House Bill 716** would provide a refundable Tax Credit for Low-Income Taxpayers equal to 20 percent of the federal earned income tax credit.

**House Bill 310** would reinstate Virginia's estate tax.

cc: Secretary of Finance

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