Overview of Local Taxing Authority

Local governments are granted their taxing authority by the General Assembly, either through:

1) general laws that apply to all localities; or

2) municipal charters, which are special legislative acts adopted for each city or town under the Uniform Charter Powers Act (§ 15.2-1100 et seq.)

Currently, local governments have available to them 26 different taxes.

Real property	Alcohol License
Tangible Personal Property	Bank Franchise
Machinery and Tools	Cable TV Franchise
Sales and Use	Cable TV Excise
BPOL	Transient Occupancy*
Merchant's Capital	Meals*
Consumer Utility	Cigarette*
Motor Vehicle License	Admissions*
Recordation	Coal and Gas Severance*
Probate	Coal/Gas Road Improvement*
E-911	Oil Severance*
Daily Rental Property	Income*
Utility License	Motor Fuels Sales*

* Taxes not equally available to all cities and counties.

Not all taxes are equally available to all local governments.

- Charter authority generally grants cities and towns authority to levy any taxes *not specifically prohibited* by the General Assembly.

- Counties may only levy taxes specifically authorized by the General Assembly.

- These differences play out most directly in limits placed on counties' ability to levy transient occupancy, meals, cigarette, and admissions taxes, and in the limited taxes granted to Northern Virginia localities (income, motor fuel sales).

-- Counties may generally levy:

Transient occupancy taxes at up to 2% *[Increments above 2% up to 5% are available by general law, if the additional revenue is dedicated for tourism promotion.];*

Meals tax at up to 4% (subject to referendum) *[Some exceptions to referendum requirement exist for specified counties.];*

Admissions taxes only if authorized county-by-county *[Arlington, Brunswick, Dinwiddie, Fairfax, and Prince George are currently authorized.];* and

Cigarette taxes only if authorized county-by-county *[Arlington and Fairfax Counties are currently authorized.]*

-- Cities may levy these taxes without limits.

Towns may preempt the right of counties to levy certain taxes. In many cases, if a town levies a tax, the county may not levy the same tax within the town's incorporated limits.

Although variations exist from locality to locality, cities and counties collect the bulk of local revenues from taxes on real property; personal property; sales; consumer utilities; and business, professional, and occupational licenses (BPOL).

These 5 taxes accounted for 84 percent of locally generated tax revenue for cities and 91 percent for counties in FY 1999.

The relative percentage for each tax has remained stable for most of the last decade.

Percent of Local Tax Revenue, FY 1999

Tax	% of Cities' Revenue	% of Counties' Revenue	No. of Cities Levying	No. of Counties Levying
Real Property	46.5%	55.2%	40	95
Personal Property	13.5	19.7	40	95
Sales Tax	10.1	8.1	40	95
Consumer Utility	7.2	3.7	39	84
BPOL	6.4	3.9	40	54
Machinery & Tools	3.1	2.1	38	93
Meals Taxes	5.1	0.9	40	31
Motor Vehicle License	1.3	1.4	39	93
Transient Occupancy	1.4	.9	34	50
Telephone Service	1.1	.9	38	81
Recordation/Wills	.4	.8	40	95
Franchise License	.9	.4	39	90
Bank Stock	.7	.4	39	68
Cigarette	1.1	.1	24	2
Coal/Gas Severance	.0	.4	1	7
Admission Taxes	.4	.0	3	16
Merchants' Capital	.0	.2	0	51
Other Local Taxes	1.0	1.0	27	16
Total	**100.0%**	**100.0%**		

During the 1970's and 1980's, a series of legislative studies examined individual local taxes one-at-a-time. The focus of each study was the need to keep tax rates within reasonable limits.

The studies led to the placement of statutory caps on most local taxes.

-- Of the 5 main local taxes, only those on real estate and tangible personal property remain uncapped.

NOTE: Cities' authority to levy a number of taxes under their charter authority (cigarette, admissions, meals, and transient occupancy) were unaffected by the caps.

Growth in Local Tax Revenue

Between 1989 and 1999, the average growth in tax revenue for local governments was about 6.7 % annually.

- However, during the same period substantial variation in revenue growth among localities is evident.

Average Percent Growth in Tax Revenues, FY's 1989-99

	Cities	Counties	All
Average	5.2%	7.3%	6.7%
Median	5.0	7.3	6.8
Highest Growth	7.9	12.7	12.7
Lowest Growth	1.7	0.7	0.7

From 1995 through 1999, growth in local tax revenue slowed somewhat--although the same general patterns still exist among localities.

Average Percent Growth in Tax Revenues, FY's 1995-99

	Cities	Counties	All
Average	4.6%	6.5%	5.9%
Median	4.1	6.3	5.7
Highest Growth	9.0	14.6	14.6
Lowest Growth	1.2	-0.6	-0.6

For over 20 years, ongoing discussions have focused on whether local governments have sufficient financial resources to carry out their responsibilities.

Conclusive findings have been difficult to develop because:

1) Virginia's 135 cities and counties are extremely different from one another.

   -- Each makes its own local choices about how best to (i) raise and spend local revenue, and (ii) provide services, within the limits defined by the state.

      Therefore, accurate generalizations that fit all or even the majority of local governments are difficult, if not impossible, to make.

2) The only comprehensive, systemically collected data that is commonly available deals with audited local revenues and expenditures.

   -- Little data is available about the unique factors that often determine local choices.

Real Property Tax

The basic elements of the tax on real property are found in Article X of the *Constitution of Virginia,* as follows:

- All property (except as specified) shall be taxed (Section 1);
- All assessments of real estate...shall be at fair market value (Section 2); and
- Real estate, coal and other mineral lands, and tangible personal property...are segregated for local taxation (Section 4).

The real property tax is levied by all cities and counties, and is the leading source of local tax revenue.

- Real property taxes accounted for 47 percent of cities' tax revenue and 55 percent of counties' tax revenue in FY 1999.

As with most local taxes, effective tax rates (the actual tax levied on the "true" value of property) vary widely.

Effective Tax Rates on Real Property, FY 1998
(Rate per $100 of "True" Value)

	Cities	Counties	All
Average	$0.96	$ 0.60	$0.71
Median	0.98	0.57	0.61
Highest	1.39	1.28	1.39
Lowest	0.50	0.29	0.29

- Average effective tax rates on real property have remained exceptionally stable over the past 5 years.

Because of varying assessment practices, it is difficult to tell whether a particular locality has raised property taxes.

- For 51 localities, effective property tax rates in 1998 were at least $0.03 **higher** than in 1994.
- For 35 localities, effective property tax rates in 1998 were at least $0.03 **lower** than in 1994.

Assessment Practices

The tax on real property is levied annually by local governments against the fair market value (**FMV**) of all taxable real property. FMV is determined by an appraisal process, the frequency of which is defined by state statute (§ 58.1-3250 et seq.).

- Cities with populations of 30,000 or above are required to reassess at least every 2 years;
- Cities under 30,000 may elect to re-assess every 4 years;
- Counties with populations above 50,000 are required to reassess at least every 4 years; and
- Counties of 50,000 or less may elect to re-assess every 5 or 6 years.

Actual assessment practices vary widely across localities.

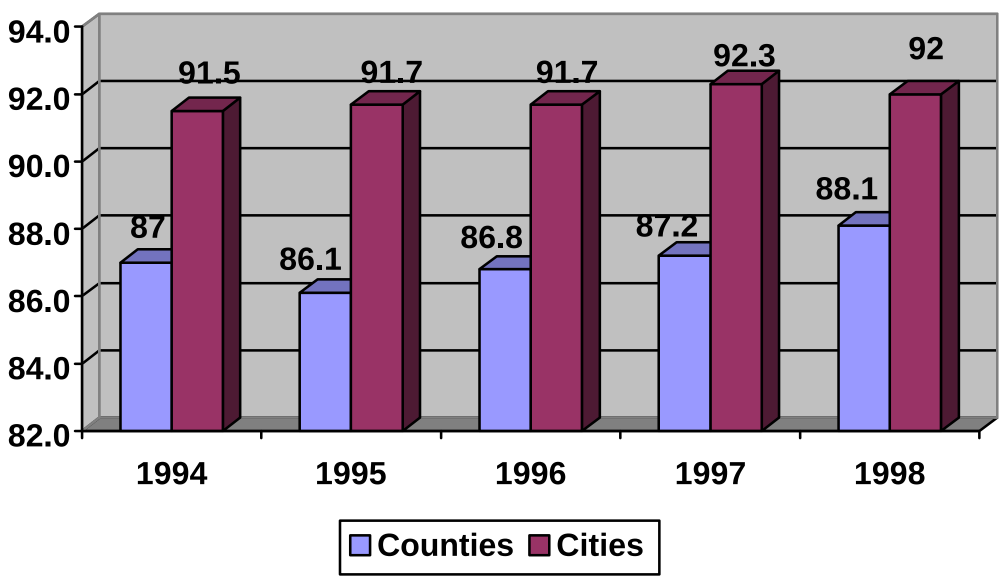
1999 Assessment Practices of Cities and Counties

Frequency	Cities	Counties
Annual Assessment	17	11
Every 2 years	12	7
Every 4 years	11	23
Every 5 years	--	4
Every 6 years	--	36
4 to 6 year cycle	--	11
Other	--	3
Total	40	95

The Department of Taxation's Assessment/Sales ratio studies reveal stable patterns of assessment from 1994 through 1998.

- City assessments reflect about 90-92% of actual sales prices.
    - -- In 1998, actual assessment ratios ranged from 99.1% (Fredericksburg) to 78.9% (Buena Vista). 10 cities had assessment ratios below 90% of FMV.
- For counties, assessments typically reflect about 86-88% of actual sales prices.
    - -- In 1998, actual assessment ratios ranged from 99.2% (Rappahannock) to 69.4% (Craig). 14 counties had assessment ratios below 80% of FMV.

Median Ratio of Assessed Value to Sales Price, 1994-98



Tax Preferences Affecting Real Property Taxes

Article X, Section 6 of the *Constitution of Virginia* provides several partial or full exemptions from real estate taxes, some of which are local option.

1) Property owned by the state or local government;

2) Property owned and used by religious groups for religious worship;

3) Non-profit cemeteries;

4) Property owned by non-profit public libraries or non-profit institutions of learning, as long as the property is used for literary, educational, or scientific purposes;

5) *By local option*, partial exemption of real estate that has undergone substantial renovation (In 1999, 27 cities and 10 counties had an ordinance in effect granting this exemption.);

6) *By local option*, property owned and occupied as their sole dwelling by those 65 or older or those permanently disabled, who are deemed by the General Assembly to be bearing an extraordinary tax burden relative to their income and net worth (In 1999, 39 cities and 76 counties reported having an ordinance in effect granting this exemption.);

7) Property used by its owner for religious, charitable, patriotic, historical, benevolent, cultural, or public park and playground purposes, as may be provided *by classification or designation*...by the General Assembly.

   - Since 1971, 960 properties have been exempted *by designation* from local real estate taxes, personal property taxes, or both, through local resolution and General Assembly action.

   - There is no record of the number of properties exempted *by classification*.

     Examples of properties exempt *by classification* include:
     - Volunteer fire departments and rescue squads
     - Boys and Girls Clubs of America affiliates
     - Auxiliaries of the Veterans of WWI
     - Societies for the Prevention of Cruelty to Animals
     - Boy Scouts and Girl Scouts of America
     - American National Red Cross

Tax exempt property can be a significant limiting factor on revenue derived from real property taxes. As with all local taxes, however, the proportion of local property that is tax exempt varies among localities.

Percent of All Real Property That Is Tax Exempt, 1998

	Cities	Counties	All
Average	20.3%	12.6%	14.9%
Highest	56.3	44.8	56.3
Lowest	7.0	2.9	2.9

The *Constitution of Virginia* also allows the General Assembly, in Article X, Section 1, to provide partial exemptions from the property tax by establishing different rate categories.

- Currently, there are fewer than 10 such classifications, most of which relate to property with narrowly defined uses.

- At their option, local governments may elect to tax such property at lower rates.

- The most widely used are the classifications granted for agricultural, horticultural, forest, or open-space uses.

Land Use Assessment. Local governments may elect to assess property used for agricultural, horticultural, forest, or open-space purposes according to its use -- rather than at FMV.

- If the landowner changes the use of the land, he is liable for "roll-back" taxes -- 5 years worth of the difference between what he would have paid at FMV and what he actually paid under land use taxation, plus interest.

- In 1999, 20 cities and 67 counties reported having a land use ordinance in effect for some or all four of the use categories.

Local Option Sales and Use Tax

Overview

Thirty-two states, including Virginia, allow a local option sales tax.

Virginia counties and cities were authorized to levy a 1% local option sales and use tax in 1969; the state tax was enacted in 1966. All counties and cities in the Commonwealth impose the 1% tax.

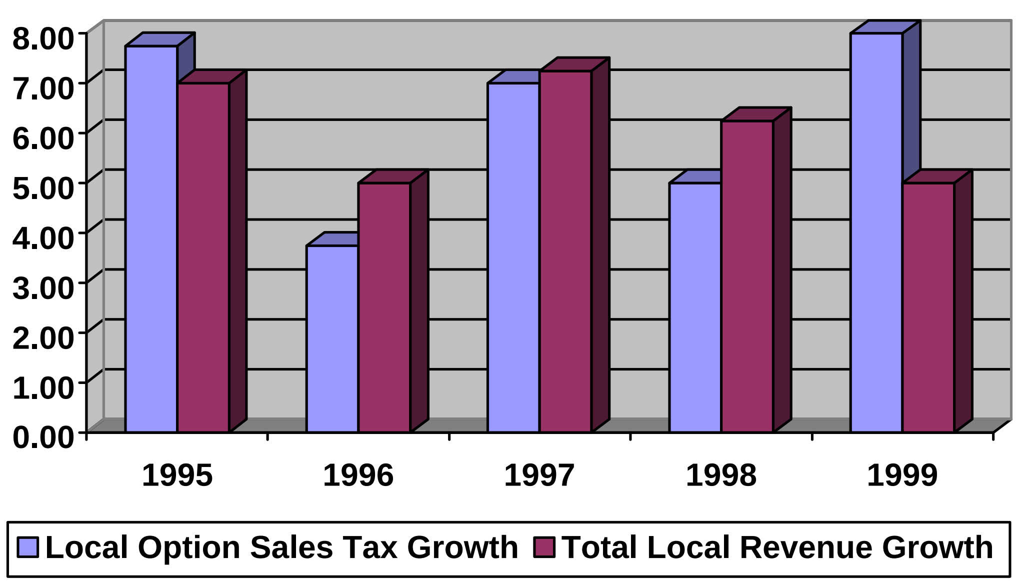
- The local sales tax revenue is collected by the Department of Taxation and distributed to the counties and cities based on the point of sale.

Local Option Sales Tax Revenue

The local option sales tax accounted for about 7.3% of local revenue in FY 1999 -- the third largest local tax revenue source.

Aggregate local sales tax revenue grew 32% between FY 1994 and FY 1999.

Local Sales Tax and Total Local Revenue Growth
FY 1994 - FY 1999



- In some years, sales tax growth outpaced total local revenues, in some years they lagged behind.

As with most local tax sources, there is variation among localities regarding sales tax -- in the amount of revenue collected and its proportion of total revenue collected.

- For cities, local sales tax revenue represented 8.3% of total local revenue in FY 1999.

- For counties, local sales tax revenue provided 6.8% of total local revenue in FY 1999.

Local Sales Tax Collections
(FY 1999, $ millions)

	Amount of Tax	Percent of Local Revenue
Cities	$ 277.3	8.3%
Counties	402.6	6.8
Towns(+3,500)	12.3	8.3
Total	692.2	7.3%

Local Sales Tax Trends Follow Those of the State

Three trends have narrowed the scope of the sales tax in the Commonwealth. These same trends affect the local sales tax.

1) Services, which are becoming an increasing majority of personal consumption, are largely exempt from the sales tax;

2) Catalog and Internet sales, which are largely untaxed, have continued to grow; and

3) An increasing number of both targeted and broad exemptions have been granted, especially in the last 8 to 10 years.

   -- In 1998, the Department of Taxation estimated that all sales and use tax exemptions together had an annual State revenue impact of about $3.6 billion. This impact would be an estimated $1.02 billion on localities.

Meals Tax

The meals tax is collected in conjunction with the sales tax at the local level only.

- In FY 1999, the meals tax generated $203 million in local revenue, making it the ninth largest source of revenue for localities.

According to § 58.1-3840 of the *Code of Virginia*, cities and towns may levy <u>an unrestricted meals tax</u> by ordinance under the "general taxing powers" found in their charters (§ 15.2-1104 of the *Code of Virginia*).

- All cities levy a meals tax.

- The average meals tax being charged in a city is 4.5%, with the range being from 2.0 to 6.5%.

Counties may levy a food and beverage tax (also called the meals tax) once approved by voter referendum, in accordance with § 58.1-3833 of the *Code of Virginia*. A referendum is required in all but 4 counties in which unanimous approval by their board of supervisors is required.

- The food and beverage tax may not exceed 4%.

- The tax may not be levied within the limits of an incorporated town unless the town grants the authority to the county.

- 30 of 95 counties have enacted a food and beverage tax, with all but 2 of the 30 imposing the maximum 4% rate.

Personal Property Tax

Introduction

- The Virginia Constitution lays out the principal framework for taxing personal property, requiring that:

  1. All property, including tangible personal property, shall be taxed unless specifically made exempt under the Virginia constitution.

     – Household goods, personal effects, and tangible farm property and products may be exempt from local taxation.

  2. Tangible personal property assessments shall be at fair market value.

  3. Tangible personal property is subject to local taxation only.

     – Since 1927, real estate and tangible personal property in Virginia have been segregated for local taxation.

  4. The General Assembly may create separate classifications of tangible personal property for rate purposes.

- Tangible personal property, as distinguished for tax purposes, is property that, by its location and character, shows that the owner intends it to be movable (i.e., it is not permanently affixed or attached to real estate).

- Tangible personal property is defined under the Code of Virginia to include nearly all tangible property. The major exception is merchants' inventory being held for sale, which is subject to a merchants' capital tax.

- Motor vehicles, travel trailers, boats, and airplanes are taxable in the locality where the vehicle is normally garaged, docked or parked. All other tangible personal property and merchants' capital is taxable in the locality in which it is physically located on the "tax day" (January 1 for most localities).

- Forty-two states tax tangible personal property.

  – 33 states exempt business inventories from property taxes.

  – 32 states exempt household items and personal effects -- Virginia provides a local option.

  – The tax on tangible personal property is one of the three basic state and local taxes which remain deductible from the federal income tax (state income, real estate, and tangible personal property taxes may be deducted).

Revenue from the Personal Property Tax

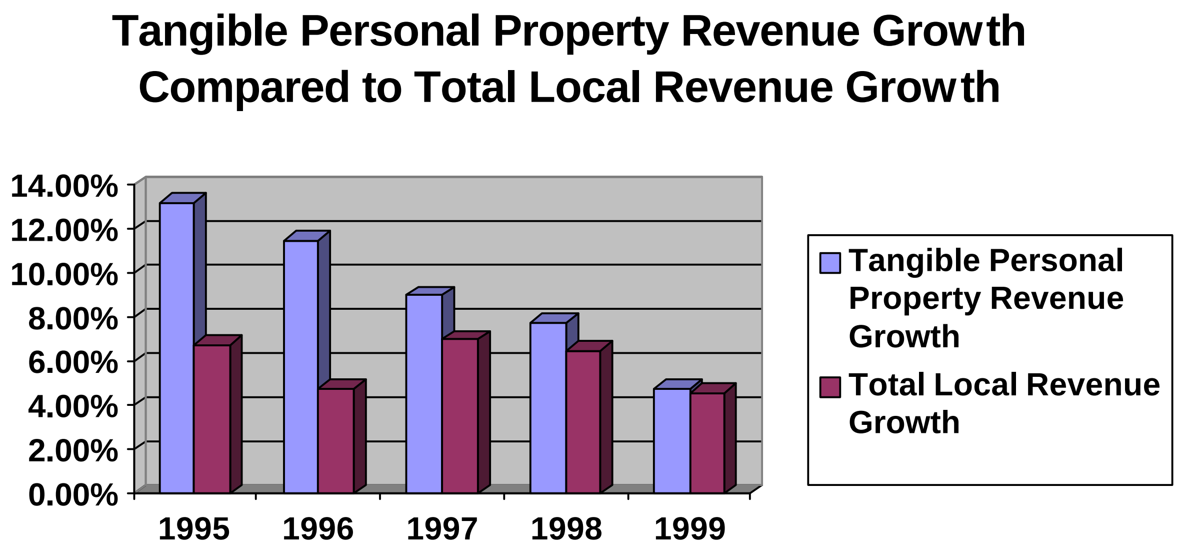
- The personal property tax is the second largest source of local source revenues after real estate, totaling over $1.4 billion in FY99.

  – It has comprised 14 to 15 percent of total local source revenues since FY94.

- Over the past 5 years, TPP revenue growth has generally grown more rapidly than other local revenue.

  – Increases in the effective tax rates on vehicles and car sales are primarily responsible.

– Each year, however, the growth gap has narrowed -- it disappeared almost entirely in FY99.



Assessing Personal Property

- The assessment of personal property is based on two components: the rate classification and the determined value of the property.

- In Virginia, 31 separate tangible personal property (TPP) rate classifications are authorized.

  – Localities have the option of providing a lower rate of taxation for each separate classification.

  – 20 classes are provided for different types of vehicles or drivers, ranging from aircraft, boats, campers to vehicles used by veterans, the physically handicapped, or those over the age of 65.

- The remaining classes are business focused with 3 being directed at businesses using or providing information technology (Appendix A).

• Once the property is classified, the value of the property for tax purposes must be established.

  - The local Commissioners of Revenue or other assessing official establishes the valuation methods for each class, with the approval of the local governing body.

  - Aircraft, tangible personal property used in a research and development business, and computer equipment and peripherals used in business are valued by taking a percentage or percentages of original cost.

  - Valuation methods and models must make provisions for obsolescence, including technological obsolescence.

• A 1995 survey by UVA's Weldon Cooper Center found that vehicles account for about 70 percent of tangible personal property tax in cities, 77 percent in counties, and 88 percent in towns.

• For vehicles, the assessing official must use a recognized pricing guide, or if a guide is not available for a vehicle, use a percentage of original cost to determine the value.

  - All localities in Virginia use NADA as their primary valuation guide for vehicles. Three possible pricing guide values can be used:

    Loan value (78%), used by 76 localities;

Trade-in value (86%), used by 37 localities; or

Retail value (100%), used by 22 localities

- In addition, localities have the option of reducing the tangible personal property tax on the vehicle by applying an assessment ratio of less than 100 percent to the vehicle value, before applying their tax rate.
  - In 2000, 20 counties and cities used assessment ratios to reduce the tangible personal property tax on vehicles.

<u>Rates of Taxation for Personal Property</u>

- There is no statutory limit on TPP tax rates.

- To compare TPP rates for vehicles, variation in local tax rates and assessment calculations must be standardized.
  - The Weldon Cooper Center calculates an adjusted effective tax rate for each locality based on the NADA retail value of a certain Toyota Camry.
  - An example of the results of this calculation is shown below.

Example of Rate & Assessment Differences -- Jan. 2000

	Arlington Co.	Harrisonburg	Madison Co.
Retail Value	$16,975	$16,975	$16,975
Basis of Assessment	Loan Value	Trade-in Value	Retail Value
Assessed Value	($13,241)	($14,599)	($16,975)
Assessment Ratio	100%	100%	20%
Nominal Tax Rate	4.4%	2.0%	8.7%
Tax Levy	$583	$292	$295
Effective Tax Rate	**$3.43**	**$1.72**	**$1.74**

- Overall, adjusted effective tax rates on vehicles increased somewhat from 1994 to 1997, but have remained flat since then.
  - TPP revenue has grown steadily.

Comparison of TPP Tax Rates & Revenue

	1994	1997	Change 94-97	1999	Change 97-99
Avg. Eff. Tax Rate					
Cities	$2.61	$2.75	5.4%	$2.76	0.4%
Counties	2.10	2.24	6.7%	2.22	-0.9%
TPP Revenue					
Cities	$288.5	$382.6	32.6%	$412.2	7.7%
Counties	635.2	884.6	39.3%	1,006.3	13.8%

- Localities may prorate the tangible personal property tax based on the number of months that the taxpayer resided in the locality.
  - The tax may be prorated for motor vehicles, trailers, semitrailers, and boats. Localities can also prorate the tangible personal property tax where a vehicle is traded-in for another vehicle.
  - 22 cities and 26 counties prorate the tangible personal property tax.
- Localities may apply a lower tax rate on motor vehicles of persons 65 or older or permanently and totally disabled who have an annual income less than $37,500 and a net worth less than $75,000 (a few localities have the authority use a lower tax rate if

annual income is less than $59,500 and net worth is less than $195,000).

- 5 cities and 6 counties apply a lower tax rate for the elderly.

- 6 cities and 11 counties apply a lower tax rate for the disabled.

Recent Changes in the Personal Property Tax

- In the last five years, the most significant change to the personal property tax in Virginia was the passage of the Personal Property Relief Act of 1998 (PPTRA).

  - 6 states took action in 1999 to adjust the rate of personal property taxation for vehicles or to provide a tax credit.

- PPTRA provides that the Commonwealth will pay an increasing share of the personal property tax levied on each qualifying vehicle, up to the maximum of $20,000 of assessed value.

  - PPTRA limits the reimbursement by the Commonwealth to the $20,000 multiplied by the effective tax rate in effect in the summer of 1997.

- The PPTRA changed the revenue source for localities for a portion of their TPP collections. The law did not limit:

  - the tax rate that could be charged;

  - the assessment method used; or

  - the utilization of an assessment ratio.

- A second change concerns rate classifications, which the General Assembly must authorize. Since 1979, the number of separate classifications has grown from 8 to 31.

- The third change involves the Department of Taxation in the administration of local taxes. In 1999, the General Assembly passed legislation allowing taxpayers to appeal local assessments on business tangible personal property, machinery and tools, and merchants' capital to the Department.

  – The appeal may include the value of the property as determined by the local assessing officer.

  – The appeals process is in lieu of filing suit in Circuit Court.

Appendix A

TPP Classifications for Local Rate Purposes

<u>Motor Vehicle Classifications</u>

– Boats or watercraft weighing 5 tons or more
– Boats or watercraft used for recreation
– Aircraft seating no more than 50
– All other aircraft and simulators
– Antique automobiles
– Vehicles without motive power (manufactured homes)
– Camping trailers
– Motor homes
– Certain vans used in ridesharing agreements
– Motor vehicles used to provide transportation to the physically disabled
– Motor vehicles owned or leased by volunteer rescue squads or volunteer fire departments
– Motor vehicles owned or leased by auxiliary volunteer rescue squads or volunteer fire department members
– Motor vehicles used by auxiliary police officers
– Motor vehicles used by a nonprofit organization to deliver meals to homebound persons or to provide transportation to senior or disabled citizens
– One motor vehicle owned and used regularly by disabled veterans
– Motor vehicles which use clean special fuels
– Motor vehicles owned or used by motor carriers
– One motor vehicle owned and used primarily by or for anyone at least 65 years of age or one permanently and totally disabled

<u>Other Classifications</u>

– Computer hardware used by businesses engaged in providing data processing services

- Tangible personal property (TPP) used by businesses providing Internet services
- Programmable computer equipment and peripherals employed in a trade or business
- Tangible personal property (TPP) used in research and development
- Heavy construction machinery
- Certain generating equipment for the purpose of changing the energy source of a manufacturing plant from oil or natural gas to any alternative source
- Wild or exotic animals kept for public exhibition in a federally licensed facility
- Furniture, office, and maintenance equipment of organizations maintaining open or common space in a planned development subdivision
- Business personal property used in manufacturing, testing, or operating satellites in a multi-county transportation improvement district
- TPP employed in a trade or business
- Forest harvesting and silvicultural activity equipment

Consumer Utility Taxes

- Consumer utility taxes are imposed by counties, cities, and towns for use or consumption of utility services. The tax is imposed on the user of the utility, which includes both individuals and businesses.
  - Rates generally are a percentage of each bill, although caps exist on the maximum that may be charged.
- Three different levies comprise the consumer utility taxes:
  - Telephone and telegraph taxes, which generally are based on user consumption.
  - The E-911 tax, which generally is a flat dollar tax unrelated to user consumption.
  - As of January 1, 2001, local taxes on heat and power (i.e., electricity and natural gas) are based on consumption or total usage.
- In FY99, 38 cities and 84 counties levied and collected telephone and telegraph and heat and power taxes. 118 localities levied and collected E-911 taxes.
- All three consumer utility taxes are collected by service providers on behalf of local governments.

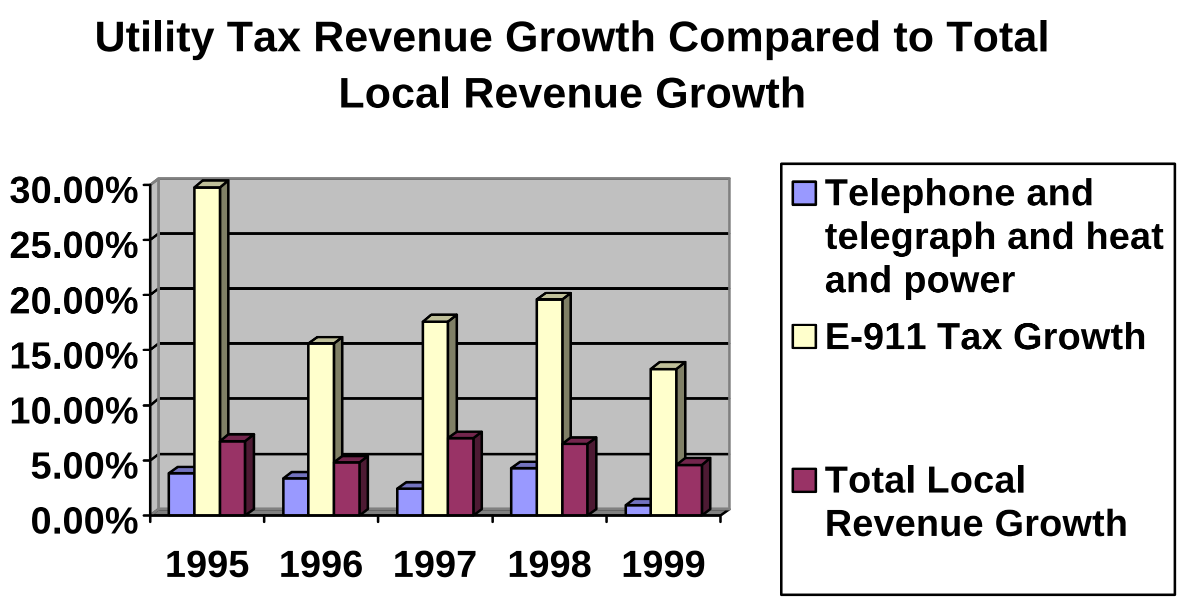
Revenues from Consumer Utility Taxes

- In FY99, local governments collected $465.1 million from consumer utility taxes.

  – Of this total, E-911 tax collections accounted for $71.9 million.

- Consumer utility taxes were the fourth largest source of local source revenues, accounting for approximately 4.9% of local source revenues.

- Between FY96 and FY99, E-911 tax revenues grew at a much faster pace than other utility tax revenues and total local revenues. In FY00, E-911 revenues and total local revenues both grew about 5.5%.



Maximum Tax Rates

- The maximum statutory tax rate and the tax base for each consumer utility tax is as follows:

Tax	Base	Maximum Amount
Telephone and Telegraph	Consumption	$3 per month; cap does not apply to businesses
E-911	Flat	$3 per month; cap applies to businesses as well as residential consumers (2000 legislation)
Electricity and Natural Gas	Consumption	$3 per month; cap does not apply to businesses

- Localities that assessed consumer utility taxes at rates above the maximum statutory rates as of July 1, 1972 are grandfathered to charge these higher rates. As a result:
  - 22 localities may charge more than $3 dollars per month for local telephone service consumption.
  - 25 localities may charge more than $3 dollars per month for electricity or natural gas consumption.

Telephone and Telegraph Taxes

- The tax on telephone and telegraph usage may be imposed only on purchases of <u>local</u> telephone service.

- Counties may not impose a tax on telephone and telegraph usage within a town if the town imposes the same taxes.

<u>E-911 Tax</u>

- The E-911 tax was changed during the 2000 Session.

  - A $3 per month maximum rate was enacted. Prior to this limit, localities could set the tax rates at a level to offset loosely defined recurring maintenance, repair, and system upgrade costs, as well as salaries of E-911 program directors and dispatchers.

  - Limits were placed on what E-911 tax revenues could be used for because of concerns that (i) the tax was being imposed but E-911 service was not being provided, and (ii) E-911 revenues were being used to pay for general government operations.

<u>Electricity and Natural Gas Taxes</u>

- As a result of deregulation of the electricity industry (1999) and the natural gas industry (2000), taxes on electricity and natural gas are now based on consumption or usage (effective January 1, 2001).

  - Localities are required to convert to kilowatt hour tax rates (electricity) and CCF tax rates (natural gas) and must set their new tax rates so as to initially maintain current annual revenues.

    - The new tax rates may not result in a tax greater than $3 per month. This is the same cap that was in effect prior to deregulation.

- Counties may not impose a tax on electricity and natural gas consumption within a town if the town imposes the same taxes.

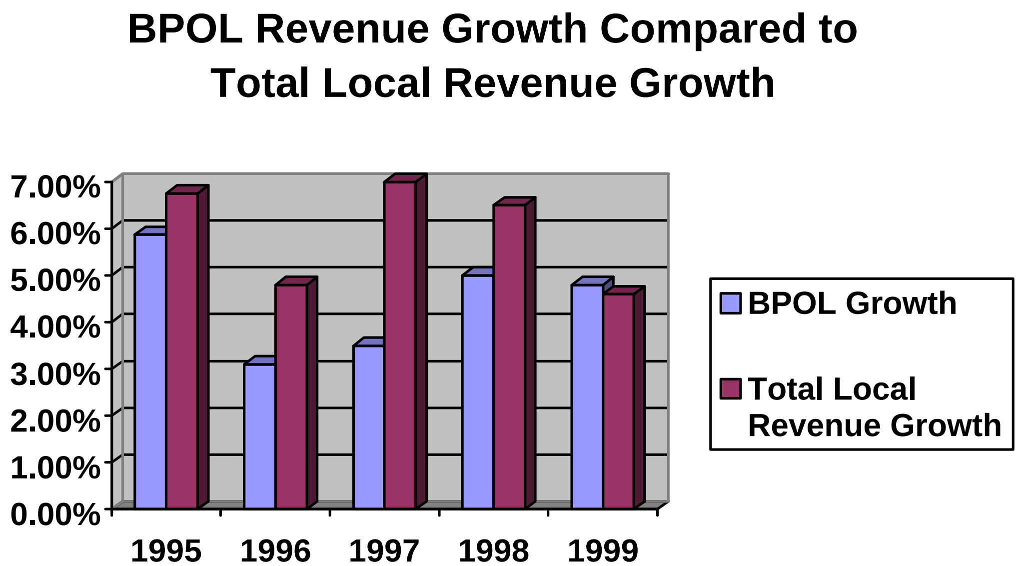
Business, Professional and Occupational License Tax (BPOL Tax)

Introduction

- The BPOL tax is a privilege or a license tax assessed by counties, cities, and towns upon Virginia businesses.
  - Businesses cannot operate without first obtaining a BPOL license.
  - The tax is imposed on "lines of business" (e.g. retailing activity and services performed by a business).
    - A business with multiple lines of business may be required to obtain a license for each line of business.
- Fifty-four counties and all 40 cities impose BPOL.
- The state BPOL tax was repealed in 1982.

Revenue from the BPOL Tax

- In FY99, local governments collected $385.1 million from BPOL taxes.
  - BPOL taxes were the fifth largest source of local source revenues, accounting for approximately 4.1% of local source revenues.
- Until FY00, BPOL revenues grew at a slower pace than total local revenues.



- The average annual growth in BPOL tax revenues between FY94 and FY99 for all local governments was 4.5%.

Maximum Tax Rates

- There are 5 major "lines of business" or activities to which the BPOL tax applies. These lines of business and the applicable maximum tax rates are:

Line of Business	Tax Rate
Wholesalers	$.05 per $100 of purchases
Construction Contractors	$.16 per $100 of gross receipts
Retailers	$.20 per $100 of gross receipts

Repair, Personal, and Business Services Providers	$.36 per $100 of gross receipts
Financial, Real Estate, and Professional Services Providers	$.58 per $100 of gross receipts

– These tax rates generally are applied to "gross receipts," which has been interpreted by the courts to mean gross sales or gross income in the case of services.

– The current maximum tax rates have been in effect since 1978.

- Approximately two-thirds (64.9%) of the 94 counties and cities that imposed a BPOL tax in FY99 imposed the tax at rates below the maximum rates authorized by law.

- Small businesses pay a flat fee instead of the gross receipts tax.

  – The maximum annual fee depends on the locality's population, but cannot be greater than $50.

Recent General Assembly Legislation

- In 1996, the General Assembly amended the BPOL statutes by adding several new definitions, including certain conditions which must exist before BPOL taxes may be imposed.

- In 1997, the General Assembly authorized the Department of Taxation to hear and rule on taxpayer appeals of local BPOL assessments.

- The taxpayer or the local governing body may appeal the Tax Commissioner's ruling to the circuit court.

- In 1999, the General Assembly expanded the appeals process to include tangible personal property taxes on businesses, machinery and tools tax, and merchants' capital tax.

- The Department has ruled on approximately 42 appeals and has issued an additional 193 advisory opinions.

• In recent years, the General Assembly has enacted several changes to the BPOL tax which potentially change its "gross receipts" nature. Examples include:

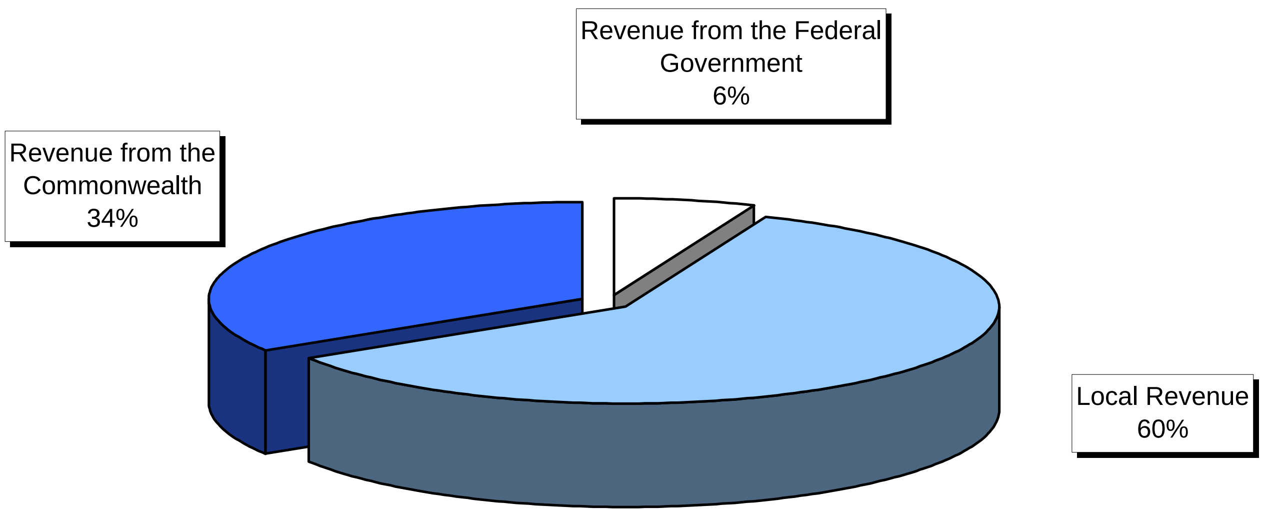
  - Providers of funeral services are allowed to deduct goods or services purchased on behalf of customers from their gross receipts (1998).

  - Providers of professional employer organizations are allowed to deduct certain employee benefit expenses from their gross receipts (1998).

  - Merchants can deduct sales returns and allowances from gross receipts (1996).

  - Charitable nonprofit organizations are exempt from the tax (1996).

Sources of Revenue For All Localities in Virginia
For the Year Ended June 30, 2000



Source: Auditor of Public Accounts, Comparative Report of Local Government Revenues and Expenditures, Year Ended June 30, 2000