# DEPARTMENT OF TAXATION
# 2012 Fiscal Impact Statement

**1. Patron** Kathy J. Byron

**2. Bill Number** HB 460

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

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

**3. Committee** Passed House and Senate

**4. Title** Corporate Income: Single Sales Factor Apportionment; Eliminates Additional Taxes, Penalties, and Interest

**5. Summary/Purpose:**

This bill would amend the performance requirements for manufacturers electing to use the single sales factor apportionment method to require that a manufacturer maintain an employment level that is not less than 90 percent of the base year level of employment in the Commonwealth for the first three taxable years after making the election. This bill would also eliminate the penalty provision for failing to meet this requirement.

Under this bill, a manufacturer would still be assessed additional taxes and interest for failing to meet the employment requirement.

The effective date for these changes would be July 1, 2012.

**6. Budget amendment necessary:** No.

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

**8. Fiscal implications:**

Administrative Impact

The Department considers implementation of this bill as routine, and does not require additional funding.

Revenue Impact

This bill would have no revenue impact on General Fund revenue. Because the phase-in began for taxable years beginning on and after July 1, 2011, the employment, recapture, penalty and interest provisions have not been applied to produce any revenue impact.

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

Department of Taxation

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

**11. Other comments:**

Background

In Virginia, multistate corporations are generally required to use a three-factor formula of property, payroll and double-weighted sales. The sum of the property factor, payroll factor and twice the sales factor is divided by four to arrive at the final apportionment factor. This amount is then multiplied by Virginia taxable income.

Prior to 1999, the property, payroll, and sales factors were weighted equally. In 1999, the formula was changed so that the sales factor was double counted. According to the Federation of Tax Administrators, as of January 1, 2011, at least fourteen other states also have a sales factor of 50%. Twelve states still utilize the standard three factor formula, and three states have a sales factor between 50% and 100%. An additional seventeen states either currently have, or will have within the next five years, a sales factor of 100% for either all taxpayers or for specified industries. These states are Connecticut, Colorado, Georgia, Illinois, Indiana, Iowa, Louisiana, Maine, Maryland, Michigan, Minnesota, Nebraska, New York, Oregon, South Carolina, Texas, and Wisconsin.

2009 Legislation

*Apportionment:*

In 2009 legislation was enacted (2009 Acts of Assembly, Chapter 821, House Bill 2437) that modified the corporate apportionment formula by allowing manufacturing companies the option to use a single sales factor to determine their Virginia taxable income. This modification will be phased in as follows: for taxable years beginning on or after July 1, 2010, but before July 1, 2012, qualifying corporations may elect to use a triple-weighted sales factor; for taxable years beginning on or after July 1, 2012, but before July 1, 2013, qualifying corporations may elect to use a quadruple-weighted sales factor; and for taxable years beginning on or after July 1, 2013, and thereafter, qualifying corporations may elect to use the single sales factor method to apportion Virginia taxable income. A manufacturer that elects to use these methods may not change for three taxable years.

Under this law a “manufacturing company” is defined as a domestic or foreign corporation which is primarily engaged in activities that, in accordance with the North American Industrial Classification System (NAICS), United States Manual, United States Office of Management and Budget, 1997 Edition, would be included in Sector 11, 31, 32, or 33. This would include the sectors of agriculture, forestry, fishing, and hunting and manufacturing.

*Performance Requirements:*

A taxpayer making the single sales factor election is required to certify to the Department that the average weekly wage of its full-time employees is greater than the lower of the state or local average weekly wage for the taxpayer’s industry.

In addition, corporations are required to maintain a base year level of employment in the Commonwealth for the first three taxable years after electing to use a single factor apportionment based on sales. If a corporation does not satisfy this criterion, the Department is directed to assess the corporation the difference between taxes calculated under the standard apportionment in which sales are double-weighted and sales-only apportionment. In addition, a ten percent penalty will be assessed; and interest will accrue.

*Non-Severability Clause*

The 2009 legislation also contained a non-severability clause to ensure that the credit could not be claimed by any manufacturer that violated any of the conditions. The Major Business Facility Jobs Tax Credits contains a similar clause. The U.S. Supreme Court has ruled multiple times that providing a tax benefit that discriminates against out-of-state businesses violates the Commerce Clause of the U.S. Constitution. If this provision was not added and a manufacturer was denied the election of this more favorable apportionment formula because it shifted employees from Virginia to other states, the constitutionality of the in-state limitation could be placed in issue.

<u>Proposed Legislation</u>

This bill would amend the performance requirements for manufacturers electing to use the single sales factor apportionment method to require that a manufacturer maintain an employment level that is not less than 90 percent of the base year level of employment in the Commonwealth for the first three taxable years after making the election. This bill would also eliminate the penalty provision for failing to meet this requirement.

Under this bill, a manufacturer would still be assessed additional taxes and interest for failing to meet the employment requirement.

The effective date for these changes would be July 1, 2012.

<u>Other Bills</u>

**House Bill 154** and **Senate Bill 49** would modify the corporate apportionment formula by requiring retail companies to use a similar single factor apportionment method based on sales to determine their Virginia taxable income.

cc : Secretary of Finance

Date: 3/7/2012 tlg
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