DEPARTMENT OF TAXATION
2018 Fiscal Impact Statement

1. **Patron** Glenn R. Davis

2. **Bill Number** HB 966
House of Origin:
X **Introduced**
____ **Substitute**
____ **Engrossed**

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

3. **Committee** House Finance

4. **Title** Taxation in the Commonwealth

5. **Summary/Purpose:**

This bill would expand the Retail Sales and Use Tax base by imposing the tax on all services except for business-to-business, educational, health care, and real estate services. This bill would also clarify the Commonwealth's jurisdictional nexus to tax these services by requiring any person that furnishes services valued at $5,000 or more during a calendar year to register with the Department as a dealer. The effective date of the provisions related to the Sales and Use Tax treatment of services is not specified.

This bill would eliminate the 1.5 percent state sales tax on food purchased for home consumption, beginning July 1, 2018.

This bill would eliminate the lowest two individual income tax brackets, effective for taxable years beginning on and after January 1, 2019. As a result, there would be no Virginia individual income tax on income of $5,000 or less.

The bill would provide a refundable tax credit against the individual income tax, corporate income tax, and income tax imposed on estates and trusts in an amount equal to a business's aggregate tax liability for certain local taxes paid. These local taxes would include the machinery and tools tax, the merchants' capital tax, and most of the business, professional, and occupational license ("BPOL") taxes. The credit would be effective for taxable years beginning on and after January 1, 2018, but before January 1, 2023.

6. **Budget amendment necessary:** Yes.
Item(s): Page 1, Revenue Estimates
273 and 275, Department of Taxation

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

7a. Expenditure Impact:

Fiscal Year	*Dollars*	*Positions*	*Fund*
2017-18	$321,099	5	GF
2018-19	$374,774	5	GF
2019-20	$491,244	7	GF
2020-21	$667,637	7	GF
2021-22	$677,648	7	GF
2022-23	$693,278	7	GF
2023-24	$708,726	7	GF

7b. Revenue Impact:

Fiscal Year	***Dollars***	***Fund***
2018-19	($896 million)	GF
2018-19	$271 million	NGF
2019-20	($1.115 billion)	GF
2019-20	$304 million	NGF
2020-21	($1.119 billion)	GF
2020-21	$312 million	NGF
2021-22	($1.132 billion)	GF
2021-22	$319 million	NGF
2022-23	($1.144 billion)	GF
2022-23	$327 million	NGF
2023-24	($30 million)	GF
2023-24	$337 million	NGF

8. Fiscal implications:

Administrative Costs

This bill would result in administrative costs of $321,099 in Fiscal Year 2018; $374,774 in Fiscal Year 2019; $491,244 in Fiscal Year 2020; $667,637 in Fiscal Year 2021; $677,648 in Fiscal Year 2022; $693,278 in in Fiscal Year 2023; and $708,726 in Fiscal Year 2024. Such costs include hiring auditors to ensure compliance with the new Sales and Use Tax collection requirement that would be imposed on affected service providers, hiring a full-time employee to administer the proposed tax credit, hiring customer services wage staff, updating the Department's systems and forms, and communicating with sales tax dealers about the changes to the Retail Sales and Use Tax.

Revenue Impact

This bill would have a negative General Fund revenue impact of $896 million in Fiscal Year 2019; $1.115 billion in Fiscal Year 2020; $1.119 billion in Fiscal Year 2021; $1.132 billion in Fiscal Year 2022; $1.144 billion in Fiscal Year 2023; and $30 million in Fiscal Year 2024. Non-General Fund revenues (Transportation Trust Fund, Local Option, HMOF, and Regional Transportation Fund) would increase by a total of $271 million in Fiscal Year 2019, $304 million in Fiscal Year 2020, $312 million in Fiscal Year 2021, $319 million in Fiscal Year 2022, $327 million in Fiscal Year 2023, and $337 million in Fiscal Year 2024.

The majority of the negative General Fund revenue impact would be a result of the refundable tax credit for local business taxes, which would have a negative General Fund revenue impact of $1.013 billion in Fiscal Year 2019; $1.035 billion in Fiscal Year 2020; $1.058 billion in Fiscal Year 2021; $1.080 billion in Fiscal Year 2022; and $1.102 billion in FY 2023.

Elimination of Virginia's two percent and three percent tax brackets would have a negative General Fund revenue impact of $242 million in Fiscal Year 2019; $481 million in Fiscal Year 2020; $475 million in Fiscal Year 2021; $475 million in Fiscal Year 2022; $476 million in Fiscal Year 2023; and $476 million in Fiscal Year 2024. The estimated revenue impact of this provision is based on the most recently available Virginia individual income tax data. Congress recently enacted Public Law 115-97, known as the "Tax Cuts and Jobs Act" ("the TCJA"), which could significantly impact the computation of federal adjusted gross income and may also increase the number of taxpayers who claim the standard deduction. As a result, the revenue impact of this provision could vary once the recent federal changes are taken into account.

Taxing additional services under the Retail Sales and Use Tax would have a positive overall revenue impact of $902 million in Fiscal Year 2019; $1.009 billion in Fiscal Year 2020; $1.035 billion in Fiscal Year 2021; $1.060 billion in Fiscal Year 2022; $1.087 billion in Fiscal Year 2023; and $1.114 billion in Fiscal Year 2024.

Elimination of the state Retail Sales and Use Tax on food for home consumption would have a negative state revenue impact (General Fund Restricted for K-12 Education and Transportation Trust Fund) of $274 million in Fiscal Year 2019; $304 million in Fiscal Year 2020; $311 million in Fiscal Year 2021; $318 million in Fiscal Year 2022; $324 million in Fiscal Year 2023; and $331 million in Fiscal Year 2024.

The table below shows the impact that each provision would have on General Fund revenues (in millions).

Fiscal Year	Elimination of Tax Brackets	Refundable Credit for Local Taxes Paid	Taxable Services (GF Unrestricted and Restricted)	Eliminate Sales Tax on Food (GF Restricted)	Total
2019	($242)	($1,013)	$540	($182)	($896)
2020	($481)	($1,035)	$604	($202)	($1,115)
2021	($475)	($1,058)	$619	($207)	($1,119)
2022	($475)	($1,080)	$634	($211)	($1,132)
2023	($476)	($1,102)	$650	($215)	($1,144)
2024	($476)	-	$666	($220)	($30)

The table below shows the impact that each provision would have on non-General Fund revenues (in millions).

Fiscal Year	Eliminate Sales Tax on Food (TTF)	Taxable Services				Total
		TTF	HMOF GF transfer	Regional Transportation Fund	Local Option	
2019	($92)	$128	$16	$59	$160	$271
2020	($102)	$143	$18	$66	$179	$304
2021	($104)	$147	$18	$68	$183	$312
2022	($107)	$150	$19	$69	$188	$319
2023	($109)	$154	$19	$71	$192	$327
2024	($111)	$158	$20	$73	$197	$337

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Background

Retail Sales and Use Tax

Under current law, the Sales and Use Tax is levied on the sale or consumption of goods and a very limited number of services. The only services currently subject to the tax are transient accommodations and services provided in connection with the sales, fabrication, or furnishing of tangible personal property.

In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the U.S. Supreme Court ruled that the Commerce Clause bars a state from requiring an out-of-state mail-order company to collect use tax on goods sold to customers located within the state when the company has no outlets, sales representatives, or significant property in the state. The Court determined that only Congress has the authority to require out-of-state vendors without a physical presence in a state to register and collect the state's tax.

Consistent with the *Quill* decision, Virginia law sets out specific criteria for evaluating whether dealers are required to collect the tax on their sales into the Commonwealth. Generally, the duty to register will arise when a dealer making sales in the Commonwealth owns or leases real property in Virginia; conducts certain activities through employees, agents, independent contractors, or representatives within Virginia; conducts certain advertising, solicitation, or delivery activities within Virginia; shares common ownership or business relationships with an in-state business; or owns tangible personal property leased or rented to Virginia consumers.

Generally, a physical presence by a dealer is required before a state may impose upon the dealer an obligation to collect sales tax. The imposition of dealer status based on one's provision of in-person services would not generally offend the Constitutional safeguards outlined by the Court in *Quill* because a physical presence of an employee or contractor is a necessary component of the transaction.

Under current law, the sales tax on food for home consumption is levied at 2.5 percent, consisting of a 1.5 percent state tax and the 1 percent local option tax.

Federal and State Individual Income Tax Structure

On December 22, 2017, the President signed into law the TCJA. The TCJA modifies the current individual income tax rate structure. The current rate structure has seven rates: 10 percent, 15 percent, 25 percent, 28 percent, 33 percent, 35 percent, and 39.6 percent. Effective beginning in Taxable Year 2018, the TCJA maintains the seven-rate structure, but taxes a taxpayer's income at modified rates: 10 percent, 12 percent, 22 percent, 24 percent, 32 percent, 35 percent, and 37 percent. The following table compares the tax brackets under prior law to those under the TCJA for married taxpayers filing a joint return.

Before the TCJA		Under the TCJA	
Federal Taxable Income	Federal Tax Rates	Federal Taxable Income	Federal Tax Rates
$0 to $19,050	10 percent	$0 to $19,050	10 percent
$19,051 to $77,400	15 percent	$19,051 to $77,400	12 percent
$77,401 to $156,150	25 percent	$77,401 to $165,000	22 percent
$156,151 to $237,950	28 percent	$165,001 to $315,000	24 percent
$237,951 to $424,950	33 percent	$315,001 to $400,000	32 percent
$424,951 to $480,050	35 percent	$400,001 to $600,000	35 percent
$480,051 or more	39.6 percent	$600,001 or more	37 percent

Different federal rate tables apply for those married taxpayers filing a separate return, those filing as head of household, and those filing as individuals.

Under current law, the Virginia individual income tax is imposed at the following rates:

Virginia Taxable Income	Virginia Tax Rates
$3,000 and less	2 percent
$3,001 to $5,000	3 percent
$5,001 to $17,000	5 percent
$17,001 or more	5.75 percent

In 1971, when Virginia revised its income tax to conform to federal income tax law, Virginia had only the first three tax brackets shown above. Therefore, the top marginal tax rate would have been 5 percent, applicable to Virginia taxable income of $5,001 or more. However, in 1972, the General Assembly added the fourth tax rate of 5.75 percent for individuals and increased the tax rate for corporations from five percent to six percent.

The amount of Virginia taxable income subject to Virginia's top marginal tax rate was last modified during the 1987 Session, in response to the 1986 federal tax reform. The income threshold for the top marginal rage was increased from $12,001 to $14,001 for Taxable Year 1987 and from $14,001 to $17,001 over the next three years.

Year	Taxable Income Subject to 5.75 percent Tax Rate
1972—1986	$12,001 or more
1987	$14,001 or more
1988	$15,001 or more
1989	$16,001 or more
1990—Present	$17,001 or more

Since 1990, the General Assembly has not enacted any legislation affecting Virginia individual income tax rates or brackets.

Several neighboring states have recently made structural changes to their individual income tax rates and bracket structures. For example, the District of Columbia enacted budget provisions that created individual income tax relief contingent upon meeting certain revenue goals. For Taxable Year 2017, this included reducing the rate on income between $40,000 and $60,000 from 6.75 percent to 6.5 percent.

North Carolina recently reformed its individual income tax by enacting a flat individual income tax rate and gradually decreasing this rate over a period of several years. Prior to Taxable Year 2014, North Carolina had three individual income tax rates of 6 percent, 7 percent, and 7.75 percent. For Taxable Year 2014, North Carolina replaced its tiered tax structure with a flat individual income tax rate of 5.8 percent. This rate decreased to 5.75 percent for Taxable Years 2015 and 2016, to 5.499 percent for Taxable Year 2017 and 2018, and is scheduled to decrease to 5.25 percent for Taxable Year 2019 and thereafter.

Tennessee only taxes individuals on interest and dividends. Tennessee enacted legislation that reduces the rate for this tax from six percent to five percent in Taxable Year 2016, and continues to reduce the rate by one percent annually, eventually eliminating the tax for the taxable years beginning on or after January 1, 2021.

Proposed Legislation

Retail Sales and Use Tax

This bill would expand the Sales and Use Tax to any service used or consumed in the Commonwealth unless specifically exempted. Exempt services would include:

- Business-to-business services, which are defined as services provided by a business to a business;

- Educational services, defined as instruction and training provided by a school, college, university, or training centers;

- Health care services, defined as a service provided by a physician, chiropractor, dentist, nurse, nurse practitioner, physician's assistant, optometrist, dental hygienist, professional counselor, clinical social worker, clinical psychologist, marriage and family therapist, physical therapist, or pharmacist; and

- Real estate services defined as services involving the rental, lease, or sale of real property, whether commercial, industrial, or residential; the brokering of real estate transactions; investment counseling related to real estate transactions; preparing, executing, and recording documents related to real estate transactions; title searches; and environmental evaluation and remediation activities related to real estate.

This bill would also clarify the Commonwealth's jurisdictional nexus to tax these services by requiring any person that furnishes services valued at $5,000 or more during a calendar year to register with the Department as a dealer. The effective date of the provisions related to the Sales and Use Tax treatment of services is not specified.

This bill would eliminate the 1.5 percent state tax on food for home consumption beginning July 1, 2018. Food for home consumption would still be subject to the one percent local option tax.

Individual Income Tax Brackets

This bill would eliminate the lowest two Virginia individual income tax brackets, effective for taxable years beginning on and after January 1, 2019. As a result, there would be no Virginia individual income tax on income of $5,000 or less. The following individual income tax rates and brackets would apply:

Virginia Taxable Income	Virginia Tax Rates
$5,000 and less	$0
$5,001 to $17,000	5 percent
$17,001 or more	5.75 percent

Refundable Tax Credit for Local Business Taxes

The bill would provide a refundable tax credit against the individual income tax, corporate income tax, and income tax imposed on estates and trusts in an amount equal to a business's aggregate tax liability for certain local taxes paid. These local taxes would include the machinery and tools tax, the merchants' capital tax, and most of the business, professional, and occupational license ("BPOL") taxes. This credit would specifically exclude payments of the local gas road improvement and Virginia Coalfield Economic Development Authority Tax, and local severance taxes on gases from the credit. Taxpayers would be required to claim the credit in the same taxable year in which the business taxes were paid.

If the amount of credits exceeds the taxpayer's tax liability for the taxable year, the excess would constitute an overpayment and the Department would be required to refund such overpayment to the taxpayer. A taxpayer would not be permitted to carry forward any unused credits. The credit would be effective for taxable years beginning on and after January 1, 2018, but before January 1, 2023.

<u>Similar Legislation</u>

Senate Bill 390 would make numerous changes to Virginia's tax structure.

House Bill 1189 would lower Virginia's top marginal individual income tax rate to five percent, effectively reducing the number of tax brackets from four to three.

Senate Bill 759 would reduce the rate of taxation for each of Virginia's individual income tax brackets by up to ten percent of the current rate over a three-year period.

cc : Secretary of Finance

Date: 1/28/2018 SK
HB966F161