

# DEPARTMENT OF TAXATION

## 2017 Fiscal Impact Statement

1. **Patron** Glen H. Sturtevant

3. **Committee** Senate Finance

4. **Title** Individual Income Tax; Rates for Small Businesses

2. **Bill Number** SB 1386

**House of Origin:**

  X   **Introduced**

       **Substitute**

       **Engrossed**

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

### 5. **Summary/Purpose:**

This bill would impose reduced individual income tax rates on small businesses. The standard tax rates applicable to small business income would be lowered one-quarter of a percent over four years. For Taxable Year 2020 and each taxable year thereafter, the rate of taxation for each individual income tax bracket would be one percent lower than the rate under current law for qualifying small business income. For purposes of the reduced rates, a "small business" would be defined as a sole proprietorship or pass-through entity with 25 or fewer employees.

This bill would be effective for taxable years beginning and after January 1, 2017.

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") has not assigned any administrative costs to this bill because the changes required by a single bill such as this can be implemented as part of the annual changes to our systems and forms. The Department considers implementation of this bill as routine, and do not require additional funding.

The Department will provide specific administrative costs on any legislation that is not "routine." Additionally, the Department will review all state tax legislation likely to be enacted prior to the passage by each house. If the aggregate number of routine bills likely to pass either house is unusually large, it is possible that additional resources will be required. If so, the Department will identify the costs at that time.

## Revenue Impact

This bill would have an unknown, but potentially significant, annual negative General Fund revenue impact, beginning in Fiscal Year 2018. According to the 2014 IRS Statistics of Income, Virginians filed 582,310 federal returns reporting \$7.8 billion in business and professional net income on federal Schedule C, as well as 218,040 federal returns reporting \$14.1 billion in partnership and S-corporation income. However, because it is not known what portion of this income is attributable to businesses with less than 25 employees, it is unknown what portion of this income would qualify for the reduced rates proposed by this bill.

Based on IRS data, it is estimated that 7.85 percent of the total amount of Virginia adjusted gross income reported on Virginia individual income tax returns is attributable to income from sole proprietorship, partnerships, and S-corporations. If all of these businesses met the employment requirement, this bill would have a negative General Fund revenue impact of \$127.3 million in Fiscal Year 2018, \$148.7 million in Fiscal Year 2019, \$212.3 million in Fiscal Year 2020, \$237.4 million in Fiscal Year 2021, \$248.2 million in Fiscal Year 2022, and \$259.4 million in Fiscal Year 2023. However, the actual impact would likely be less, depending on the amount of income attributable to companies that meet the employment threshold.

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

Department of Taxation

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

### **11. Other comments:**

#### Proposal

This bill would impose reduced individual income tax rates on small businesses. The standard tax rates applicable to small business income would be lowered one-quarter of a percent over four years. For Taxable Year 2020 and each taxable year thereafter, the rate of taxation for each individual income tax bracket would be one percent lower than the rate under current law for qualifying small business income. As a result, income attributable to qualifying Virginia small businesses would be subject to the following tax rates:

Virginia Taxable Income	Current Rates	Tax Rates			
		2017	2018	2019	2020 and After
\$0 to \$3,000	2%	1.75%	1.5%	1.25%	1%
\$3,001 to \$5,000	3%	2.75%	2.5%	2.25%	2%
\$5,001 to \$17,000	5%	4.75%	4.5%	4.25%	4%
\$17,001 or more	5.75%	5.5%	5.25%	5%	4.75%

“Small business” would be defined as a sole proprietorship or pass-through entity with 25 or fewer employees. Current law defines a pass-through entity as 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. Because this bill would only reduce the individual income tax rates for small business income, it would have no impact on small business income, reported by a corporate partner, member, or shareholder.

This bill would be effective for taxable years beginning and after January 1, 2017.

#### Similar Bills

**Senate Bill 849** would create an income tax deduction for income attributed and for the ownership and operation of a small business.

**Senate Bill 788** would lower the rate of taxation for each individual income tax bracket by one-quarter percent each year for four years.

**House Bill 2226** would decrease the maximum individual income tax rate from 5.75 percent on income in excess of \$17,000 to 5 percent on income in excess of \$5,000.

**Senate Bill 1029** would increase the personal exemption amount from \$930 to \$1,000, and would increase the additional personal exemption for blindness or age from \$800 to \$900.

**Senate Bill 1439** would create a corporate and individual income tax credit for each new job that is created in Virginia by a small business, equal to \$1,500 for each new full-time job.

**Senate Bill 793** would allow tax penalties to be waived for a small business during its first two years of operation, provided that such small business enters into an installment agreement with the Tax Commissioner.

cc : Secretary of Finance

Date: 1/22/2017 NM  
SB1386F161