DEPARTMENT OF TAXATION
2012 Fiscal Impact Statement

1. Patron Mark L. Cole

2. Bill Number HB 24

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

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

3. Committee House Finance

4. Title Business, Professional, and Occupational License Tax; Limits on Imposition and Rates

5. Summary/Purpose:

This bill would provide that any locality that did not impose the Business, Professional and Occupational License ("BPOL") tax in license year 2011 may only impose the BPOL tax on the Virginia taxable income of a business, rather than on gross receipts. However, this limitation would not apply to the BPOL tax on i) telephone and telegraph companies, ii) water companies, and ii) certain heat, light and power companies.

Under current law, localities may impose the BPOL tax on either the gross receipts or the Virginia taxable income of a business, except for certain public service corporations. The BPOL tax on i) telephone and telegraph companies, ii) water companies, and ii) certain heat, light and power companies is required to be imposed on the gross receipts.

Legislation enacted in the 2011 Session of the General Assembly, House Bill 1500 (*Acts of Assembly* 2011, Chapter 890), directed the Joint Legislative Audit and Review Commission ("JLARC") to study the impact on local revenue streams of restructuring the BPOL Tax such that the basis of the tax is changed from gross receipts to net income and submit its final report by November 1, 2013.

The effective date of this bill is not specified.

6. Budget amendment necessary: No.

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

8. Fiscal implications:

This bill would have no impact on state revenues. To the extent that the gross receipts of the businesses in a locality differ from the Virginia taxable income of the businesses in the locality, the bill would have an unknown revenue impact on any locality that did not impose the BPOL tax in license year 2011 and thereafter enacts a BPOL tax based on Virginia taxable income. In Fiscal Year 2010, the BPOL tax generated more than $632.2 million for the counties, cities, and towns that imposed the tax. The BPOL tax is imposed in all 39 cities, 46 of the 95 counties, and many of the towns of the Commonwealth.

9. Specific agency or political subdivisions affected:

Localities that did not impose the BPOL tax in license year 2011.

10. Technical amendment necessary: No.

11. Other comments:

<u>BPOL Tax</u>

The Business, Professional and Occupational License (BPOL) tax is a tax on businesses for the privilege of engaging in business at a definite place of business within a Virginia locality. The measure or basis of the BPOL tax generally is the gross receipts of the business. The BPOL tax is a tax on gross receipts, not net income. Under current BPOL law, any locality may charge a license fee in an amount not to exceed:

- $50 for any locality with a population of 25,000 and greater
- $30 for any locality with a population smaller than 25,000

The locality may not assess a license tax on gross receipts upon which it charges a license fee. Additionally, the locality may not impose a license tax on a business with gross receipts:

- less than $100,000 in any locality with a population greater than 50,000
- less than $50,000 in any locality with a population of 25,000 but no more than 50,000.

Any business with gross receipts in excess of these thresholds may be subject to license tax at a rate not to exceed the rates set forth below:

- Contracting - sixteen cents per $100 of gross receipts
- Retail sales - twenty cents per $100 of gross receipts
- Financial, real estate and professional services - fifty eight cents per $100 of gross receipts
- Repair, personal and business services, and all other businesses - thirty six cents per $100 of gross receipts.

Localities that imposed a higher rate structure on January 1, 1978 are allowed to continue to impose the tax at those rates.

<u>Situs Rules</u>

Where a business has a definite place of business or office in more than one locality, for the purposes of the BPOL tax the situs of the gross receipts is generally determined as follows:

- Contracting - The definite place of business where the services are performed. If the services are not performed at any definite place of business, then the gross receipts are attributed to the definite place of business where the services are directed or controlled. However, if the amount of business that a contractor has done in a locality exceeds $25,000 in any year, the locality may impose the BPOL tax on such amount of business even if the contractor does not have a definite place of business in the locality. That portion of the contractor's gross receipts would not be subject to the BPOL tax in any other locality.

- Retail sales - The definite place of business where the sales solicitations occurred. If the sales solicitations do not occur at any definite place of business, then the gross receipts are attributed to the definite place of business where the sales solicitations are directed or controlled.

- Rentals of tangible personal property – The definite place of business where the tangible personal property is rented. If the property is not rented from any definite place of business, then the gross receipts are attributed to the definite place of business where the rental is managed.

- Performance of services - The definite place of business where the services are performed. If the services are not performed at any definite place of business, then the gross receipts are attributed to the definite place of business where the services are directed or controlled.

If it is impractical or impossible to determine which definite place of business the gross receipts of a business should be attributed to under the general rules, then the gross receipts are apportioned between the definite places of business on the basis of payroll. In order for gross receipts to be apportioned to a definite place of business, activities applicable under the general rule must have occurred at or have been controlled from such definite place of business.

<u>Virginia Taxable Income</u>

An individual's Virginia taxable income is his federal adjusted gross income for the taxable year with numerous modifications unrelated to the operation of a business, including, but not limited to, i) the addition of interest or dividends on obligations of any state other than Virginia, ii) the subtraction of Social Security benefits, iii) a deduction for blind or aged taxpayers, iv) a deduction for contributing to a Virginia College Savings Plan, etc.

A corporation's Virginia taxable income is its federal taxable income for the taxable year with numerous modifications some of which are unrelated to a business, including, but not limited to, i) the addition of interest or dividends on obligations of any state other than Virginia, ii) the subtraction of dividends upon stock in any domestic international corporation, iii) the subtraction of the amount contributed in funds to the Virginia Public School Construction Grants Program and Fund, etc.

<u>Basis of the BPOL Tax</u>

The measure or basis of the BPOL tax is generally the gross receipts of the business. As the BPOL tax is a tax on gross receipts, not net income, the BPOL tax has been the subject of criticism for many years. Opponents of the tax point out that the gross receipts of a business have little or no relation to the profitability of the business, and that different types of businesses have different levels of profitability compared to their gross receipts.

While Virginia taxable income may resemble net income for certain businesses, the additions, subtractions, and deductions used to determine an individual's or corporation's Virginia taxable income may not be appropriate in the determination of a business' profitability or as a measure of its activities in a locality. Virginia taxable income, for both individuals and corporations, includes income from all sources, not just from business activities, and not just from the operations of the business in a particular locality. Additionally, Virginia allows deductions from taxable income for personal items that a sole proprietor may legitimately take on his individual income tax return that have no bearing on his business activities. For example, deductions for prepaid tuition contracts, and long term care insurance. If the intent of this bill is to allow localities to use the net income of a business in a particular locality as the basis for the BPOL tax instead of gross receipts, one suggestion would be to allow a deduction from the gross receipts of a business for any item deductible under federal law as an ordinary and necessary business expense, but not to use Virginia taxable income.

JLARC Study

The Joint Legislative Audit and Review Commission ("JLARC") has been directed to do a study of the BPOL tax and specifically they have been directed to study the impact of restructuring the local BPOL tax such that the basis of the tax is changed from gross receipts to net income.

Proposal

This bill would provide that any locality that did not impose the Business, Professional and Occupational License ("BPOL") tax in license year 2011 may only impose the BPOL tax on the Virginia taxable income of a business, rather than on gross receipts. However, this limitation would not apply to the BPOL tax on i) telephone and telegraph companies, ii) water companies, and ii) heat, light and power companies (except electric suppliers, gas utilities and gas suppliers, and pipeline distribution companies).

The effective date of this bill is not specified.

Similar Legislation

House Bill 10 would provide that localities may not impose the BPOL tax or fee at a rate higher than the rate imposed by the locality for license year 2011.

cc : Secretary of Finance
Date: 1/17/2012 AM
DLAS File Name: HB24F161