

# DEPARTMENT OF TAXATION

## 2023 Fiscal Impact Statement

1. **Patron** Phillip A. Scott

3. **Committee** House Finance

4. **Title** Individual Income Tax; Sales and Use Tax;  
Motor Vehicle Sales and Use Tax; Tax on  
Motor Fuels; Rate Changes

2. **Bill Number** HB 1863

**House of Origin:**

X **Introduced**

       **Substitute**

       **Engrossed**

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

### 5. **Summary/Purpose:**

This bill would make numerous changes to taxation in the Commonwealth. This bill would provide that, beginning January 1, 2025, all income tax rates would be reduced by 1.15 percent each year that a tax reduction condition, defined in the bill, is met until the tax rate reaches zero.

The bill would also increase the rate of the state Retail Sales and Use Tax from 4.3 to 5.3 percent beginning July 1, 2024, and would increase this rate by one percent each year until reaching 9.3 percent beginning July 1, 2028. The bill would also increase the tax on cigarettes by three cents per cigarette and would double the statutory tax rate on tobacco products.

The bill would also increase the motor vehicle sales and use tax rate ("MVSUT") by one percent beginning July 1, 2024, and would continue to increase it by one percent each year until reaching an additional five percent over current rates beginning July 1, 2028.

The bill would also increase the motor fuels tax by five cents per gallon beginning July 1, 2024, with additional five cents per gallon increases until reaching an additional 25 cents per gallon beginning July 1, 2028.

If enacted during the regular session of the 2023 General Assembly, this bill would become effective for July 1, 2023.

6. **Budget amendment necessary:** Yes.

Item(s): Page 1: Revenue Estimates

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

## 8. Fiscal implications:

### Administrative Costs

The Department of Taxation (“the Department”) has not assigned any administrative costs to this bill because the changes required by a single bill such as this can be implemented as part of the annual changes to our systems and forms. As stand-alone legislation, the Department considers implementation of this bill as “routine” and does not require additional funding.

The Department will provide specific administrative costs on any legislation that is not “routine.” Additionally, the Department will review all state tax legislation likely to be enacted prior to the passage by each house. If the aggregate number of routine bills likely to pass either house is unusually large, it is possible that additional resources will be required. If so, the Department will identify the costs at that time.

The Department of Motor Vehicles (“DMV”) incurs collection costs in the form of credit card fees and DMV Select agent compensation payments. Whenever the MVSUT rate is increased, these collection costs increase. Language in *Va. Code* § 58.1-2425 allows DMV to recover collection costs prior to transferring MVSUT revenues to the Virginia Department of Transportation. A large portion of MVSUT revenue is collected through the online dealer program, where rate increases do not translate to increased collection costs. However, approximately 9 percent of MVSUT revenue is collected through credit card payments and about 8 percent is collected by Select agents. DMV pays around one to two percent in credit card merchant fees. The compensation paid to select agents is between 4.5 percent and five percent.

As the language allowing the cost recovery was enacted during the 2020 General Assembly Session, DMV has only been able to recover collection costs for the past two fiscal years. In Fiscal Year 2021, DMV recovered \$8.6 million out of MVSUT revenue collections of \$1.1 billion. In Fiscal Year 2022, DMV recovered \$8.8 million out of \$1.2 billion in revenue. On average, the recovery amount equals 0.75 percent (three-quarters of one percent) of the revenue collected.

The programmatic changes necessary to effectuate the bill's changes to the fuels tax and MVSUT should be minimal and can be absorbed by DMV.

Fiscal Year	Rate	Estimated Revenue	Estimated DMV Collection Cost (0.75%)
FY 2025	1%	\$292,500,000	\$2,189,225
FY 2026	2%	\$585,000,000	\$4,378,450
FY 2027	3%	\$877,400,000	\$6,566,927
FY 2028	4%	\$1,169,900,000	\$8,756,152
FY 2029	5%	\$1,462,400,000	\$10,945,377

## Revenue Impact

### *Sales Tax*

The language in the bill that would increase the sales tax rate one percent annually would increase General Fund revenues by \$1.502 billion in Fiscal Year 2025, \$3.228 billion in Fiscal Year 2026, \$5.040 billion in Fiscal Year 2027, \$6.944 billion in Fiscal Year 2028, and \$8.944 billion in Fiscal Year 2029.

<b>Impact (\$ millions)</b>	<b>FY 2025</b>	<b>FY 2026</b>	<b>FY 2027</b>	<b>FY 2028</b>	<b>FY 2029</b>
General Fund	\$1,501.7	\$3,228.1	\$5,040.0	\$6,944.0	\$8,943.6

### *Tax on Cigarettes and Other Tobacco Products ("OTP")*

The language in the bill that would increase the tax on cigarettes and OTP would increase General Fund revenues by \$159.2 million in Fiscal Year 2025, \$174.7 million in Fiscal Year 2026, \$172.3 million in Fiscal Year 2027, \$172.5 million in Fiscal Year 2028, and \$172.6 million in Fiscal Year 2029.

<b>Impact (\$ millions)</b>	<b>FY 2025</b>	<b>FY 2026</b>	<b>FY 2027</b>	<b>FY 2028</b>	<b>FY 2029</b>
Cigarette	\$ 123.1	\$ 134.3	\$ 131.6	\$ 131.6	\$ 131.6
OTP	\$ 38.8	\$ 43.2	\$ 43.6	\$ 43.7	\$ 43.9
SUT - General Fund	\$ (2.7)	\$ (2.8)	\$ (2.8)	\$ (2.8)	\$ (2.8)
SUT- Other Funds	\$ (1.9)	\$ (2.0)	\$ (2.0)	\$ (2.0)	\$ (2.0)
Total General Fund	\$ 159.2	\$ 174.7	\$ 172.3	\$ 172.5	\$ 172.6

### *Motor Vehicle Sales and Use Tax and Motor Fuels Tax*

The language in the bill that would increase the MVSUT rate by one percent annually would increase revenues generated by that tax by \$211.2 million in Fiscal Year 2025, \$468.2 million in Fiscal Year 2026, \$728 million in Fiscal Year 2027, \$989 million in Fiscal Year 2028, and \$1.251 billion in Fiscal Year 2029.

The language in the bill that would increase the tax on motor fuels by five cents per gallon annually would increase revenues generated by that tax by \$288.1 million in Fiscal Year

2025, \$591 million in Fiscal Year 2026, \$899.8 million in Fiscal Year 2027, \$1.215 billion in Fiscal Year 2028, and \$1.572 billion in Fiscal Year 2029.

<b>Impact (\$ millions)</b>	<b>FY 2025</b>	<b>FY 2026</b>	<b>FY 2027</b>	<b>FY 2028</b>	<b>FY 2029</b>
Motor Fuels Tax	\$ 211.2	\$ 468.2	\$ 728.0	\$ 989.0	\$1,250.9
Motor Vehicle Sales Tax	\$ 288.1	\$ 591.0	\$ 899.8	\$1,214.6	\$1,571.9

The total General Fund revenue impact of all of the proposed tax increases in the bill would be \$2.16 billion in Fiscal Year 2025, \$4.462 billion in Fiscal Year 2026, \$6.84 billion in Fiscal Year 2027, \$9.32 billion in Fiscal Year 2028, and \$11.939 billion in Fiscal Year 2029.

<b>General Fund Impact (\$ millions)</b>	<b>FY 2025 *</b>	<b>FY 2026</b>	<b>FY 2027</b>	<b>FY 2028</b>	<b>FY 2029</b>
General SUT rate	\$ 1,501.7	\$ 3,228.1	\$ 5,040.0	\$ 6,944.0	\$ 8,943.6
Cigarettes	\$ 123.1	\$ 134.3	\$ 131.6	\$ 131.6	\$ 131.6
OTP	\$ 38.8	\$ 43.2	\$ 43.6	\$ 43.7	\$ 43.9
SUT-General Fund (from cigarette and OTP tax increase)	\$ (2.7)	\$ (2.8)	\$ (2.8)	\$ (2.8)	\$ (2.8)
Motor Fuels Tax	\$ 211.2	\$ 468.2	\$ 728.0	\$ 989.0	\$ 1,250.9
Motor Vehicle Sales Tax	\$ 288.1	\$ 591.0	\$ 899.8	\$ 1,214.6	\$ 1,571.9
Total Additional General Fund from the Tax Increases proposed in the bill	\$ 2,160.2	\$ 4,462.0	\$ 6,840.2	\$ 9,320.1	\$ 11,939.1

\* Reflects 11 months of revenue collections for RSUT, MVSUT, cigarette, and OTP

\* Reflects 10 month of collections for motor fuels tax

### *Individual Income Tax*

The language in the bill that would reduce the individual income tax rates is contingent upon meeting a revenue trigger that is specified in the bill. Because it is unknown whether this revenue trigger would be met and during which fiscal years, the revenue impact of this portion of the bill is unknown but likely significant.

However, assuming that this revenue trigger would be met and caused a 1.15 percent rate reduction for Taxable Year 2025 and then again for Taxable Year 2027, then it would result in a reduction to General Fund revenues of \$1.99 billion in Fiscal Year 2025, \$4.31 billion in Fiscal Year 2026, \$6.67 billion in Fiscal Year 2027, \$9.37 billion in Fiscal Year 2028, and

\$9.80 billion in Fiscal Year 2029. If such negative revenue impact were combined with the positive revenue impact resulting from the other provisions of this bill, then this bill would result in a net positive General Fund revenue impact of \$170.5 million in Fiscal Year 2025, \$147.8 million in Fiscal Year 2026, and \$170.2 million in Fiscal Year 2027. It would result in a net negative General Fund revenue impact of \$51.7 million in Fiscal Year 2028 and a net positive General Fund revenue impact of \$2.14 billion in Fiscal Year 2029. However, as stated before, it is unknown whether and when these revenue triggers would be met. Therefore, the actual net General Fund revenue impact of this bill is unknown but likely significant.

The bill would also have an indirect negative impact on non-General Funds of approximately \$2 million per fiscal year due to reduced sales and use tax collections on the sales of cigarette and other tobacco products related to the increase in the excise tax rate.

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

Department of Taxation  
Department of Motor Vehicles

**10. Technical amendment necessary: Yes.**

The Department recommends amending the language in the bill in new *Va. Code* § 58.1-320.1 to clarify whether comparisons of revenues, including revenues generated by tax policy changes, against appropriations are to be based all on information from the current fiscal year, a prior fiscal year, or a subsequent fiscal year. The relevant revenue information from the current fiscal year would not be available in sufficient time for the Department to make the necessary programming changes for the next taxable year. The timing issue could be avoided, however, if the determination as to whether or not the individual income tax rate will change shall be made is based on the prior fiscal year's revenue information, as that information, for Taxable Year 2024 for instance, would be available by December 2024 and would give the Department sufficient time to program the changes that would not need to be in place until January of 2026 for Taxable Year 2025.

**11. Other comments:**

Retail Sales and Use Tax

The state Retail Sales and Use Tax is currently levied at a rate of 4.3 percent statewide. In addition to the state rate, all localities levy a local rate of one percent bringing the lowest rate levied statewide to 5.3 percent. Moreover, the rate levied in some localities will be higher due to collection of a regional rate and an additional local rate. The areas of the Commonwealth where the rate currently differs from the 5.3 percent rate are as follows:

- The rate in the Northern Virginia, Central Virginia, and Hampton Roads regions (outside of the Historic Triangle) is 6.0 percent consisting of the state 4.3 percent rate, local one percent rate, and 0.7 percent regional rate to fund transportation.
- The rate in the Historic Triangle region consisting of James City County, York County, and the City of Williamsburg, is 7.0 percent consisting of the state 4.3 percent rate, local one percent rate, 0.7 percent Hampton Roads regional rate to

fund transportation, and an additional one percent state rate to fund tourism within the Historic Triangle.

- The rate of sales tax in the counties of Charlotte, Gloucester, Halifax, Henry, Northampton, and Patrick and the city of Danville is 6.3 percent consisting of the state 4.3 percent rate, local one percent rate, and additional one percent local rate to fund school renovation or construction.

### Virginia Individual Income Tax Rates and Tax Brackets

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

<b>Virginia Taxable Income</b>	<b>Virginia Tax Rates</b>
\$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 only 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.

<b>Year</b>	<b>Taxable Income Subject to 5.75 percent Tax Rate</b>
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.

### Taxation of Cigarettes and Other Tobacco Products

Under current law, the Tobacco Products Tax is imposed on cigars, smokeless tobacco, pipe tobacco, loose leaf tobacco, liquid nicotine, and heated tobacco products. Cigars are defined as any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco other than any roll of tobacco that is a cigarette. Cigarettes are not subject to the tax on tobacco products.

Effective July 1, 2020, Item 3-5.21 of House Bill 30 (the 2020 Appropriation Act) doubled the tobacco products tax rates on all products subject to the tax. As a result, most tobacco products, other than moist snuff, loose leaf tobacco, and liquid nicotine are subject to the tax at the rate of 20% of the manufacturer's sales price. This includes cigars. This bill would double the rate to 40%.

The statutory rate of tax on cigarettes is currently 1.5 cents per cigarette, but Item 3-5.21 of House Bill 30 (the 2020 Appropriation Act) increased that rate to 3 cents effective July 1, 2020. This bill would double the tax to 6 cents.

### Motor Fuels Tax

Effective July 1, 2022 to June 30, 2023, the rate of excise tax on gasoline is 28 cents per gallon and on diesel fuel is 28.9 cents per gallon. These rates are indexed to the change in the United States Average Consumer Price Index for all items, all urban consumers ("CPI-U") and are published annually by the Department of Motor Vehicles. This bill would not affect the annual indexing of this tax but would rather levy an additional five cents per gallon tax on these items which would increase by five cents annually until reaching a rate of 25 cents per gallon applicable beginning July 1, 2028.

### Motor Vehicle Sales and Use Tax

MVSUT is collected by the DMV and is currently levied at the rate of 4.15 percent of the vehicle's gross sales price, or \$75, whichever is greater. The "gross sales price" is the cost of the vehicle after any rebates or incentives are applied. It includes the dealer processing fee but not any other price reductions.

### Proposed Legislation

This bill would make numerous changes to taxation in the Commonwealth. This bill would provide that, beginning January 1, 2025, all income tax rates would be reduced by 1.15 percent each year that a tax reduction condition is met until the tax rate reaches zero.

The bill would consider a "tax reduction condition" as being met if the amount of General Fund revenues collected in the preceding fiscal year, excluding required rainy day deposits, plus the amount of additional general fund revenues is greater than or equal to the amount of General Fund appropriations made for such fiscal year plus the income tax equivalent for such fiscal year. For purposes of this determination, "General Fund revenues collected in the preceding fiscal year" would not include revenues generated as a result of tax policy changes in any fiscal year in which a rate reduction did not occur.

The bill would define "additional General Fund revenues" as the amount of General Fund revenues forecast to be deposited in the General Fund as the result of tax policy changes in the succeeding fiscal year plus the amount of increased General Fund revenues resulting from tax policy changes in years in which the tax reduction condition was not met.

The bill would define "tax policy changes" as the changes proposed by the bill to the sales tax, MVSUT, fuels taxes, cigarette tax, and OTP taxes.

The bill would define “income tax equivalent” as the amount of revenue reduction that would result from a 1.15 percent reduction in the individual income tax rate.

“Income tax reduction” would be defined as the 1.15 percent reduction in the individual income tax rate as described in this bill.

The bill would define “rainy day deposits” as required deposits of revenues to the Revenue Stabilization Fund and the Revenue Reserve Fund.

Virginia Tax Brackets	Proposed Virginia Tax Rates				Reduction Per Year
	2024 and Prior	1 <sup>st</sup> Year Reduction	2 <sup>nd</sup> Year Reduction	3 <sup>rd</sup> Year Reduction	
\$0 to \$3,000	2%	0.85%	0%	0%	1.15%
\$3,001 to \$5,000	3%	1.85%	0.7%	0%	1.15%
\$5,001 to \$17,000	5%	3.85%	2.7%	1.55%	1.15%
\$17,001 or more	5.75%	4.6%	3.45%	2.3%	1.15%

The bill would also increase the Retail Sales and Use Tax rate to 5.3 percent beginning July 1, 2024, and would increase this rate by one percent each year until reaching 9.3 percent beginning July 1, 2028.

Virginia State Sales Tax Rate	Proposed Sales Tax Rates				Increase Per Year
	FY 2024 and Prior	FY 2025 Rate	FY 2026 Rate	FY 2027 Rate	
Statewide	4.3%	5.3%	6.3%	7.3%	1.0%

The bill would also increase the tax on cigarettes by three cents per cigarette and would double the statutory tax rate on tobacco products with the revenues from such taxes to be deposited in the General Fund.

Virginia Statewide Tax Rate	Proposed Tax Rates			
	FY 2024 and Prior	FY 2025 Rate	FY 2026 Rate	FY 2027 Rate
OTP	20%	40%	40%	40%
Cigarettes (each)	\$0.03	\$0.06	\$0.06	\$0.06

The bill would also increase the MVSUT rate by one percent beginning July 1, 2024, and would continue to increase it by one percent each year until reaching an additional five percent over current rates beginning July 1, 2028.

Virginia State MVSUT Rate	Proposed MVSUT Rates				Increase Per Year
	FY 2024 and Prior	FY 2025 Rate	FY 2026 Rate	FY 2027 Rate	
Statewide	4.15%	5.15%	6.15%	7.15%	1.0%

The bill would also increase the tax levied on motor fuels tax by five cents per gallon through the levy of an additional tax beginning July 1, 2024, with additional five cents per gallon increases until reaching an additional 25 cents per gallon beginning July 1, 2028. The bill would require all additional revenue generated by such tax increases to be deposited in the General Fund.



Virginia Statewide Excise Tax Rate	Proposed Motor Fuels Tax Rates				Increase Per Year
	FY 2024 and Prior	FY 2025 Rate	FY 2026 Rate	FY 2027 Rate	
Gasoline (gal.)	\$0.28	>\$0.33*	>\$0.38*	>\$0.43*	\$0.05/gal
Diesel (gal.)	\$0.289	>\$0.339*	>\$0.389*	>\$0.439*	\$0.05/gal

*\*The base rate of the tax is indexed to the CPI-U so the future rates are indeterminable at this time*

Finally, the bill would direct the Secretary of Finance to convene a workgroup to recommend additional tax policy changes that would be needed to eliminate personal income tax liability.

cc : Secretary of Finance

Date: 1/29/2023 VB  
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