DEPARTMENT OF TAXATION
2019 Fiscal Impact Statement

1. Patron Mark D. Obenshain

2. Bill Number SB 1428

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

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

3. Committee Senate Finance

4. Title Income Tax; Make Page County a Qualified Locality for Purposes of Certified Company Apportionment and the Issuance of Certain Grants or Loans by Localities

5. Summary/Purpose:

This bill would add Page County to the list of qualified localities that a company may invest in for purposes of becoming eligible to utilize modified apportionment factors to decrease the amount of income taxed by Virginia (“certified company apportionment”). This bill would also add Page County to the list of localities authorized to give grants or loans to such companies.

If enacted during the 2019 Regular Session of the General Assembly, this bill would become effective July 1, 2019.

6. Budget amendment necessary: No.

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

8. Fiscal implications:

Administrative Costs

The Department of Taxation ("the Department") and the Virginia Economic Development Partnership Authority ("VEDP") consider implementation of this bill as routine and do not require additional funding.

Revenue Impact

This bill would have an unknown General Fund revenue impact beginning in Fiscal Year 2020. The extent to which companies would make investments in Page County and qualify to use certified company apportionment is unknown.

9. Specific agency or political subdivisions affected:

Department of Taxation
Virginia Economic Development Partnership Authority

10. Technical amendment necessary: No.

11. Other comments:

Virginia's Methods of Apportionment

Statutory Method of Apportionment

Virginia generally requires the Virginia taxable income of a multistate corporation to be apportioned to Virginia by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor, plus twice the sales factor, and the denominator of which is four. The property factor is a fraction that consists of the average value of the corporation's real and tangible personal property owned or rented and used in Virginia over the like property located everywhere. The payroll factor is a fraction, the numerator being the total amount of compensation paid or accrued within Virginia during the taxable year by a taxpayer, and the denominator being the total compensation paid or accrued everywhere during the taxable year. The sales factor is a fraction, the numerator of which is the total sales of the corporation in Virginia during the taxable year, and the denominator of which is the total sales of the corporation everywhere during the taxable year.

Modified Method of Apportionment for Manufacturing Companies

During the 2009 Session, the General Assembly enacted legislation (House Bill 2437 (2009 *Acts of Assembly*, Chapter 821)) that allows manufacturing companies to elect whether to apportion Virginia taxable income using the statutory method of apportionment or using a single sales factor method of apportionment. This modification was phased in as follows:

- For taxable years beginning on or after July 1, 2011, but before July 1, 2013, qualifying corporations could elect to use a triple-weighted sales factor;
- For taxable years beginning on or after July 1, 2013, but before July 1, 2014, qualifying corporations could elect to use a quadruple-weighted sales factor; and
- For taxable years beginning on or after July 1, 2014, and thereafter, qualifying corporations may elect to use the single sales factor method to apportion Virginia taxable income.

A manufacturing company that elects to use the modified method of apportionment will be subject to additional taxes if such manufacturing company's average annual number of full-time employees for the first three taxable years that it used the modified method of apportionment is less than 90 percent of its base year employment, or if the average wages of the manufacturing company's full-time employees, as certified by the manufacturing company, is not greater than the lower of the state or local average weekly wage for its industry. "Base year employment" is defined as the average number of full-time employees employed by the manufacturing company in Virginia in the taxable year that ended immediately prior to the first taxable year in which the manufacturing company used the modified method of apportionment for manufacturing companies.

Modified Method of Apportionment for Retail Companies

During the 2012 Session, the General Assembly enacted legislation (House Bill 154 and Senate Bill 49 (2012 *Acts of Assembly*, Chapters 86 and 666)) that requires certain retail companies to apportion Virginia taxable income using a single sales factor method of apportionment. This modification was phased in as follows:

- For taxable years beginning on or after July 1, 2012, but before July 1, 2014, such corporations were required to use a triple-weighted sales factor;

- For taxable years beginning on or after July 1, 2014, but before July 1, 2015, such corporations were required to use a quadruple-weighted sales factor; and

- For taxable years beginning on or after July 1, 2015, and thereafter, such corporations are required to use the single sales factor method to apportion Virginia taxable income.

Modified Method of Apportionment for Certain Enterprise Data Center Operations

During the 2015 Session, the General Assembly enacted legislation (House Bill 2162 and Senate Bill 1142 (2015 *Acts of Assembly*, Chapters 237 and 92)) that requires a taxpayer with an enterprise data center operation to apportion Virginia taxable income using single factor apportionment based on sales if such taxpayer enters into a memorandum of understanding with the Virginia Economic Development Partnership on or after July 1, 2015, to make a new capital investment of at least $150 million in an enterprise data center in Virginia on or after July 1, 2015. The modified method of apportionment applies beginning with the taxable year for which the Virginia Economic Development Partnership provides a written certification to such taxpayer that the new capital investment has been completed. The modification is being phased in as follows:

- From July 1, 2016 until July 1, 2017, qualifying corporations are required to use a quadruple-weighted sales factor; and

- From July 1, 2017, and thereafter, qualifying corporations are required to use the single sales factor method to apportion Virginia taxable income.

Modified Method of Apportionment for Debt Buyers

During the 2018 Session, the General Assembly enacted legislation (House Bill 798 (2018 *Acts of Assembly*, Chapter 807)) that requires debt buyers to apportion their Virginia taxable income using a single factor method of apportionment based on sales. The legislation also provides that, for debt buyers, sales other than sales of tangible personal property are in Virginia if they consist of money recovered on debt that a debt buyer collected from a person who is a resident of Virginia or an entity that has its commercial domicile in Virginia. The modified method of apportionment applies for taxable years beginning on and after January 1, 2019.

Modified Method of Apportionment for Specific Industries

In addition to the modified methods of apportionment described above, Virginia requires a taxpayers in certain industries to apportion their Virginia taxable income using single factor apportionment. However, this form of single factor apportionment is not necessarily based upon sales but instead is based upon other criteria that reflect how income is earned in the particular industry. These industry-specific methods of apportionment include:

- **Motor carriers**. Motor carriers of property or passengers must apportion their income to Virginia by multiplying their Virginia taxable income by a fraction, the numerator of which is vehicle miles in-state and denominator of which is total vehicle miles everywhere.

- **Railway companies.** Railway companies apportion their income to Virginia by multiplying their Virginia taxable income by a fraction, the numerator of which is revenue car miles in Virginia and the denominator of which is total revenue car miles everywhere.

- **Financial Corporations**. Financial corporations apportion their income to Virginia by multiplying their Virginia taxable income by a fraction, the numerator of which is business in Virginia and the denominator of which is the total business. Business in Virginia is based on cost of performance in Virginia over cost of performance everywhere.

- **Construction Corporations**. Construction corporations electing to report income on the completed contract basis apportion their income to Virginia by multiplying their Virginia taxable income by a fraction, the numerator of which is business in Virginia and the denominator of which is total business.

Alternative Method of Apportionment

If any corporation believes that the statutorily prescribed method of apportionment has operated or will operate as to subject it to taxation on a greater portion of its Virginia taxable income than is reasonably attributable to business or sources within Virginia, then it may submit a statement of objections to the Department and detail an alternative method of apportionment that it believes to be proper under the circumstances. If the Department concludes that the statutorily prescribed method of apportionment is inapplicable or inequitable, then it shall redetermine the corporation's taxable income by another method that best assigns to Virginia the portion of the income reasonably attributable to business and sources within Virginia. The amount assigned through an alternative method of apportionment may never exceed the amount that would have been assigned using the statutorily prescribed method.

The Department will not grant permission to use an alternative method of apportionment unless it determines that (a) the statutorily prescribed method of apportionment is inapplicable because it produces an unconstitutional result under the taxpayer's particular facts and circumstances; or (b) the statutorily prescribed method of apportionment is inequitable because (i) it results in double taxation of the income, or a class of income, of the taxpayer; and (ii) the inequity is attributable to Virginia, rather than to the fact that some other state has a unique method of allocation and apportionment.

Apportionment by Pass-Through Entities

Virginia requires the Virginia taxable income of a multistate pass-through entity to be apportioned to Virginia by using the apportionment methods applicable to corporations. However, the effect of the pass-through entity's apportionment method may vary from one owner to another, depending on the entity types of the owners:

- Virginia resident individual owners are taxable on all of their pass-through entity income regardless of the pass-through entity's apportionment method;

- Nonresident individual owners must use the entity's Virginia apportioned income in determining his or her own Virginia nonresident percentage; and

- A corporate owner must include the pass-through entity's apportionment factors in determining its own apportionment percentage.

Certified Company Apportionment

During the 2018 Session, the General Assembly enacted House Bill 222 (2018 Acts of Assembly, Chapter 802) and Senate Bill 883 (2018 Acts of Assembly, Chapter 801), which allow certain companies that have been certified by VEDP ("certified companies") to use certified company apportionment. Under certified company apportionment, a certified company may elect to modify the application of Virginia's statutory three-factor method of apportionment by:

- Reducing the numerator of the property factor by an amount equal to the value of its property acquired in any qualified localities on or after January 1, 2018 but before January 1, 2025;

- Reducing the numerator of the payroll factor by an amount equal to any payroll attributable to jobs created on or after January 1, 2018 but before January 1, 2025 in any of such localities; and

- Reducing the numerator of the sales factor by an amount equal to any sales in Virginia for the taxable year.

In addition to certified companies using Virginia's statutory three-factor method of apportionment, certified company apportionment permits a certified company using certain single factor methods of apportionment to modify its apportionment factor. Certified company apportionment also permits a certified company conducting its entire business within Virginia to elect to apportion its income between qualified localities and other Virginia localities and utilize modified apportionment factors, provided that the certified company does not apportion any of its income to a state other than Virginia

Requirements for Using Certified Company Apportionment

To be eligible to use certified company apportionment, the company must be a corporation or pass-through entity that does not have any existing property or payroll in Virginia as of January 1, 2018 and, on or after January 1, 2018, but before January 1, 2025:

- Either (a) spends at least $5 million on new capital investment in a qualified locality or qualified localities and creates at least 10 new jobs in a qualified locality or qualified localities or (b) creates at least 50 new jobs in a qualified locality or qualified localities;
- Is a traded-sector company; and
- Is certified by VEDP as generating a positive fiscal impact.

As part of the certification process, VEDP is required to determine whether a company will generate a positive fiscal impact based on the following factors:

- Job creation;
- Private capital investment; and
- Anticipated additional state and local tax revenue.

VEDP must make an annual re-certification, and no company is permitted to continue using certified company apportionment for any taxable year that VEDP does not grant re-certification.

Localities in Which Certified Companies Must Operate

To be certified by VEDP, the company must operate in certain qualified localities. A "qualified locality" is defined as:

- The Counties of Alleghany, Bland, Buchanan, Carroll, Craig, Dickenson, Giles, Grayson, Lee, Russell, Scott, Smyth, Tazewell, Washington, Wise, or Wythe, or the Cities of Bristol, Galax, or Norton;
- The Counties of Amelia, Appomattox, Buckingham, Charlotte, Cumberland, Halifax, Henry, Lunenburg, Mecklenburg, Nottoway, Patrick, Pittsylvania, or Prince Edward, or the Cities of Danville or Martinsville;
- The Counties of Accomack, Caroline, Essex, Gloucester, King and Queen, King William, Lancaster, Mathews, Middlesex, Northampton, Northumberland, Richmond, or Westmoreland;
- The Counties of Brunswick or Dinwiddie, or the City of Petersburg; or
- A qualified development site.

A "qualified development site" is defined as real property that is in a locality adjacent to a qualified locality and, before January 1, 2018, either (i) was owned or partly owned by a qualified locality or an industrial development authority of which a qualified locality is a member or (ii) was owned or partly owned by a locality or industrial development authority, was leased to a private party, and was subject to a revenue-sharing agreement providing that a portion of the revenues from the lease would be distributed to a qualified locality. "Qualified development site" does not include real property that is not owned by Virginia or a political subdivision thereof.

Other Incentives

In addition to making specific modifications to their apportionment of income, House Bill 222 and Senate Bill 883 authorized the Governor to give grants or loans from the Commonwealth's Development Opportunity Fund to companies eligible to use certified company apportionment, provided that certain conditions are met. The legislation also authorized the following localities to give grants or loans to such companies:

- The Counties of Alleghany, Bland, Buchanan, Carroll, Craig, Dickenson, Giles, Grayson, Lee, Russell, Scott, Smyth, Tazewell, Washington, Wise, and Wythe and the Cities of Bristol, Galax, and Norton;
- The Counties of Amelia, Appomattox, Buckingham, Charlotte, Cumberland, Halifax, Henry, Lunenburg, Mecklenburg, Nottoway, Patrick, Pittsylvania, and Prince Edward and the Cities of Danville and Martinsville;
- The Counties of Accomack, Caroline, Essex, Gloucester, King and Queen, King William, Lancaster, Mathews, Middlesex, Northampton, Northumberland, Richmond, and Westmoreland; and
- The Counties of Brunswick and Dinwiddie and the City of Petersburg.

Proposed Legislation

This bill would add Page County to the list of qualified localities that a company may invest in for purposes of becoming eligible to utilize modified apportionment factors to decrease the amount of income taxed by Virginia (“certified company apportionment”). This bill would also add Page County to the list of localities authorized to give grants or loans to such companies.

If enacted during the 2019 Regular Session of the General Assembly, this bill would become effective July 1, 2019.

cc : Secretary of Finance

Date: 1/15/2019 JJS
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