

DEPARTMENT OF TAXATION

2010 Fiscal Impact Statement

1. **Patron** Barbara J. Comstock

3. **Committee** House Finance

4. **Title** Corporate Income Tax: Rate Reduction for
Small Businesses

2. **Bill Number** HB 896

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would reduce the corporate income tax rate from 6% to 5.4% for every small business. A "small business" would be an independently owned and operated business that has 250 or fewer employees.

The tax rate reduction would be effective for taxable years beginning on or after January 1, 2010.

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

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

8. **Fiscal implications:**

Administrative Costs

TAX 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, TAX considers implementation of this bill as "routine," and does not require additional funding.

TAX will provide specific administrative costs on any legislation that is not "routine." Additionally, TAX 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, TAX will identify the costs at that time.

Revenue Impact

This bill would result in an unknown loss in General Fund revenues beginning in FY 2010. Based on data from the Quarterly Census of Employment and Wages (2008, Quarter 1), there were 220,936 establishments in Virginia that have fewer than 250 employees. However, it is not possible to identify how many of these establishments meet the other

requirements to be a small business or the number that are subject to the Virginia corporate income tax. Businesses that are organized as S-corporations, LLCs, LLPs, partnerships, or sole proprietorships are not subject to the corporate income tax and would not qualify for the proposed reduced tax rate.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Federal Law

According to the Small Business Administration ("SBA"), a small business is defined as a business establishment or enterprise that is organized for profit, with a place of business in the United States, and which operates primarily within the United States or makes a significant contribution to the U.S. economy through payment of taxes or use of American products, materials or labor. Further, the business establishment or enterprise cannot be dominant in its field, on a national basis. Finally, the business establishment or enterprise must meet the numerical small business size standard for its industry.

The SBA has established a size standard for most industries in the U.S. economy. The most common size standards are as follow:

- 500 employees for most manufacturing and mining industries
- 100 employees for all wholesale trade industries
- \$6.5 million for most retail and service industries
- \$31 million for most general & heavy construction industries
- \$13 million for all special trade contractors
- \$0.75 million for most agricultural industries

About one-fourth of industries have a size standard that is different from these levels. They vary from \$0.75 million to \$32.5 million for size standards based on average annual revenues and from 100 to 1500 employees for size standards based on number of employees.

Virginia Definition of Small Business

Under Va. Code § 2.2-904.1, a “small business” is an independently owned and operated business that, together with affiliates, has 250 or fewer employees or average annual gross receipts of \$10 million or less averaged over the previous three years.

Virginia Corporate Income Tax

The corporate income tax is imposed at the rate of six percent on the Virginia taxable income of domestic and foreign corporations doing business in Virginia. A “corporation” is any entity created as a corporation under the laws of any state or local domestic or foreign jurisdiction, and any association, joint stock company, or any other entity subject to corporate income tax under the Internal Revenue Code § 7701.

A corporation’s taxable income is determined by allocation and apportionment when the income is derived from sources both within and without Virginia. Multistate corporations allocate and apportion federal taxable income after Virginia modifications are made to determine the amount of attributable to Virginia. There is no allocation or apportionment needed when the entire business of a corporation is conducted or transacted within Virginia. Instead, the Virginia corporate income tax is imposed upon the entire Virginia taxable income of the corporation for each taxable year.

The corporate income tax has become a major revenue source for Virginia. According to the Annual Report for Fiscal Year 2009, the corporate income tax produced \$648 million in revenue. The corporate income tax produces the third highest amount of revenue behind the individual income tax and the state sales and use tax.

There are other business entities that are not subject to corporate income tax and would not receive a benefit under this bill. Banks and trust companies are subject to a bank franchise tax, and insurance companies are subject to a premiums tax. Businesses organized as pass-through entities, such as partnerships, LLPs, LLCs, etc., are not taxed at the entity level, but their members are typically subject to the individual income tax. Individuals who operate businesses as sole proprietorships also are subject to the individual income tax. For Taxable Year 2007, over 170,000 pass-through entity returns were filed, as compared to under 71,000 corporate income tax returns. In addition, based on IRS data, there were 535,294 individual returns filed for Taxable Year 2007 in Virginia that were sole proprietorships. This number includes a broad range of businesses, from people selling products part-time, to tradesmen (plumbers, electricians, carpenters, etc.) running a full-time business.

Proposed Legislation

This bill would reduce the corporate income tax rate from 6% to 5.4% for every small business.

“Small business” would mean an independently owned and operated business that has 250 or fewer employees.

This bill would also require the Governor to appoint a special Small Business Job Growth Commission. This Commission would identify and provide recommendations to the General Assembly and Governor by November 1, 2010, on removing barriers for business formation and investment in order to encourage job growth.

The tax rate reduction would be effective for taxable years beginning on or after January 1, 2010.

Similar Legislation

Senate Bill 421 is identical to this bill.

House Bill 94 would reduce the corporate income tax rate by one percent for small businesses that increase the number of their employees by a minimum of five percent over the number of employees in the immediately preceding year. This bill would also provide that the one percent tax rate reduction would be allowed for no more than three taxable years.

House Bill 119 would eliminate Virginia's corporate income tax for taxable years beginning on and after January 1, 2010.

House Bill 860 would reduce the corporate income tax rate from 6.0% to 5.75%.

Senate Bill 325 would reduce the corporate income tax rate from six percent to three percent for the first three years after a business establishes a new office or operation or expands an existing office or operation in a nonattainment area under the Clear Air Act, for taxable years beginning on or after January 1, 2010. The capital investment must be \$250,000 or more and the tax reduction may not exceed that amount of the capital investment made by the corporation.

cc : Secretary of Finance

Date: 1/17/2010 TG
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