DEPARTMENT OF TAXATION
2008 Fiscal Impact Statement

1. **Patron** Kathy J. Byron

2. **Bill Number** HJ 177

   House of Origin:

   _____ **Introduced**

   _____ **Substitute**

   _____ **Engrossed**

   Second House:

   __X__ **In Committee**

   _____ **Substitute**

   _____ **Enrolled**

3. **Committee** Senate Rules

4. **Title** Corporate income tax. Joint subcommittee to study single sales factor and report.

5. **Summary/Purpose:**

   This resolution would establish a joint subcommittee to study the benefits of adopting a single sales factor to apportion the income of multistate corporations and related issues for purposes of the corporation income tax.

6. **No Fiscal Impact.**

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

8. **Fiscal implications:** None.

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

   Department of Taxation

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

11. **Other comments:**

    Since 1991 TAX has extensively analyzed the fiscal impact of increasing the weight of the sales factor in apportioning multistate corporate income.

    1991: HB 1267 proposed increasing the sales factor weight from one-third to one-half (double-weighted).

    After the 1991 Session, TAX pulled a larger sample of 1988 returns to analyze the fiscal impact of increasing the weight of the sales factor.

    1992: HB 233 also proposed increasing the sales factor weight from one-third to one-half (double-weighted).

    1998: SB 279 also proposed increasing the sales factor weight from one-third to one-half (double-weighted). The bill passed with a reenactment clause.

After the 1998 Session, TAX pulled a larger sample of 1994 returns to analyze the fiscal impact of increasing the weight of the sales factor.

1999: HB 1818 and SB 1076 were enacted and increased the sales factor weight from one-third to one-half (double-weighted).

2005: SJR 361 continued a subcommittee studying the needs of Virginia's manufacturers. At the request of the Subcommittee TAX pulled a large sample of 2003 returns and analyzed the fiscal impact of increasing the weight of the sales factor to 100% (single sales factor).

The conclusion of every study was the same: (i) some corporations paid less tax, while others paid more, but many corporations were not affected by the change in the sales factor; (ii) the winners outnumbered the losers; consequently (iii) the net revenue impact was negative. The amounts of the revenue losses varied, but were always significant. TAX is not aware of any change that would cause another study to produce a different result other than the magnitude of the revenue loss.

The external environment, however, is changing. First, other states have been increasing the weight of their sales factor. Virginia is now in the minority when apportionment factors are ranked by the weight accorded to the sales factor. To the extent that the apportionment formula for a state's income tax influences business location decisions, this may put Virginia at a competitive disadvantage. On the other hand, studies generally conclude that state taxes are one of many factors influencing business location decisions, and are rarely decisive. Therefore, a component of one of Virginia's taxes may have even less influence on business location decisions.

Second, a change in the sales factor would not affect financial corporations or motor carriers that have their own single factor (costs of performance and miles, respectively). By regulation the term "costs of performance" is tied to the location of offices and employees. Financial corporations have expressed interest in having a sales factor applied to their business.

Third, improvements in communications have enabled more business to be conducted through the internet, telephone and mail. Federal law prohibits states from taxing a business selling tangible property whose only contacts with a state are by internet, telephone and mail. Bills have been pending in Congress for several years that would expand the federal law to apply to all types of businesses. In states with a single sales factor, corporations can take advantage of this federal law to structure themselves so that the apportionment formula assigns most of their income to other states that are prohibited from taxing them. This suggests that the long-term impact of adopting a single sales factor apportionment formula may be that revenue losses would grow as corporations structure their operations to take advantage of the federal law, or changes in federal law.

Because the scope of the proposed study would not be limited exclusively to the single sales factor issue, it may not be possible to conclude the study before the next Session.

Similar Legislation

Senate Joint Resolution 101 would require a similar study, but it would not authorize the subcommittee to include other relevant issues.

House Bill 1514 would modify the corporate apportionment formula by allowing manufacturing companies to use a single sales factor to determine their Virginia taxable income. Such companies would still have the option of using the current apportionment formula, which is one fourth property, one fourth payroll, and one half sales. This change would be effective for taxable years beginning on and after July 1, 2010.

If House Bill 1514 is enacted, there would be little value in also conducting the study proposed by this bill.

cc : Secretary of Finance

Date: 2/15/2008 AMS
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