DEPARTMENT OF TAXATION
2017 Fiscal Impact Statement

1. **Patron** Glenn R. Davis

2. **Bill Number** HB 1499
   House of Origin:
   X Introduced
   ___ Substitute
   ___ Engrossed

3. **Committee** House Finance

4. **Title** Income Tax; Modifies Virginia's Method for Apportioning Corporate Income

   Second House:
   ___ In Committee
   ___ Substitute
   ___ Enrolled

5. **Summary/Purpose:**

This bill would make several changes to Virginia's law regarding the apportionment of corporate income. Specifically, this bill would change Virginia's primary method of apportionment from the three-factor method of apportionment with a double-weighted sales factor to a single sales factor method of apportionment. This bill would also change Virginia's method for sourcing sales, other than sales of tangible personal property, from the cost of performance method to market-based sourcing, as well as provide certain communications service providers and national defense contractors with a modified method for sourcing such sales.

This bill would eliminate the requirement that a manufacturing company must meet certain employment and wage requirements in order to utilize the modified method of apportionment for manufacturing companies.

In the event that this bill would result in net additional revenues, the General Assembly would be required to provide tax relief in an amount at least equal to the net additional revenues certified by the Tax Commissioner.

The provisions of this bill related to the modified method of apportionment for manufacturing companies would be effective for taxable years beginning on or after July 1, 2017. All other provisions of this bill would become effective for taxable years beginning on or after January 1, 2018, only if the Department determines that the provisions of this bill are not estimated to reduce Virginia's official forecasted General Fund revenues by more than $50 million for any fiscal year.

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

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

8. **Fiscal implications:**

<u>Administrative Costs</u>

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

Revenue Impact

This bill would have an unknown but potentially significant negative General Fund revenue impact beginning in Fiscal Year 2018. The Department does not have sufficient information regarding the corporations that would be impacted by this bill to accurately estimate the extent of such negative impact. During 2015, the Department conducted a study regarding market-based sourcing, but was unable to provide a definitive revenue estimate due to a lack of relevant data. It is also uncertain whether the majority of this bill's provisions would become effective since they are contingent on the negative General Fund revenue impact of this bill not exceeding $50 million.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Virginia's Methods of Apportionment

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.

Modified Method of Apportionment for Manufacturing Companies

During the 2009 Session, the General Assembly enacted legislation (House Bill 2437 (2009 *Acts of Assembly*, Chapter 821)) 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 could 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 could 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 will be subject to additional taxes if such manufacturing 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 the manufacturing 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 the manufacturing company used the modified method of apportionment for manufacturing companies.

Modified Method of Apportionment for Retail Companies

During the 2012 Session, the General Assembly enacted legislation (House Bill 154 and Senate Bill 49 (2012 *Acts of Assembly*, Chapters 86 and 666)) that requires certain retail companies to apportion Virginia taxable income using a single sales factor method of apportionment. This modification was phased in as follows:

- For taxable years beginning on or after July 1, 2012, but before July 1, 2014, such corporations were required to use a triple-weighted sales factor;
- For taxable years beginning on or after July 1, 2014, but before July 1, 2015, such corporations were required to use a quadruple-weighted sales factor; and

For taxable years beginning on or after July 1, 2015, and thereafter, such corporations are required to use the single sales factor method to apportion Virginia taxable income.

Modified Method of Apportionment for Certain Enterprise Data Center Operations

During the 2015 Session, the General Assembly enacted legislation (House Bill 2162 and Senate Bill 1142 (2015 *Acts of Assembly*, Chapters 237 and 92)) that requires a taxpayer with an enterprise data center operation to apportion Virginia taxable income using single factor apportionment based on sales if such taxpayer enters into a memorandum of understanding with the Virginia Economic Development Partnership on or after July 1, 2015, to make a new capital investment of at least $150 million in an enterprise data center in Virginia on or after July 1, 2015. The modified method of apportionment applies beginning with the taxable year for which the Virginia Economic Development Partnership provides a written certification to such taxpayer that the new capital investment has been completed. The modification is being phased in as follows:

- From July 1, 2016 until July 1, 2017, qualifying corporations are required to use a quadruple-weighted sales factor; and
- From July 1, 2017, and thereafter, qualifying corporations are required to use the single sales factor method to apportion Virginia taxable income.

Alternative Method of Apportionment

If any corporation believes that the statutorily prescribed method of apportionment has operated or will operate as to subject it to taxation on a greater portion of its Virginia taxable income than is reasonably attributable to business or sources within Virginia, then it may submit a statement of objections to the Department and detail an alternative method of apportionment that it believes to be proper under the circumstances. If the Department concludes that the statutorily prescribed method of apportionment is inapplicable or inequitable, then it shall redetermine the corporation's taxable income by another method that best assigns to Virginia the portion of the income reasonably attributable to business and sources within Virginia. The amount assigned through an alternative method of apportionment may never exceed the amount that would have been assigned using the statutorily prescribed method.

The Department will not grant permission to use an alternative method of apportionment unless it determines that (a) the statutorily prescribed method of apportionment is inapplicable because it produces an unconstitutional result under the taxpayer's particular facts and circumstances; or (b) the statutorily prescribed method of apportionment is inequitable because (i) it results in double taxation of the income, or a class of income, of the taxpayer; and (ii) the inequity is attributable to Virginia, rather than to the fact that some other state has a unique method of allocation and apportionment.

Primary Methods of Apportionment in Other States

Twelve out of the 45 jurisdictions that impose a corporate income tax or a gross receipts tax on businesses generally use a method of apportionment that is similar to Virginia's double-weighted sales factor formula. Seven jurisdictions generally utilize a method of apportionment that is similar to Virginia's, but do not double weight the sales factor. Tennessee generally employes a statutory method of apportionment that is similar to Virginia's, but triple weights the sales factor.

Three-Factor Methods of Apportionment (as of January 2017)		
Three-Factor, Evenly Weighted Factors	**Three-Factor, Double-Weighted Sales**	**Three-Factor, Triple-Weighted Sales**
Alaska	Alabama	Tennessee
Hawaii	Arkansas	
Kansas	Arizona	
Missouri	Florida	
Montana	Idaho	
North Dakota	Kentucky	
Oklahoma	Massachusetts	
	Maryland	
	New Hampshire	
	Virginia	
	Vermont	
	West Virginia	

Twenty-four jurisdictions primarily use the single sales factor method of apportionment, are currently phasing-in the use of such method, or will use the method for Taxable Year 2018 and thereafter. Mississippi uses a variety of industry specific methods of apportionment, but requires the use of the single sales factor method of apportionment if no specific formula is specified. In addition, Texas uses the single sales factor method of apportionment for its gross receipts tax. Therefore, 26 jurisdictions are considered to be single sales factor method of apportionment jurisdictions. Connecticut, Delaware, and North Carolina are the most recent states to enact the single sales factor method of apportionment

Single Sales Factor Jurisdictions (as of January 2017)	
California	Minnesota
Colorado	Nebraska
Connecticut	New Jersey
Delaware	New Mexico
District of Columbia	New York
Georgia	North Carolina
Illinois	Oregon
Indiana	Pennsylvania
Iowa	Rhode Island
Louisiana	South Carolina
Maine	Texas
Michigan	Utah
Mississippi	Wisconsin

Determining the Sales Factor for Purposes of Apportionment

Virginia's Cost of Performance Method

For Virginia apportionment purposes, sales of tangible personal property are deemed in Virginia if the tangible personal property is delivered to a location in Virginia. In contrast, 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 ("the cost of performance method").

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.

When it is applied, Virginia's cost of performance method acts as an "all-or-nothing" sourcing rule because it sources a particular sale completely to one jurisdiction to the exclusion of all other jurisdictions. Under Virginia's cost of performance method, a sale may not be sourced to more than one jurisdiction.

Cost of Performance Method in Other Jurisdictions

Twenty-four out of the 45 jurisdictions that impose a corporate income tax or a gross receipts tax on businesses use the cost of performance method. Two of these jurisdictions (Arizona and Missouri) generally require taxpayers to use the cost of performance method, but allow certain taxpayers the option of using market-based sourcing. In addition, Texas applies the cost of performance method to its gross receipts tax. Therefore, 25 jurisdictions are considered to be cost of performance method jurisdictions.

Cost of Performance Jurisdictions (as of January 2017)	
Alaska	Montana
Arizona	New Hampshire
Arkansas	New Jersey
Colorado	New Mexico
Delaware	North Carolina
Florida	North Dakota
Hawaii	Oregon
Idaho	South Carolina
Indiana	Texas
Kansas	Vermont
Kentucky	Virginia
Mississippi	West Virginia
Missouri	

Market-Based Sourcing

Until recently, the majority of jurisdictions utilized the cost of performance method to source sales of intangible property and services. However, the trend in state corporate income taxation over the past ten years has been for jurisdictions to adopt market-based sourcing. The term "market-based sourcing" encompasses several variations of an apportionment method that sources a sale to the jurisdiction in which the corporation's market for such sale is located. When providing guidance regarding how a corporation is to determine its market for sales, other than sales of tangible personal property, market-based sourcing jurisdictions have distinguished between sales of intangible property and services. All market-based sourcing jurisdictions generally source sales of intangible property to the jurisdiction where such property is used. Market-based sourcing jurisdictions have developed four general methods for sourcing sales of services:

- Where the benefit of the service is received by the customer;
- Where the service is delivered;
- Where the service is received;
- Where the customer is located; or
- Where the service is used.

Of the 45 jurisdictions that impose a corporate income tax, 22 states and the District of Columbia have adopted market-based sourcing. The application of market-based sourcing is mandatory in 21 of these jurisdictions. Only Arizona and Missouri allow certain corporations to elect whether to apply either the cost of performance method or market-based sourcing. In addition, Ohio and Washington apply mandatory versions of market-based sourcing to their respective taxes on gross receipts that are imposed in lieu of a corporate income tax. Therefore, 25 jurisdictions are considered to be market-based sourcing jurisdictions.

Market-Based Sourcing Jurisdictions (as of January 2017)	
Alabama	Minnesota
Arizona	Missouri
California	Nebraska
Connecticut	New York
District of Columbia	Ohio
Georgia	Oklahoma
Illinois	Pennsylvania
Iowa	Rhode Island
Louisiana	Tennessee
Maine	Utah
Maryland	Washington
Massachusetts	Wisconsin
Michigan	

California's Application of Market-Based Sourcing to Cable Providers

California requires that members of certain combined groups that operate cable systems source sales, other than sales of tangible property, using market-based sourcing, except that the total amount of sales of network services that are sourced to California using such method is required be multiplied by 0.5, and the result assigned to California. For its members to be subject to such requirement, a combined group must:

- Have expenditures attributable to California for tangible property, payroll, services, franchise fees, or any intangible property distribution or other rights of not less than $250 million during the calendar year; and
- For the combined reporting group's taxable year beginning in Calendar Year 2006, the combined reporting group derived more than 50 percent of its United States network gross business receipts from the operation of one or more cable systems.

Tennessee's Application of Market-Based Sourcing to Telecommunications Providers

Tennessee requires that certain telecommunications providers determine the amount of sales, other than sales of tangible personal property to source to Tennessee by averaging the amount that would be sourced to Tennessee using market-based sourcing with the amount that would be sourced to Tennessee using the cost of performance method. A telecommunications provider is subject to this requirement if it is:

- Principally engaged in the sale of telecommunications, mobile telecommunications services, Internet access services, video programming services, direct-to-home satellite television programming services, or a combination of such services.
- A member of an affiliated group that:
    - o Incurs, in the aggregate, expenditures on tangible personal property placed in service in Tennessee by a member of the qualified group that exceed $150 million during the tax period; or
    - o Makes sales in excess of $150 million.

North Carolina's Study on Market-Based Sourcing

On September 18, 2015, in lieu of adopting market-based sourcing, North Carolina enacted a budget measure that required the North Carolina General Assembly's Revenue Laws Study Committee to complete a study regarding market-based sourcing. To help estimate the revenue impact of enacting market-based sourcing for purposes of such study, North Carolina required each corporate taxpayer with apportionable income greater than $10 million and a North Carolina apportionment percentage of less than 100 percent to file an informational report with the North Carolina Department of Revenue on or before April 15, 2016. For purposes of North Carolina's informational reporting requirement, corporations were required to include:

- The corporation's actual 2014 North Carolina apportionment percentage;
- The corporation's 2014 North Carolina apportionment percentage determined using market-based sourcing;
- The corporation's primary industry code under the North American Industry Classification System; and
- Any other information prescribed by the North Carolina Secretary of Revenue.

The Revenue Laws Study Committee completed such study during 2016, but did not make a comprehensive report regarding the results of the study publicly available.

On July 14, 2016, North Carolina enacted a budget measure that sets forth proposed statutory language for market-based sourcing. The North Carolina General Assembly must take separate legislative action in order to adopt market-based sourcing. However, the measure did require the North Carolina Department of Revenue to publish proposed rules on market-based sourcing as if the proposed statutory language had been enacted. On October 3, 2016, the North Carolina Department of Revenue published proposed rules on market-based sourcing.

Other State Studies Requiring the Filing of Informational Returns

Vermont's Tax Commissioner recently expressed interest in utilizing a methodology similar to North Carolina's for purposes of studying the impact of enacting market-based sourcing. Similar reporting requirements have been imposed by Maryland and Rhode Island when studying the adoption of measures such as single sales factor apportionment and combined reporting.

Virginia's Study on Market-Based Sourcing

During the 2015 Session, the General Assembly considered House Bill 2233, which would have required the Department to form a working group to review and make recommendations concerning the desirability and feasibility of changing Virginia's method of sourcing a corporation's sales, other than sales of tangible personal property, to either market-based sourcing or to a bifurcated method that utilizes both the cost of performance method and market-based sourcing. Although, the General Assembly did not enact this legislation, the Chairman of the House Finance Committee requested that the Department form a working group of interested parties to:

- Study the desirability and feasibility of Virginia changing its method of sourcing a corporation's sales, other than sales of tangible personal property, from the cost of performance method to market-based sourcing;
- Study the desirability and feasibility of adopting a bifurcated approach to sourcing a corporation's sales that would allow certain corporations to elect to use market-based sourcing in lieu of the cost of performance method;
- Provide recommendations regarding the desirability and feasibility of implementing such changes; and
- Provide draft legislation based on the Department's recommendations for potential consideration by the General Assembly.

The results of such report were inconclusive, primarily because the Department does not currently have access to the data necessary to provide a concrete revenue estimate. To develop a definitive estimate regarding the impact of enacting market-based sourcing, it is critical for the Department to have data from corporations regarding the amount of sales that are sales of intangible property or services, and where such sales would be sourced under a particular version of market-based sourcing. Corporations do not currently report such information to the Department, and the Department does not have access to any other source of data that would let it ascertain such information.

Proposed Legislation

Modification of Virginia's Method of Apportionment

This bill would change Virginia's primary method of apportionment from the three-factor method of apportionment with a double-weighted sales factor to a single sales factor method of apportionment. This method of apportionment would be phased in as follows:

- For taxable years beginning on or after January 1, 2018, but prior to January 1, 2019, corporations would be required to apportion income using the existing three-factor method of apportionment with a triple-weighted sales factor;
- For taxable years beginning on or after January 1, 2019, but prior to January 1, 2020, corporations would be required to apportion income using the existing three-factor method of apportionment with a quadruple-weighted sales factor; and
- For taxable years beginning on or after January 1, 2020, corporations would be required to use single sales factor apportionment.

Corporations that are motor carriers, financial corporations, construction corporations, and railway companies would not be subject to such method of apportionment. Such corporations would be required to continue using the special methods of apportionment specified for such industries. Similarly, retail corporations and certain enterprise data center operations would not be subject to the phased in adoption of single sales factor apportionment provided in this bill. Instead, such corporations would continue to be required to use single sales factor apportionment.

Special Rules for Manufacturing Companies

Manufacturing companies would be permitted to elect whether to continue using the existing primary method of apportionment or single sales factor apportionment. A manufacturing company that elects to use the single sales factor method of apportionment would not be permitted to revoke such election.

This bill would eliminate the requirement that a manufacturing company that elects to use the modified method of apportionment for manufacturing companies be subject to additional taxes if such manufacturing 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 the manufacturing company, is not greater than the lower of the state or local average weekly wage for its industry.

Adoption of Market-Based Sourcing

This bill would change Virginia's method for sourcing sales, other than sales of tangible personal property, from the cost of performance method to market-based sourcing. A taxpayer's market for a sale would be deemed in Virginia:

- In the case of sales of intangible personal property, to the extent that the purchaser of the intangible personal property uses such property in Virginia;
- In the case of sales of services, to the extent that the purchaser of the service receives the benefit of the service in Virginia; and
- In the case of sales of marketable securities, if the customer is in Virginia.

If the information necessary to determine whether such a sale is in Virginia, the taxpayer would be permitted to estimate the dollar value or portion of such sale in Virginia, provided that the taxpayer can demonstrate to the satisfaction of the Tax Commissioner that:

- The estimate has been undertaken in good faith;
- The estimate is a reasonable approximation of the dollar value or portion of such sale in Virginia; and
- In using an estimate, the taxpayer did not have as a principal purpose the avoidance of any corporate income taxes due.

The Department would be permitted to implement procedures to approve such estimates. The Department would be required to adopt remedies and corrective procedures for cases in which the Department has determined that the sourcing rules for such sales have been abused by a taxpayer, which may include reliance on the location of income-producing activities and direct costs of performance under the law and regulations of Virginia as they existed for taxable years beginning prior to January 1, 2018.

If the sourcing of such sale cannot be determined or reasonably approximated, this bill would require the sale to be excluded from the denominator of the corporation's sales factor. If such sale is sourced to one or more states, but not Virginia, and the taxpayer is not taxable in any state to which the sale is sourced, this bill would require that such sale be excluded from the denominator of the corporation's sales factor. A taxpayer would be considered to be taxable in another state if:

- The taxpayer is subject to a net income tax, franchise tax measured by net income, franchise tax for the privilege of doing business, or a corporate stock tax in such state; or

- That state has jurisdiction to subject the taxpayer to a net income tax regardless of whether the state actually imposes such tax.

The corporate income tax on sales subject to these provisions would be imposed to the maximum extent permitted under the Virginia and U.S. Constitutions, and federal law. For the collection of such taxes on such sales, this bill would provide that it is the intent of the General Assembly that the Tax Commissioner and the Department assert the taxpayer's nexus with Virginia to the maximum extent permitted under the U.S. and Virginia Constitutions, and federal law.

Sales Factor for Certain Communications Service Providers

This bill would require certain communications service providers to source sales, other than sales of tangible property, using market-based sourcing, except that the total amount of sales sourced to Virginia using such method would be multiplied by 0.5, and the result would be included in the numerator of such qualified member's sales factor. This rule would apply to each qualified member of a qualified group or a single entity that is a qualified group.

For purposes of applying this rule, a "qualified member" would be defined as a person that is principally engaged in the sale of qualified communications services. A "qualified group" would be defined as an affiliated group or a single entity that meets both of the following criteria: (i) one or more members of the group or the single entity is a qualified member; and (ii) the members of the group or the single entity during the taxable year incurs, in the aggregate, qualified expenditures in excess of $100 million.

"Qualified communications services" would be defined as communications services or Internet access services. "Communications services" would mean services subject to Virginia's Communications Sales and Use Tax. "Internet access service" would mean a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to users. "Internet access service" would not include telecommunications services, except to the extent telecommunications services are purchased, used, or sold by a provider of Internet access to provide Internet access.

"Qualified expenditures" would mean expenditures related to the provision of qualified communications services for:

- Purchases of tangible personal property placed in service in Virginia during the taxable years by a member of the qualified group; and
- Salaries and wages paid during the taxable year for employees employed by a member of the qualified group in Virginia.

If the qualified group is an affiliated group, a qualified expenditure would not include any expenditure incurred by a member of the affiliated group in a transaction with a person who is a member of the same group or any expenditure incurred with a pass-through entity that is controlled by a member of the qualified group.

If a pass-through entity is a qualified member, then a corporation that owns a controlling interest, either alone or in conjunction with one or more corporations under common control, in such pass-through entity, directly or indirectly through one or more pass-through entities, would be deemed a qualified member and the qualified expenditures of such pass-through entity would be deemed the qualified expenditures of such corporation in proportion to its interest in the pass-through entity and not expenditures of the pass-through entity. "Pass-through entity" would mean any entity, including a limited partnership, a limited liability partnership, a general partnership, a limited liability company, a professional limited liability company, a business trust or a Subchapter S corporation, that is recognized as a separate entity for federal income tax purposes, in which the partners, members or shareholders report their share of the income, gains, losses, deductions and credits from the entity on their federal income tax returns.

If any provision set forth in this bill regarding the determination of the sales factor for certain communications services providers is for any reason held to be invalid or unconstitutional by the decision of a court of competent jurisdiction, then that provision would not be deemed severable, and all provisions set forth in this bill regarding the determination of the sales factor for certain communications service providers would expire beginning with the taxable year immediately following the date of such decision.

Sales Factor for Certain National Defense Contractors

This bill would require that sales, other than sales of tangible personal property, made by a national defense contractor be excluded from the numerator of the contractor's sales factor if:

- A greater proportion of the income-producing activity is performed outside Virginia, based on costs of performance;
- The laws of another state require that the sale be included in the numerator of the fraction used in apportioning the contractor's income to the state for income tax purposes; and
- The laws of such state require that such sale be included in such numerator only if the greater proportion of the income-producing activity is performed in that state, based on costs of performance.

This provision would only apply to sales that are attributable to a contract that is:

- For a sale, other than a sale of tangible personal property; and
- Subject to the requirements of the rules regarding federal defense contracts.

This provision would not apply to any corporation subject to the special methods of apportionment for motor carriers, financial corporations, construction corporations, and railway companies.

"National defense contractor" would be defined as a corporation that is principally engaged in the business of entering into contracts with a federal government entity to produce materials or goods or to perform services for national defense, which business would, in accordance with the North American Industrial Classification System (NAICS), United States Manual, United States Office of Management and Budget, 2012 Manual, be included in Sector 33 for certain manufacturing companies.

Tax Relief from Additional Revenues Attributable to this Bill

This bill would require that the Tax Commissioner, by September 1 of each year beginning in 2019, make a written certification to the Governor and the General Assembly reporting any net additional revenues, if any, attributable to this bill that are received in the state treasury for the immediately prior fiscal year. If the Tax Commissioner reports net additional revenues, then the General Assembly would be required to provide an amount of tax relief that is at least equal to the amount of net additional revenues certified by the Tax Commissioner during the next regular Session.

Guidelines Regarding the Provisions of this Bill

The Department would be required to develop and make publicly available guidelines implementing the provisions of this bill, including market-based sourcing. Any guidelines promulgated on or before December 31, 2021 would not be subject to the provisions of the Administrative Process Act. The Department would be required to cooperate with and seek the counsel of interested groups. The Department would not be permitted to promulgate any guidelines, preliminary or final, without first seeking such counsel and conducting a public hearing. The Department would be required to promulgate preliminary guidelines and make them publicly available by December 31, 2017.

The Department would be required to promulgate the final guidelines and make them publicly available by December 31, 2018. Subsequent to December 31, 2018, the Department would be required to update the guidelines by December 31, 2021, under the same procedures required for the preliminary and final guidelines. After December 31, 2021, the guidelines would be subject to the Administrative Process Act and accorded the weight of a regulation.

Revenue Estimate and Reporting Requirements for Corporations

For purposes of determining the impact this bill would have on General Fund revenue, this bill would require the Department to prepare a fiscal impact statement on the revenues and expenditures of Virginia from the implementation of all provisions of this bill. The Department would be required to provide such fiscal impact statement by December 31, 2017 to the Governor and the Chairmen of the House Committee on Appropriations, House Committee on Finance, and Senate Committee on Finance.

To facilitate the preparation of the fiscal impact statement, every corporation that had income from business activity that was taxable both within and without Virginia for Taxable Year 2015 and that had Virginia taxable income before apportionment equal to or in excess of $50 million on its return filed for Taxable Year 2015 would be required to submit information to the Department showing the computation of its Taxable Year 2015 sales factor using market-based sourcing. Such information would be required to be submitted to the Department using a form and containing the information prescribed by the Tax Commissioner. The information would be required to reconcile with the information reported on Taxable Year 2015 return of the corporation.

If an affiliated group of corporations elected to file a combined return for Taxable Year 2015, such information would be required to be reported for each affiliate included in the combined return if the aggregate Virginia taxable income of such group for such taxable year before apportionment was equal to or in excess of $50 million. The Tax Commissioner would be required to prescribe the form and manner for reporting the required information by each affiliate of an affiliated group of corporations that elected to file a combined return for Taxable Year 2015.

Corporations subject to this requirement would be required to submit such information to the Department on or before July 1, 2017. This bill would not allow for the Department to grant an extension to corporations subject to this requirement. The Department would be authorized to audit any corporation that is required to submit such information and fails to do so on or before July 1, 2017, or fails to submit such information accurately. Any corporation required to submit such information to the Department that fails to do so by the due date, or that fails to submit accurate information, would be subject to a penalty of $5,000. The Tax Commissioner would have the authority to waive such penalty upon a determination that the submission requirement would cause an undue hardship. All requests for waiver would be required to be submitted to the Tax Commissioner in writing.

Effective Dates for the Provisions of this Bill

The provisions of this bill that would eliminate the base year employment and average weekly wage requirements for manufacturing companies that elect to use the modified method of apportionment for manufacturing companies would be effective for taxable years beginning on or after July 1, 2017.

The revenue estimating and reporting provisions would be effective July 1, 2017. Because that is the date that corporations would be required file information regarding market-based sourcing, before that date, the Department would be required to issue guidance as to the nature and format of the information to be filed, and corporations would be required to prepare such information. By December 31, 2017, the Department would be required to analyze the information received, report the results to the General Assembly, and issue preliminary guidelines regarding the provisions of this bill.

All of the other provisions of this bill would become effective for taxable years beginning on or after January 1, 2018, but only if the Department determines that the provisions of this bill are not estimated to reduce Virginia's official forecasted General Fund revenues by more than $50 million for any fiscal year. For purposes of this bill, Virginia's official forecasted General Fund revenues would be those official General Fund revenue estimates that are in effect immediately prior to the completion of the required fiscal impact statement by the Department.

cc: Secretary of Finance

Date: 1/17/2017 MTH
HB1499F161