TO: Members of the Sub-Committee Studying SSF (HJR 177 and SJR101)
From: Albert Pollard
Re: The Chair's Request.
Date: November 13, 2008

This memo is per the request from our chair to outline thoughts about a recommendation from the Joint Subcommittee Studying the Single Sales Factor.

First, it seems to me that as policy makers we should not be asking if we need to do something to aid the business and manufacturing climate in Virginia, rather we should be asking ourselves what we should be doing.

In studying the impact of a new formula, I think Page 16 and 17 of the September 30th presentation by Mr. Joseph's from the Department of Taxation is most instructive. In it he details that the top 97 corporations (which account 1/10 of 1% of Virginia's 77,000 corporations) account for 63%, 75%, 120% of the tax relief if we were to adopt various SSF formulas. The 120% figure is arrived at because under some scenarios, the effective tax rate would go up for some smaller corporations.

While I am not automatically opposed to bigger companies getting more relief (it might be that the larger relief is in proportion to a larger employment and economic impact), these are sobering statistics in terms of distribution of the proposed tax relief.

What gives me more pause than the numbers stated above is that there are no performance numbers associated with the relief under a new SSF formula. Nor, if were to adopt a new formula, would relief in any way be correlated to long-term investment in the Commonwealth.

For instance, we know that money spent by companies on machinery and tools is money invested in our workers as well. Thus a tax like the local Machinery and Tools Tax is a very hostile tax to a quality business investment.

A quick glance at Machinery and Tools rates around the state (a link to localities Machinery and Tools Tax rates is at the bottom of this memo) shows that the "effective" rates range from a high of $6/$100 to a low of .10/$100 of value. Perhaps a better way to help manufacturing companies would be for Virginia to give alternative taxing authority to localities who abandon the machinery and tools tax. Or, perhaps, the Commonwealth should take this revenue source from localities altogether.

Conformity to Federal Code (which in and of itself should be a strong policy goal) can also provide tax relief for companies which make investments in Virginia. Below is a portion of memo which I requested from Staff Attorney Mark Vucci:

> "You also asked for the fiscal impact for Virginia to conform to additional bonus depreciation granted by the federal government in 2008. The vast majority of the fiscal impact of 2008 bonus depreciation is attributable to changes to § 168 (k) of the Internal

> Revenue Code. Under this section, bonus depreciation is allowed for property placed in service in calendar year 2008 that is (i) an improvement to a commercial building, (ii) property with a depreciation recovery period of twenty years or less under federal income tax laws, (iii) computer software, (iv) water utility property, or (v) certain aircraft. The Department of Taxation has indicated to me that the fiscal impact of conforming to 2008 federal legislation for additional bonus depreciation is in the neighborhood of ($17) million in the current fiscal year and ($130) million in the 2009-2010 fiscal year. Conforming to the 2008 federal legislation for additional bonus depreciation will not increase the aggregate amount that can be taken as a depreciation deduction for a qualifying asset on a Virginia income tax return, however, conforming to the 2008 federal law (in contrast to current Virginia law) will accelerate the amount of depreciation that can be deducted for a qualifying asset on a Virginia income tax return."

Obviously, depreciation, by its very definition, is relief for companies which have invested in the Commonwealth and, by extension, her workers. In a global environment where investment in heavy capitalization outweighs reliance on cheap labor, not adopting certain depreciation rules is hostile indeed.

In summary, Virginia needs to maintain a tax code that is business friendly and encourages the core economic actively of manufacturing and intellectual property investments. Given unlimited resources, changing to a Single Sales Factor Formula would have beneficial impacts in that regard. However, since we do not have unlimited resources, I am strongly inclined to look at other sources of tax relief which would have equal relief for companies but would likely have far greater positive economic benefits for the Commonwealth.

I look forward to kicking these ideas around more at the Monday meeting.

The link to Virginia's Machinery & Tools Tax rates can be found at:

http://www.virginia.edu/coopercenter/vastat/taxrates2007/tr1007.pdf