DEPARTMENT OF TAXATION
2012 Fiscal Impact Statement

1. Patron David J. Toscano

2. Bill Number HB 146

House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

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

3. Committee House Rules

4. Title Commission to Review the Effectiveness of Virginia's Tax Preferences; Report Established

5. Summary/Purpose:

This bill would establish the Commission to Review the Effectiveness of Virginia's Tax Preferences in the legislative branch of government, which would oversee the evaluation of Virginia's tax preferences. The Commission would consist of five members of the House of Delegates and three members of the Senate. The Commission would be permitted to direct that the Department of Taxation, under the Commission's guidance and instruction, conduct independent evaluations of tax preferences and report its findings to the Commission. The Commission would be authorized to establish a technical advisory group to assist the Commission and the Department of Taxation.

The chairman of the Commission would be required to submit an annual executive summary of the interim activity and work of the Commission by the first day of each regular General Assembly session to the General Assembly and to the Governor.

If, during its first year of existence, the Commission is not funded by a separate appropriation in the Appropriations Act, the Commission would be funded from the operating budgets of the Clerk of the House of Delegates and the Clerk of the Senate upon approval from the Joint Rules Committee. If the Commission is not funded by a separate appropriation in the Appropriations Act for any year after the first year, the Commission would expire on July 1 of that fiscal year. The Commission would expire on July 1, 2016.

The effective date of this bill is not specified.

6. Budget amendment necessary: No.

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

8. Fiscal implications:

Administrative Costs

This bill would require the Department of Taxation to conduct evaluations upon request from the Commission. The Department would require additional funding for additional full-time positions to conduct such evaluations. This bill would require the Commission to develop procedures regarding which tax preferences shall be reviewed and how often they shall be reviewed. Accordingly, the amount of funding required would depend on the scope of the Commission's study.

If, in accordance with this bill, the Commission were to require the Department to conduct an annual in-depth study of all tax preferences for all taxes that it administers, the Department would need to greatly expand the number and types of preferences that it currently studies. In order to conduct a study of this magnitude, the Department would need additional Economists to develop source data, research the data, make adjustments for Virginia, develop revenue estimates, and analyze the distribution of benefits by income level or size or type of business. The Department would also require additional Policy Analysts to identify, cite, and explain each state tax preference, provide information on the taxpayers who benefit from the preference, evaluate the extent to which the purpose of the tax preference has been accomplished, conduct comparative studies with other states, and research national trends with respect to each preference.

Even if the Commission requires a less intensive evaluation from the Department, additional funding may still be necessary. For example, when the Sales and Use Tax Expenditure Study was instituted in 1989, the Department dedicated six staff members to conducting the study. In 2005, when the Department was mandated to conduct a similar study, two new positions were required, with a minimal cost of $114,306 in the first year of the study and increasing costs each year thereafter.

Depending on the scope of the studies directed by the proposed Commission, similar costs may be necessary. However, the temporary funding set forth in this bill would not cover the Department's administrative costs. Without additional funding, the Department would be able to provide only limited assistance to the Commission.

Revenue Impact

The existence of the Commission itself would not have a revenue impact. If actions of the Commission result in the repeal or modification of tax preferences, there would likely be a revenue impact.

9. Specific agency or political subdivisions affected:

Department of Taxation
Division of Legislative Services
Office of the Clerk of the House of Delegates
Office of the Clerk of the Senate

10. Technical amendment necessary: No.

11. Other comments:

JLARC Tax Preferences Study

The 2010 General Assembly passed Senate Joint Resolution 21, which required the Joint Legislative Audit and Review Commission (JLARC) to conduct a two-year examination of Virginia individual income tax, corporate income tax, and retail sales and use tax preferences. In its report, JLARC was required to do the following:

- Determine which individual income, corporate income, and sales and use tax preferences are being claimed or taken and to what extent;
- Provide an estimate of the fiscal impact of all such tax preferences claimed or taken;
- Examine the public policies for which the tax preferences were established and whether the desired public policies have been achieved;
- Report on whether other states routinely provide a sunset date for their tax preferences; and
- Establish a proposed mechanism or processes for the ongoing evaluation of the effectiveness of such tax preferences in bringing about the desired public policies for which the tax preferences were established.

JLARC was required to complete its meetings for the first year by November 30, 2010 and for the second year by November 30, 2011. A Commission Draft of the report was published November 14, 2011 and the final report will be submitted to the General Assembly during the 2012 session.

In its report, JLARC provided an overview of Virginia's tax preferences and the overall fiscal impact of these preferences. JLARC then divided existing preferences into various categories and determined the utilization of preferences within each category. The report identified several factors that hinder the effectiveness of certain tax preferences, including the limited use of sunset dates in tax preference bills and the lack of a formal process for evaluating the effectiveness of tax preferences.

The report concluded with the suggestion that the General Assembly establish a joint subcommittee to oversee an ongoing evaluation process. This subcommittee would direct the Department of Taxation to conduct routine evaluations and would assemble a technical advisory group to provide guidance and review findings. JLARC mentioned in its report that, if such a subcommittee were established, the Department would require additional staff, but the number of additional positions required would depend upon the scope of evaluations established by the joint subcommittee.

Sales and Use Tax Expenditure Study

The 1989 General Assembly passed legislation that required the Department to study all sales and use tax exemptions on a continuous five-year cycle, studying two categories of exemptions each year. The Department was required to publish the Sales and Use Tax Expenditure Study and present it to the Chairmen of the House Finance and Senate Finance

Committees in December of each year. The goal of the Sales and Use Tax Expenditure Study was to provide a more complete picture of the revenue impact and policy issues surrounding each of the exemptions contained in the Retail Sales and Use Tax Act. The study included detailed information on the policy, fiscal, and economic impact of the exemptions as well as the apparent rationale for the exemptions and their legislative history. It was believed that the periodic review of sales and use tax exemptions was necessary in order to strengthen oversight and control over the process by which sales tax exemptions are granted. In order to complete the study, the Department needed to employ additional economists and analysts. The Department published its last study in December 1995. The 1996 General Assembly repealed the requirement that the Department conduct the study.

In 2005, the General Assembly reinstated a similar but limited study that requires the Department to determine the fiscal, economic, and policy impact of each miscellaneous and nonprofit sales and use tax exemption. Specifically, the Department must include the following in its report:

- An estimate of the foregone state and local revenues as a result of each exemption;
- Beneficiaries of each exemption;
- Direct or indirect local, state, or federal government assistance received by the persons or entities granted each exemption, to the extent such information is reasonably available;
- The extent to which a comparable person, entity, property, service, or industry is exempt from the retail sales and use tax in other states, particularly states contiguous to Virginia;
- Any external statutory, constitutional, or judicial mandates supporting an exemption;
- Other Virginia taxes to which the person, entity, property, service, or industry is subject;
- Similar taxpayers who are not entitled to a retail sales and use tax exemption; and
- Other criteria, facts, or circumstances that may be relevant to each exemption.

The Department must present its report to the chairmen of the House and Senate Finance Committees no later than December 1 of each year. Subgroups of the exemptions are reviewed in periodic cycles and reports are issued on a rotating basis. When such reports have been completed for each subgroup of the sales and use tax exemptions, the Tax Commissioner must repeat the process beginning with the subgroup of exemptions for which a report was made in 2007. No individual exemption is analyzed more frequently than once every five years.

<u>Corporate Tax Preferences Report</u>

In 2005, the General Assembly directed the Department to issue an annual report detailing the amount of income tax relief granted to corporations in the Commonwealth. This report must include the total dollar amount of income tax subtractions, deductions, exclusions, exemptions and credits claimed cumulatively by corporations. Beginning in 2010, this report also includes summary information regarding the types of taxpayers that claim corporate income tax relief, as well as information regarding the number of companies that have qualified for the major business facility job tax credit and the amount of such credits.

The Tax Commissioner is required to issue the corporate tax preferences report annually to the members of the House Appropriations Committee, the House Finance Committee, and the Senate Finance Committee. This report does not reflect all of the exemptions and exclusions available to corporations because not all of them are reported on the Virginia income tax return.

Fiscal Year Tax Credit Report

Beginning in 2011, the Department publishes an annual fiscal year tax credit report as part of its annual report. This report shows the number of individual and corporate taxpayers that claim each tax credit and the dollar amount of tax credits that are claimed each fiscal year.

Proposal

This bill would establish the Commission to Review the Effectiveness of Virginia's Tax Preferences in the legislative branch of government, which would oversee the evaluation of Virginia's tax preferences. The Commission would consist of five members of the House of Delegates and three members of the Senate. The Commission would be responsible for the following:

- Undertaking a thorough review of Virginia's tax preferences and their cost in lost revenue;
- Examining whether specific tax preferences are meeting their intended purpose;
- Creating a ranking system that prioritizes the relative importance and effectiveness of each tax preference within the universe of all studies tax preferences; and
- Recommending each year tax preferences that are either ineffective, outdated, no longer needed, or whose cost outweighs the benefit for repeal to the next regular Session of the General Assembly.

This bill does not specify the extent of the review that would be undertaken annually. Rather, the Commission would have the authority to develop procedures regarding which tax preferences shall be reviewed, how often they shall be reviewed, and what performance measures should be used in the evaluation of tax preferences.

The Commission would be permitted to direct that the Department of Taxation, under the Commission's guidance and instruction, conduct independent evaluations of tax preferences and report its findings to the Commission. The Commission would be authorized to establish a technical advisory group to assist the Commission and the Department of Taxation. Such technical advisory group would consist of individuals with tax policy and economic expertise, legislative staff, and commissioners of the revenue.

The chairman of the Commission would be required to submit an annual executive summary of the interim activity and work of the Commission by the first day of each regular General Assembly session to the General Assembly and to the Governor.

If, during its first year of existence, the Commission is not funded by a separate appropriation in the Appropriations Act, the Commission would be funded from the operating budgets of the Clerk of the House of Delegates and the Clerk of the Senate upon approval from the Joint Rules Committee. If the Commission is not funded by a separate appropriation in the Appropriations Act for any year after the first year, the Commission would expire on July 1 of that fiscal year. The Commission would expire on July 1, 2016.

The effective date of this bill is not specified.

Similar Legislation

House Bill 777 would establish the Joint Subcommittee to Evaluate Tax Preferences and would require the Department to assist the proposed Joint Subcommittee in evaluating Virginia's tax preferences.

House Bill 246 would require the Tax Commissioner to undertake an annual study of tax credits that are scheduled to expire within the following two calendar years.

House Joint Resolution 52 would establish a joint subcommittee to study reforming Virginia's tax structure and would require the Department to provide technical assistance.

House Bill 1032 would prohibit any committee of the General Assembly from reporting any bill that proposes to establish, increase, or expand a state or local tax exemption, credit, deduction or any other reduction in tax liability, unless the bill contains an expiration date of not longer than five years from the effective date of the bill.

cc : Secretary of Finance

Date: 1/26/2012 KLC
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