DEPARTMENT OF TAXATION
2023 Fiscal Impact Statement

1. **Patron** James A. "Jay" Leftwich

2. **Bill Number** HB 1978
House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

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

3. **Committee** House Finance

4. **Title** Corporate Income Tax: Apportionment Retail Companies

5. **Summary/Purpose:**

This bill would allow an affiliated group of corporations with eighty percent or more of their sales derived from retail company activities to apportion all their income using the single sales factor on a Virginia consolidated return. Under current law, such affiliated groups must use a combination of single sales factor apportionment and three factor apportionment to determine their income subject to Virginia corporate income tax if they contain at least one member that is not a retail company. This election would only be effective in years during which the eighty percent or more of sales test is met, and such an election could not be changed without permission of the Department of Taxation ("the Department").

If enacted during the regular session of the 2023 General Assembly, this bill would be effective for taxable years beginning on and after January 1, 2023.

6. **Budget amendment necessary:** No.

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

8. **Fiscal implications:**

Administrative Costs

The Department of Taxation ("the Department") considers implementation of this bill as routine and would not require additional funding.

Revenue Impact

This bill would have an unknown negative General Fund revenue impact beginning as early as Fiscal Year 2024. Because the provisions of this bill are elective, it is anticipated that only eligible affiliated groups that expect to reduce their Virginia income tax liability would make the election. However, it is unknown how many of these affiliated groups would qualify for or make the election allowed by this bill. It is also unknown how many affiliated groups of corporations would be able to continue to qualify for this election from year to year.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Federal Corporate Tax Filings Rules for Affiliated Corporations

For federal income tax purposes, an affiliated group of corporations has the option of filing a consolidated return in lieu of separate returns for each corporation. If a consolidated return is filed, the affiliated group members are treated as one entity and their financial activities are combined for purposes of computing their federal income tax liability. A corporation generally meets the federal requirements for affiliation if it possesses at least 80 percent of the total voting power and at least 80 percent of the total value of a corporation's stock.

Virginia's Corporate Tax Filings Rules for Affiliated Corporations

Virginia is a separate return state. As a result, Virginia allows each corporation with nexus with the state the ability to elect to file a separate Virginia return, regardless of its federal tax filings. In addition, Virginia allows corporations that are members of an affiliated group of corporations with Virginia nexus the ability to elect to file on a consolidated basis or on a Virginia combined basis. All returns for subsequent years are required to be filed on the same basis unless permission to change is granted by the Department. If a new corporation becomes a member of an affiliated group, the new corporation must follow the filing method previously elected by the group.

If an affiliated group of corporations elects to file separately, each corporation in the affiliated group that has nexus in Virginia is required to file its own separate corporate income tax return and report only that corporation's income, expenses, gains, losses, and allocation and apportionment factors on such return. This type of reporting follows the separate entity concept, in which each corporation in an affiliated group is treated as distinct and separate from the other corporations in such group for purposes of determining each corporation's corporate income tax liability.

A consolidated return includes the aggregate income, expenses, gains and losses, and allocation and apportionment factors of all of the corporations in an affiliated group that have nexus with Virginia. The corporate income tax liability of the affiliated group is computed in the aggregate, and the entire affiliated group files one corporate income tax return.

In a Virginia combined return, each corporation in an affiliated group that has nexus with Virginia determines its income, expenses, gains, losses, and allocation and apportionment factors separately. Each corporation then separately computes its individual corporate income tax liability. The final corporate income tax liability, after apportionment, of each corporation is then combined and included on one corporate income tax return.

Apportionment of Corporate Income

Corporations doing business in multiple states are required to allocate and apportion their income to determine the income subject to tax in Virginia. In the 1960's, most states imposing a corporate income tax used an equally-weighted three-factor formula of property, payroll, and sales. The sales factor sourced sales of tangible property to the state in which it was delivered, while other sales were sourced to the state in which the greater portion of costs of performance were incurred.

Virginia's General Three-Factor 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 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.

Virginia's Single Sales Factor Method of Apportionment for Certain Industries

In addition to Virginia's general three-factor method of apportionment, Virginia allows or requires a taxpayers in certain industries to apportion their Virginia taxable income using single sales factor method of apportionment, which is explained in more detail below.

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. After July 1, 2014, qualifying corporations may elect to use a single sales factor method of apportionment.

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 phased in a requirement that certain retail companies apportion their Virginia taxable income using only the single sales factor method. After July 1, 2015, all corporations primarily engaged in activities that, in accordance with the North American Industry Classification System, would be classified in the Retail Trade Sector are required to use this "single sales factor" method of apportionment.

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 ("MOU") with the Virginia Economic Development Partnership. The MOU would require that the taxpayer 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. After July 1, 2017, all qualifying corporations are required to use a single sales factor method of apportionment.

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.

Mixed Apportionment Factors

If a company is: (i) part of an affiliated group consisting of entities using the single sales factor apportionment method and entities using Virginia's general three-factor apportionment method; and (ii) such affiliated group files a Virginia consolidated return, then the affiliated group must use the mixed apportionment factors method. Such method requires the affiliated group to use both single sales factor apportionment and three factor apportionment to determine their income subject to Virginia corporate income tax.

Proposed Legislation

This bill would allow an affiliated group of corporations with eighty percent or more of their sales derived from retail company activities to apportion all their income using the single sales factor on a Virginia consolidated return. Under current law, such affiliated groups must use a combination of single sales factor apportionment and three factor apportionment to determine their income subject to Virginia corporate income tax if they contain at least one member that is not a retail company. This election would only be effective in years during which the eighty percent or more of sales test is met, and such an election could not be changed without permission of the Department.

If enacted during the regular session of the 2023 General Assembly, this bill would be effective for taxable years beginning on and after January 1, 2023.

Similar Bills

Senate Bill 1346 is identical to this bill.

cc : Secretary of Finance

Date: 1/29/2023 RWC
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