

Small Revenue Sources

A Presentation to the Joint Subcommittee Studying Taxes, Assessments and Fees Imposed by the Commonwealth that Generate Little Revenue – Pursuant to HJR 656

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Background

HJR 656 created this joint subcommittee to study the taxes, assessments and fees imposed by the Commonwealth to determine whether they are administered efficiently. Further, the subcommittee was to determine whether the taxes, assessments and fees could be collected in a more efficient manner so that taxpayers will pay less in administrative costs. One direction made by HJR 656 instructed the subcommittee to decide if some taxes, assessments and fees may be eliminated or consolidated in order to generate larger amounts of revenue while reducing administrative expenses.

The department administers 30 taxes:

<u><i>Income and related taxes:</i></u> <ul style="list-style-type: none">• Individual income tax• Corporation income tax• Fiduciary income tax• Individual estimated tax• Corporation estimated tax• Employer withholding tax <u><i>Sales and use taxes:</i></u> <ul style="list-style-type: none">• Retail sales and use tax• Transportation district motor fuel sales tax (two districts)• Aircraft sales and use tax• Watercraft sales and use tax	<u><i>Other taxes:</i></u> <ul style="list-style-type: none">• Cigarette tax• Other tobacco products tax• Estate tax• Bank franchise tax (state and local components)• Recordation tax (state and local components)• Wills and administration (probate) tax (state and local components)• Writ tax• Litter tax• Soft drink excise tax• Tire tax• Railroad rolling stock tax• Corn excise tax• Cotton excise tax• Egg tax• Forest products tax• Peanut excise tax• Sheep tax• Small grains tax• Soybean tax• Intangible personal property tax
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Taxes that Generate Little Revenue

HJR 656 did not define “little revenue,” but did name the sheep and soft drink excise taxes as examples. For FY 2004, ten of the taxes administered by the Department generated less than \$2 million. All of these taxes are distributed to a special fund and, combined, raise less than \$4 million in revenue. These taxes, and their corresponding special funds, are shown in the following table.

<i>Tax</i>	<i>FY 2004 Revenue</i>	<i>Special Fund Distributed to:</i>
Corn Assessment	\$263,000	Virginia Corn Fund administered by the Virginia Corn Board, pursuant to referendum.
Cotton Assessment	\$91,000	Virginia Cotton Fund administered by the Cotton Board, pursuant to referendum.
Egg Excise Tax	\$161,000	Virginia Egg Fund administered by the Virginia Egg Board.
Forest Products Tax	\$1,661,000	Reforestation of Timberlands State Fund administered by the Department of Forestry.
Litter Tax	\$792,000	Litter Control and Recycling Fund administered by the Department of Environmental Quality with the advice of the Litter Control and Recycling Fund Advisory Board.
Peanut Excise Tax	\$92,000	Virginia Peanut Fund administered by the Virginia Peanut Board.
Sheep Assessment	\$11,000	Virginia Sheep Industry Promotion and Development Fund administered by the Virginia Sheep Industry Board, pursuant to referendum.
Small Grains Assessment	\$102,000	Virginia Small Grains Fund administered by the Virginia Small Grains Board, pursuant to referendum.
Soft drink Excise	\$210,000	Litter Control and Recycling Fund administered by the Department of Environmental Quality with the advice of the Litter Control and Recycling Fund Advisory Board.
Soybean Assessment	\$515,000	Virginia Soybean Fund administered by the Virginia Soybean Board, pursuant to referendum.

Most of these industry specific assessments have been requested by the industry. The General Assembly authorized these assessments, but required industry members to vote in a referendum before imposing the assessment. Upon referendum approval, the special fund is spent on industry-specific promotion. The litter tax and soft drink excise taxes were imposed by the General Assembly and revenue is distributed to the Litter Control and Recycling Fund.

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ADMINISTRATIVE COSTS

HJR 656 is concerned with the balance between the expense of revenue collection and amount of revenue actually collected. In Fiscal Year 2004, the Department collected almost \$11 billion from the 30 taxes that it administers and processed over 7.5 million returns and payment vouchers. For the same fiscal year, the Department's operating costs were \$64.7 million, or about 59 cents per \$100 of revenue collected. It is impossible to allocate specific expenditures to specific taxes as the Department is not organized by tax type, nor does it account for its expenses by tax type. Rather, the Department is organized by function. In general terms, the Department's costs can be broken down among its major functions as follows:

Processing

The commodity taxes generate few returns annually, and processing costs are low because the returns are so simple (no deductions, credits, check-offs, detailed schedules, or split distributions). Funds are deposited with all of the other tax revenue, but we inform the Treasurer how much has been deposited for each tax so that appropriate distributions by tax type can be made. The return for each tax type is printed with machine-readable codes that enable our automated systems to process payments and apply them to the proper tax fund, which significantly reduces processing costs. Putting more than one tax type on a return would require manual keying to ensure proper distribution and greatly increase processing costs.

Enforcement

The Department's enforcement procedures with respect to these small revenue sources generally consist of letters and phone calls about late returns and math or other obvious errors. The appropriation to administer these special fund taxes is not sufficient for a program of field audits to enforce taxpayer compliance. Several statutes require the taxpayer to file a copy of the return with the relevant Board or authorize the Department to share tax return information with the Board. In some cases the relevant Board may be interested in a more vigorous enforcement effort, and may contact taxpayers themselves. We have delegated certain administrative auditing authority to one such Board.

Set-up and Programming

We have an enormously complex and integrated automated system designed to handle the processing of over 7.5 million returns, accounting for almost \$11 billion in revenue, and integrating of a variety of customer service and enforcement activities. This system enables the Department to process and track a huge volume of transactions and taxpayer contacts at a relatively low cost. In order to maintain the benefits associated with automated processing, each type of tax return has its own unique set of programs and processes. Setting up a new tax, even a simple one, requires expensive modifications to many system modules, which typically costs \$250,000 and up. Legislative

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changes to any tax also require systems changes that, depending on their scope, can approach the cost of setting up a new tax.

Once the automated system has been set up, processing costs are low. Several commodity taxes have been authorized, but not implemented by the industry. If the Department has to implement a new commodity tax, or significantly change a current commodity tax, expenditures from the Department's General Fund appropriation will be required to incorporate and modify new processes into the Department's automated systems.

Non revenue generating activities

In addition to the functions related to collecting revenue, the Department performs various functions for the following taxes that generate no state revenue.

Tax	Nature of Function
Intangible Personal Property tax	Property, tangible in fact, classified as intangible is exempt from local property tax (state tax rate set to zero in 1984)
Local sales & use tax Local recordation tax Local tax on wills & administration Local tax on writs	Administered in conjunction with similar state tax and rarely a separate issue. Local officials, however, often review and question data on sales tax revenue from their jurisdictions and the impact on distributions.
Local Bank Franchise Tax	Administered in conjunction with similar state tax. A frequent issue is the division of tax liability among Virginia localities in which a bank has branches.
Business, Professional & Occupation License ("BPOL") Tax	Advisory opinions on classification issues; appeals from decisions of local Commissioners of the Revenue
Other business local taxes (e.g., machinery & tools, business tangible property)	Appeals from decisions of local Commissioners of the Revenue
Real Property Assessment	Advice on general reassessments and special assessments; assessment-sales ratio studies; mapping; assessment of railroad & pipeline property

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Reimbursement

Most of the Department's expenses for administering the collection and enforcement of taxes come out of the general fund regardless of the type of tax being collected. Therefore, the revenues distributed to the special funds do not bear their respective costs. Three funds reimburse the state treasury for such administrative expenses incurred by the Department. The Appropriations Act, (2005 Chapter 951, §3-1.01), transferred \$33,878 from the Forest Products Tax Fund (§ 58.1-1609) and \$969 from the Peanut Fund (§ 3.1-662) in order to reimburse the general fund of the state treasury. The Department administers the Transportation District Motor Fuel Sales Tax and deducts its direct costs for auditors from monthly distributions of revenue to the two transportation districts in which the tax is imposed. No other special funds reimburse the state treasury for the Department's administrative expenses.

Possible changes to current operating procedures

- Standardize and simplify administrative provisions

This would slightly reduce the costs of setting up new taxes and administering existing taxes but, as discussed above, would incur significant setup expenses for the modifications to the Department's accounting system.

- Reduce the frequency of filing

This would also reduce processing costs, but would delay distribution of funds to the special fund and the intended recipient. This would also require changes, with the corresponding set-up expenses, to the Department's automated system.

- Assign new taxes to other agencies with smaller accounting systems

A simpler accounting system would require smaller set-up costs, while processing costs should be comparable to the Department's current costs. Unfortunately, few agencies other than TAX currently have a system capable of administering a tax.