DEPARTMENT OF TAXATION
2015 Fiscal Impact Statement

1. Patron Kenneth C. Alexander

2. Bill Number SB 1364

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

3. Committee House Finance

4. Title Modified Method of Apportionment for Manufacturing Companies; Defense Employers

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

5. Summary/Purpose:

This bill would allow defense employers to elect to apportion Virginia taxable income using the modified method of apportionment for manufacturing companies without meeting the base year employment and weekly wage requirements.

This bill would require the Department to submit a report to the General Assembly regarding the modified method of apportionment for manufacturing companies.

This bill would not become effective unless reenacted by the General Assembly during the 2016 Session. If it is reenacted, this bill would be effective for taxable years beginning on or after January 1, 2016, but before January 1, 2021.

6. Budget amendment necessary: No.

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

8. Fiscal implications:

Administrative Costs

The Department of Taxation ("the Department") considers implementation of this bill as routine, and does not require additional funding.

Revenue Impact

This bill would have an unknown negative General Fund revenue impact beginning in Fiscal Year 2017. A taxpayer that elects to use the modified method of apportionment for manufacturing companies is required to meet certain base year employment and weekly wage requirements for the first three years after electing to use such method. A taxpayer that fails to meet such requirements is required to pay additional taxes and any interest due on such taxes. It is uncertain how many defense employers would be required to pay additional taxes and interest for failing to meet the wage and employment requirements in the absence of this bill.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Current Law

Statutory Method of Apportionment

Virginia generally requires the Virginia taxable income of a multistate corporation to be apportioned to Virginia by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor, plus twice the sales factor, and the denominator of which is four.

The property factor is a fraction that consists of the average value of the corporation's real and tangible personal property owned or rented and used in Virginia over the like property located everywhere. The payroll factor is a fraction, the numerator being the total amount of compensation paid or accrued within Virginia during the taxable year by a taxpayer, and the denominator being the total compensation paid or accrued everywhere during the taxable year. The sales factor is a fraction, the numerator of which is the total sales of the corporation in Virginia during the taxable year, and the denominator of which is the total sales of the corporation everywhere during the taxable year. Sales, other than sales of tangible personal property, are deemed in Virginia if:

- The income-producing activity is performed in Virginia; or

- The income-producing activity is performed both in and outside of Virginia and a greater proportion of the income producing activity is performed in Virginia than in any other state, based on costs of performance.

An "income producing activity" is an act or acts directly engaged in by the taxpayer for the ultimate purpose of producing a sale subject to apportionment. "Cost of performance" is defined as the cost of all activities directly performed by the taxpayer for the ultimate purpose of producing the sale to be apportioned.

Modified Method of Apportionment for Manufacturing Companies

During the 2009 Session, the General Assembly enacted legislation that allows manufacturing companies to elect whether to apportion Virginia taxable income using the statutory method of apportionment or using a single sales factor method of apportionment. This modification was phased in as follows:

- For taxable years beginning on or after July 1, 2011, but before July 1, 2013, qualifying corporations may elect to use a triple-weighted sales factor;

- For taxable years beginning on or after July 1, 2013, but before July 1, 2014, qualifying corporations may elect to use a quadruple-weighted sales factor; and

- For taxable years beginning on or after July 1, 2014, and thereafter, qualifying corporations may elect to use the single sales factor method to apportion Virginia taxable income.

A manufacturing company that elects to use the modified method of apportionment is required to pay additional taxes if such company's average annual number of full-time employees for the first three taxable years that it used the modified method of apportionment is less than 90 percent of its base year employment, or if the average wages of the manufacturing company's full-time employees, as certified by such company, is not greater than the lower of the state or local average weekly wage for its industry. “Base year employment” is defined as the average number of full-time employees employed by the manufacturing company in Virginia in the taxable year that ended immediately prior to the first taxable year in which it used the modified method of apportionment for manufacturing companies.

The amount of additional taxes due is equal to the difference between the tax that would have been due under the statutory method of apportionment and the amount of tax that was due using the modified method of apportionment for each of the first three years after electing to use such method. A taxpayer that is required to pay additional taxes is also required to pay any interest due, which will begin accruing from the original due date of the Virginia income tax return on which the election to use the modified method of apportionment was made, on such amount.

<u>Proposed Legislation</u>

This bill would allow defense employers to elect to apportion Virginia taxable income using the modified method of apportionment for manufacturing companies without meeting the base year employment and weekly wage requirements.

A “defense employer” would be defined as a manufacturing company that has contracts subject to the federal defense acquisition regulations.

This bill would require the Department to submit a report to the General Assembly regarding the modified method of apportionment for manufacturing companies no later than January 1, 2016. Such report would be required to include:

- The amount of taxes assessed because of manufacturers not maintaining the required levels of employment;

- An estimate of the fiscal impact of this bill had it been in effect for taxable years beginning on or after January 1, 2015; and

- If applicable, an analysis of and findings regarding the causes for any decline in employment for defense employers.

Because Virginia corporate income tax returns for Taxable Year 2015 are not due until April 15, 2016 at the earliest, and many corporations file on extension, the Department will not receive complete Taxable Year 2015 tax return data until well after the January 1, 2016 due date for the report proposed by this bill. Such data may be further modified after the respective Virginia income tax return due dates by amended returns filed by taxpayers or by taxpayer audits completed by the Department. Therefore, it would be difficult for the Department to accurately report the information that would be required by this bill regarding the modified method of apportionment by the January 1, 2016 due date.

This bill would not become effective unless reenacted by the General Assembly during the 2016 Session. If it is reenacted, this bill would be effective for taxable years beginning on or after January 1, 2016, but before January 1, 2021.

Similar Bills

House Bill 2162 and **Senate Bill 1142** would require certain taxpayers with enterprise data center operations to apportion Virginia taxable income using single factor apportionment based on sales.

cc : Secretary of Finance

Date: 2/10/2015 MTH
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