

# DEPARTMENT OF TAXATION

## 2008 Fiscal Impact Statement

1. **Patron** Vivian E. Watts

3. **Committee** House Rules

4. **Title** Local Piggyback Income Tax and Personal Property Tax

2. **Bill Number** HB 472

**House of Origin:**

  X   **Introduced**

      **Substitute**

      **Engrossed**

**Second House:**

      **In Committee**

      **Substitute**

      **Enrolled**

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

This bill would allow every locality to impose a local income tax at a rate either 0.5% or 1% upon the Virginia taxable income of individuals, trusts, estates, and corporations, provided that the locality's personal property tax rate does not exceed \$0.01 per \$100 of value on personally owned motor vehicles. TAX would collect the tax and return it to the locality based on taxpayers' residences. A new classification for personal property tax purposes would also be created for motor vehicles used for nonbusiness purposes.

The effective date of this bill is January 1, 2009.

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

7. **Budget amendment necessary:** No.

### 8. **Fiscal implications:**

#### Administrative Impact

TAX would not incur administrative costs as a result of this bill unless a locality exercised its authority under this legislation. If every locality in the Commonwealth adopted a local income tax effective for the 2009 taxable year then TAX would incur costs of \$470,000 for Fiscal Year 2009, \$1,803,000 for Fiscal Year 2010, \$427,000 for Fiscal Year 2011, \$438,000 for Fiscal Year 2012, \$449,000 for Fiscal Year 2013, and \$461,000 for Fiscal Year 2014 for significant forms and systems changes. TAX would also need 3 additional full time employees as customer service representatives to deal with the increase in contacts with TAX as a result of this bill and 1 additional full time employee to oversee the distributions to the localities. Budget Item 273 B authorizes TAX to request and receive a treasury loan to fund the necessary start-up costs associated with the implementation of local income tax if any locality takes action to put the tax option on a referendum. The treasury loan would be repaid for these costs from the local income tax revenues.

## Revenue Impact

It is not possible to provide an actual fiscal impact on localities because this bill would allow any county or city to impose the local option income tax at either 0.5% or 1% and it is not known which localities will choose to implement the local income tax. While localities would be required to reduce the tax rate on personal motor vehicles, they would continue to receive their share of the \$950 million annual distribution under the Personal Property Tax Reform Act ("PPTRA"). (See explanation on Line 10.) Therefore, the net effect of the rate reduction is the difference between the estimated tax on 100% of the value of personal motor vehicles and the PPTRA reimbursement.

Based on 2005 taxable year data, if all localities chose to impose a 1% local income tax, the estimated revenue gain would be \$899.0 million in Fiscal Year 2010, \$1,272.7 million in Fiscal Year 2011, \$1,180.1 million in Fiscal Year 2012, \$1,152.2 million in Fiscal Year 2013, and \$1,132.2 million in Fiscal Year 2014. If all localities chose to impose a 0.5% local income tax, there would be an estimated revenue gains of \$385.4 million in Fiscal Year 2010, \$184.8 million in Fiscal Year 2011, \$68.0 million in Fiscal Year 2012, and estimated revenue losses of \$7.5 million in Fiscal Year 2013, and \$77.7 million in Fiscal Year 2014.

The following table illustrates the net local impact of the reduction in personal property tax revenue and a 1% local income tax:

(\$ Millions)	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Corporate (1%)	\$77.6	\$185.8	\$139.4	\$135.3	\$131.5
Individual (1%)	\$949.7	\$1,989.9	\$2,084.8	\$2,184.2	\$2,288.3
Car Tax Revenue Loss	(\$128.2)	(\$903.0)	(\$1,044.1)	(\$1,167.3)	(\$1,287.6)
<b>Total</b>	<b>\$899.0</b>	<b>\$1,272.7</b>	<b>\$1,180.1</b>	<b>\$1,152.2</b>	<b>\$1,132.2</b>

The following table illustrates the net local impact of the reduction in personal property tax revenue and a 0.5% local income tax:

(\$ Millions)	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Corporate (0.5%)	\$38.8	\$92.9	\$69.7	\$67.7	\$65.8
Individual (0.5%)	\$474.8	\$994.9	\$1,042.4	\$1,092.1	\$1,144.2
Car Tax Revenue Loss	(\$128.2)	(\$903.0)	(\$1,044.1)	(\$1,167.3)	(\$1,287.6)
<b>Total</b>	<b>\$385.4</b>	<b>\$184.8</b>	<b>\$68.0</b>	<b>(\$7.5)</b>	<b>(\$77.7)</b>

The revenue estimates in the tables above assume that TAX is able to collect and distribute local income tax throughout the taxable year as estimated and withholding tax payments are made. There are several reasons why distributions to localities for the first fiscal year or two may be considerably below estimates.

- Estimated tax filers may rely on the exception that avoids penalty by paying last year's tax. Since it would not include the new local tax, no local tax would be paid until the return is filed on May 1, or November 1 if the extension is utilized.
- Employers would have to withhold local tax depending on whether each employee lives in a locality that has imposed the tax. A separate line on the return (or an attached schedule) would have to identify how much tax was withheld for each locality in order for TAX to properly distribute funds during the taxable year. The imposition of new and complex rules inevitably results in initial confusion and noncompliance.
- Instead of receiving virtually all of their 2010 property tax revenue on the scheduled payment date during 2010, income tax revenue for the taxable year 2010 is received over a period from February 20, 2010 (employer return of withholding tax for January) through November 1, 2011 (payment with return filed under extension). For example, a locality that requires payment of property tax on June 15 would receive most of its 2010 property tax revenue in fiscal year 2010, but its income tax for taxable year 2010 would be spread over three fiscal years: FY2010 – 2012.

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

All localities  
Department of Taxation

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

If the intent of the bill is to cease PPTRA distributions to any locality that enacts a local income tax, then a substitute bill would be required to amend Va. Code § 58.1-3524 to specify when distributions to a locality would cease, and whether undistributed portions of the \$950 million would be reallocated to other localities or remain with the Commonwealth.

**11. Other comments:**

**Background**

**Local Income Tax**

Legislation enacted during the 1989 General Assembly session authorized certain cities and counties to impose a local income tax on individual residents of the localities and corporations, estates, and trusts with income from sources within the localities. Under current law, the city or county must hold a referendum and, upon voter approval, pass an ordinance to impose the tax. The 1989 legislation permits the levy of an income tax on individuals, estates, trusts and corporations at any increment of .25% up to a maximum rate of 1% above the state income tax rate. Counties and cities can levy an income tax for a period of not more than five years, and any revenue from the tax must be expended for transportation purposes. No city or county currently imposes the local income tax.

## Personal Property Tax Relief Act of 1998

The PPTRA originally was intended to eliminate the tangible personal property tax imposed on the first \$20,000 of value on passenger cars, pickup or panel trucks, and motorcycles owned or leased by natural persons and used for nonbusiness purposes.

The tax was originally scheduled to be eliminated over five years with 12.5% of the tax eliminated in 1998, 27.5% in 1999, 47.5% in 2000, 70% in 2001, and 100% in 2002 and thereafter. The tax on vehicles valued at \$1,000 or less was completely eliminated in 1998. The amount of the tax relief was shown on the taxpayer's bill and the Commonwealth reimburses localities for the amount of the tax relief.

The PPTRA provided a mechanism for freezing the tax relief if the Commonwealth's revenue growth is insufficient. The percentage of tax relief was frozen at the current percentage of tax relief in effect if any one of three revenue growth tests was not met. When revenue growth was sufficient, the percentage of tax relief increased to the next highest level of tax relief. The level of tax relief never exceeded 70%.

## Senate Bill 5005

Senate Bill 5005 (Chapter 1, 2004 Special Session I) changed the personal property tax relief program for motor vehicles. The state currently distributes \$950 million annually to localities as reimbursement for the personal property tax relief provided by each locality. Each locality's share of the \$950 million state reimbursement for tax year 2006 and subsequent tax years is based upon its share of the total state reimbursement for tax year 2005.

## **Proposal**

### Local Income Tax

This bill would amend the local option income tax to allow any county or city to impose a local income tax at a rate either one-half of one percent or one percent with the adoption of an ordinance and provided the locality's personal property tax rate does not exceed \$0.01 per \$100 of value on personally owned motor vehicles. This bill would also eliminate (i) the referendum requirement for the enactment of the local income tax, (ii) the current restriction that revenue from the local income tax must be spent solely on transportation and (iii) the current provision mandating the expiration of the tax five years after its imposition. This bill would not repeal the current requirement that the Commonwealth provide \$950 million a year to localities for personal property tax relief.

### Classification of Personal Use Vehicles for Purposes of Local Taxation

This bill would create a separate classification of personal use motor vehicles in order for localities to apply a different personal property tax rate to these vehicles.

## **Other Legislation**

**House Bill 58** would repeal the changes to the Personal Property Tax Relief Act of 1998 (the "PPTRA") provided by Senate Bill 5005 (Chapter 1, 2004 Special Session I) and set the PPTRA reimbursement level at 100 percent.

cc : Secretary of Finance

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