A Legislator's Guide to Taxation in Virginia

Volume 1: State Taxes

Revised 2010

Virginia Division of Legislative Services

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Published by the Division of Legislative Services

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January 2010

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Introduction

Introduction

THE art of taxation consists in so plucking
the goose as to obtain the largest amount of feathers with
the least amount of hissing.

Jean-Baptiste Colbert

A Guide to This Volume

The power to tax has been exercised in the Commonwealth of Virginia since the poll tax (four pounds of tobacco) in 1639. A glance at the number of chapters in this volume should demonstrate that taxation has grown substantially since the residents of Middlesex County, in 1912, submitted a total of $30 in individual income taxes.

This report examines (i) the major general fund taxes administered by the Virginia Department of Taxation; (ii) the gross receipts premium tax imposed on insurance companies; (iii) the electric utility and natural gas consumption taxes, all of which are administered by the State Corporation Commission; (iv) the motor fuels and titling taxes administered by the Department of Motor Vehicles; and (v) the cigarette tax. The goal is to provide legislators with an easy reference to the major taxes imposed by the Commonwealth. These taxes constitute the vast majority of the Commonwealth's tax revenues.

Each of the following 13 chapters is devoted to a particular tax and most are organized as follows: (i) a brief history of the tax; (ii) a description of the current structure of the tax; (iii) a discussion of how the tax is administered; (iv) the importance of the tax to the Commonwealth's revenue stream; (v) a comparison with other states; (vi) a discussion of issues that are likely to be raised in the future regarding the tax; and (vii) a brief summary. Chapter 10 examines current enforcement and collection procedures for the taxes administered by the Department of Taxation.

Virginia is a relatively large and wealthy state with a variety of taxes used to finance the essential functions of state government. This guide is an attempt to provide a clear, organized, and concise explanation of Virginia's major taxes to assist the legislator in dealing with the complex taxation issues facing the Commonwealth now and in the future.

Overview of Virginia Taxation

Population

Virginia's population, according to the 2007 estimates of the U.S. Census Bureau, was 7,712,000, which placed Virginia 12th in the country by population, the same ranking as in 1990. Table 1 provides a listing of the top 20 most populous states based on the 2007 estimates of the U.S. Census. Of the other southern states, Texas is second, Florida is fourth, Georgia and North Carolina are ranked 9th and 10th respectively, Tennessee is 17th, and Maryland is 19th.

TABLE 1

2007 U.S. Resident Population, by State

Rank	State	2007 Population
1	California	36,553,000
2	Texas	23,904,000
3	New York	19,298,000
4	Florida	18,251,000
5	Illinois	12,853,000
6	Pennsylvania	12,433,000
7	Ohio	11,467,000
8	Michigan	10,072,000
9	Georgia	9,545,000
10	North Carolina	9,061,000
11	New Jersey	8,686,000
12	**VIRGINIA**	**7,712,000**
13	Washington	6,468,000
14	Massachusetts	6,450,000
15	Indiana	6,345,000
16	Arizona	6,339,000
17	Tennessee	6,157,000
18	Missouri	5,878,000
19	Maryland	5,618,000
20	Wisconsin	5,602,000

SOURCE: U.S. Census Bureau, *Statistical Abstract of the United States: 2009.*

Personal Income

Not only is Virginia a relatively populous state, but also a relatively wealthy one. Based on the latest estimates by the U.S. Department of Commerce, Virginia has the 10th highest personal income in the country. As Table 2 shows, Virginia's total personal income is well ahead of all the southern states, with the exception of Texas and Florida, which have the second and fourth highest personal income in the U.S. During this decade, Virginia surpassed Georgia, which had been ranked ahead of Virginia in 2000.

After adjusting personal income for population, Virginia has the eighth highest per capita income in the country and the highest such income of any state in the South except for Maryland, which is fifth. Virginia's per capita income ranks ahead of California and ahead of many other large states. Two states, Wyoming and Alaska, rank ahead of Virginia due to their dependence on and the price of oil and other natural resources, which can fluctuate greatly from year to year.

TABLE 2
Top 20 States in Personal Income and Personal Income Per Capita -- 2008

Personal Income (Millions of Dollars)			Personal Income Per Capita		
Rank	State	Amount	Rank	State	Amount
1	California	$1,569,370	1	Connecticut	$56,248
2	Texas	$ 938,406	2	New Jersey	$50,919
3	New York	$ 937,010	3	Massachusetts	$50,735
4	Florida	$ 716,089	4	Wyoming	$49,719
5	Illinois	$ 546,985	5	Maryland	$48,091
6	Pennsylvania	$ 501,225	6	New York	$48,076
7	New Jersey	$ 442,116	7	Alaska	$43,321
8	Ohio	$ 407,874	**8**	**VIRGINIA**	**$42,876**
9	Michigan	$ 353,113	9	New Hampshire	$42,830
10	**VIRGINIA**	**$ 333,110**	10	Minnesota	$42,772
11	Massachusetts	$ 329,673	11	California	$42,696
12	Georgia	$ 329,071	12	Illinois	$42,397
13	North Carolina	$ 317,613	13	Colorado	$42,377
14	Washington	$ 277,397	14	Washington	$42,356
15	Maryland	$ 270,924	15	Rhode Island	$41,008
16	Minnesota	$ 223,288	16	Delaware	$40,852
17	Indiana	$ 217,467	17	Hawaii	$40,490
18	Arizona	$ 214,203	18	Nevada	$40,353
19	Tennessee	$ 213,359	19	Pennsylvania	$40,265
20	Wisconsin	$ 209,999	20	North Dakota	$39,321

SOURCE: Bureau of Economic Analysis, U.S. Department of Commerce, "Survey of Current Business, April 2009."

State Gross Domestic Product

Another measure of the size of a state's economy is a state's gross domestic product, which is defined as the value of all goods and services produced in a state. According to the Bureau of Economic Analysis of the U.S. Department of Commerce, Virginia has the 11th largest economy of the 50 states. California has the largest gross domestic product, 50 percent more than the second ranked state-Texas. In terms of other southern states, Florida is ranked fourth while North Carolina and Georgia ranked 9th and 10th, respectively.

TABLE 3
State Gross Domestic Product (GDP)
By State, 2008
(Millions of Dollars)

Rank	State	Gross Domestic Product
1	California	$ 1,846,757
2	Texas	$ 1,223,511
3	New York	$ 1,144,481
4	Florida	$ 744,120
5	Illinois	$ 633,697
6	Pennsylvania	$ 553,301
7	New Jersey	$ 474,936
8	Ohio	$ 471,508
9	North Carolina	$ 400,192
10	Georgia	$ 397,756
11	**VIRGINIA**	**$ 397,025**
12	Michigan	$ 382,544
13	Massachusetts	$ 364,988
14	Washington	$ 322,778
15	Maryland	$ 273,333
16	Minnesota	$ 262,847
17	Indiana	$ 254,861
18	Tennessee	$ 252,127
19	Arizona	$ 248,888
20	Colorado	$ 248,603
	U.S. TOTAL	**$14,165,565**

SOURCE: Bureau of Economic Analysis, U.S. Department of Commerce, "Survey of Current Business, June 2009."

General Fund

To finance the goods and services provided by the Commonwealth in the current 2008-2010 biennium, Virginia will spend approximately $77.1 billion, of which the general fund makes up approximately 41.2 percent. The remaining funds will be generated from nongeneral fund taxes, fees and charges, and federal reimbursements and payments. The Commonwealth collected $14,315,060,000 from general fund sources in fiscal year 2009, a 9.2 percent decrease over the previous year.

Table 4 shows the relative importance of the Virginia's individual income tax and sales and use tax to the general fund. These two sources alone constituted 86.5 percent of the general fund, and combined with the next two largest sources of tax revenue (corporate income and recordation taxes) comprise 93.2 percent of the total general fund. A number of other sources generated large amounts of revenue, but in comparison to the total general fund, yielded a relatively small percentage of the total, and none contributing more than two percent of the general fund.

TABLE 4
General Fund Revenue Sources

Source	FY 2009 Collections	% of Total	Cumulative %
Taxes:			
Individual Income	9,481,110,000	66.2%	66.2%
Sales and Use	2,903,443,000	20.3%	86.5%
Corporate Income	648,033,000	4.5%	91.0%
Recordation	314,264,000	2.2%	93.2%
Insurance Premiums	255,019,000	1.8%	95.0%
Alcoholic Beverage Sales	173,227,000	1.2%	96.2%
Public Service Corporations	91,340,000	0.6%	96.8%
Bank Franchise	22,461,000	0.2%	97.0%
Estate and Gift	6,006,000	0.1%	97.1%
Other Taxes	5,769,000	0.0%	97.1%
Total Taxes	**13,900,672,000**	**97.1%**	
Other Revenues			
Fines, Forfeitures & Fees	215,308,000	1.5%	98.6%
Interest	104,217,000	0.7%	99.3%
Rights and Privileges	67,426,000	0.5%	99.8%
Other Revenue	27,437,000	0.2%	100.0
Total Other Revenue	**414,388,000**	**2.9%**	**100.0**
Total General Fund:	**14,315,060,000**		

SOURCE: Department of Accounts, Commonwealth of Virginia.

Virginia's growth in population and personal income during the past decade is reflected in its collections of general fund revenue, which has increased approximately 33.5 percent since 2000 (see Table 5). This time span reflects three very distinct periods of growth or lack thereof. With the mild recession of 2000 and 2001, general fund revenues were relatively flat from 2000 to 2003. During this period, general fund revenues increased by only 1.4 percent. In the next period (2004 through 2006), the Virginia and U.S. economies experienced solid growth with average general fund growth rates increasing at double-digit levels. The period since 2007 has been the exact opposite. As the U.S. and Virginia sank into the worst economic conditions since the Great Depression, the growth rates also sank to 4.9 percent for fiscal year 2007, to 1.3 percent in fiscal year 2008, and to -9.2 percent for fiscal year 2009. General fund collections for fiscal year 2009 were below general fund collections in fiscal year 2006 by over $500 million.

TABLE 5
Virginia General Fund Revenues, Fiscal Years 2000 - 2009
(Thousands of Dollars)

Fiscal Year	Revenues	% Change
2000	$10,721,543	+10.5%
2001	$11,105,275	+2.9%
2002	$10,678,954	-3.8%
2003	$10,867,149	+1.8%
2004	$11,917,867	+9.7%
2005	$13,687,252	+14.8%
2006	$14,834,298	+8.4%
2007	$15,565,827	+4.9%
2008	$15,766,951	+1.3%
2009	$14,315,060	-9.2%

SOURCE: Department of Accounts, Commonwealth of Virginia.

TABLE 6
State Tax Collections, Per Capita and as a Percent of State Personal Income, 2008

State	State Tax Collections Per Capita	Rank	1999 Rank	State Tax Collections, as a % of Income	Rank	1999 Rank
Alabama	$ 1,946	42	45	6.0%	39	34
Alaska	$12,276	1	44	30.9%	1	46
Arizona	$ 2,109	39	38	6.6%	34	32
Arkansas	$ 2,637	19	19	8.8%	7	7
California	$ 3,193	12	8	7.7%	14	16
Colorado	$ 1,949	41	43	4.8%	48	49
Connecticut	$ 3,818	5	1	7.0%	26	12
Delaware	$ 3,357	10	2	8.5%	10	3
Florida	$ 1,956	40	39	5.1%	46	43
Georgia	$ 1,877	45	36	5.7%	42	38
Hawaii	$ 3,996	4	3	10.3%	3	1
Idaho	$ 2,397	28	25	7.7%	16	14
Illinois	$ 2,472	26	22	6.1%	38	44
Indiana	$ 2,339	33	21	7.1%	24	21
Iowa	$ 2,295	36	29	6.6%	32	23
Kansas	$ 2,555	22	26	7.1%	25	26
Kentucky	$ 2,356	30	17	7.7%	15	11
Louisiana	$ 2,495	24	46	7.2%	21	33
Maine	$ 2,797	15	12	8.2%	11	8
Maryland	$ 2,948	13	18	6.4%	36	42
Massachusetts	$ 3,360	9	5	6.9%	27	22
Michigan	$ 2,477	25	6	7.2%	22	5
Minnesota	$ 3,509	8	4	8.6%	9	4
Mississippi	$ 2,252	37	32	7.9%	12	10
Missouri	$ 1,855	47	40	5.5%	45	35
Montana	$ 2,541	23	41	7.7%	13	20
Nebraska	$ 2,341	32	37	6.5%	35	39
Nevada	$ 2,352	31	15	6.0%	40	31
New Hampshire	$ 1,711	49	50	4.1%	50	50
New Jersey	$ 3,526	7	11	7.1%	23	40
New Mexico	$ 2,860	14	13	9.4%	5	2
New York	$ 3,356	11	10	7.3%	20	30
North Carolina	$ 2,470	27	16	7.5%	17	17
North Dakota	$ 3,604	6	23	10.0%	4	13
Ohio	$ 2,296	35	33	6.7%	31	36
Oklahoma	$ 2,329	34	34	6.7%	29	18
Oregon	$ 1,913	43	35	5.5%	44	37
Pennsylvania	$ 2,581	21	20	6.7%	30	29
Rhode Island	$ 2,628	20	14	6.6%	33	27
South Carolina	$ 1,887	44	42	6.2%	37	28
South Dakota	$ 1,643	50	49	4.6%	49	48
Tennessee	$ 1,857	46	47	5.6%	43	45
Texas	$ 1,836	48	48	5.1%	47	47
Utah	$ 2,172	38	27	7.5%	18	15
Vermont	$ 4,095	2	28	10.9%	2	24
Virginia	**$ 2,369**	**29**	**31**	**5.7%**	**41**	**41**
Washington	$ 2,740	16	9	6.8%	28	19
West Virginia	$ 2,689	17	24	9.2%	6	6
Wisconsin	$ 2,681	18	7	7.4%	19	9
Wyoming	$ 4,070	3	30	8.8%	8	25
U.S.	**$ 2,575**			**6.7%**		

SOURCE: Bureau of Economic Analysis, U.S. Department of Commerce and U.S. Bureau of the Census.

Comparison with Other States

Table 6 provides total state tax collections for 2008 adjusted by population and personal income. It should be noted that these rankings generally should be used with extreme caution for a number of reasons. The first is a state's mix of state and local taxes and vice versa. In some states, local governments pay for services that are provided by state governments in other states. Another reason for caution is a state's mix between taxes and the increasing use of user fees and charges. Finally, it is important to keep in mind that, in many cases, taxes are paid in one state, but the burden is shifted to the citizens of another through higher consumer prices. In the state of Alaska, for example, severance taxes equaled over 82 percent of the total state taxes in 2008 (or $10,111 per resident), but it is incorrect to assume that residents of Alaska pay such high state taxes, because a large portion of the severance tax is exported. In fact, Alaska citizens receive rebate checks from oil severance and royalty revenues.

Table 6 shows that the average Virginia resident paid $2,369 in state taxes in 2008, representing general fund and nongeneral fund sources, well below the U.S. average of $2,575. Virginia ranked 29th among the 50 states in this measure in 2008.

TABLE 7
State Tax Burden (Selected States) -- 2008
Per Capita and as Percent of Personal Income

State	Per Capita	Rank	% Personal Income	Rank
Kentucky	$2,356	30	7.7%	15
Maryland	$2,948	13	6.4%	36
North Carolina	$2,470	27	7.5%	17
Tennessee	$1,857	46	5.6%	43
VIRGINIA	**$2,369**	**29**	**5.7%**	**41**
West Virginia	$2,689	17	9.2%	6

SOURCE: Bureau of Economic Analysis, U.S. Department of Commerce and U.S. Bureau of the Census.

Tax Burden

Another method used to calculate tax burden is to adjust tax collections by personal income. State taxes in Virginia equaled 5.7 percent of personal income in 2008, which ranked Virginia 41st out of the 50 states. The average state's taxes equaled 6.7 percent of personal income, or a full percentage point higher than Virginia's. Thus, when ability to pay is factored in, Virginia's tax burden relative to other states is quite low.

In comparison with neighboring states (Table 7), Virginia's state taxes per capita are relatively low. Maryland, North Carolina, and West Virginia have higher state tax per capita. Kentucky and Tennessee are ranked lower. A comparison of state taxes as a percentage of personal income shows that Virginia has an even more favorable tax ranking. Virginia is ranked 41st, and of neighboring states, only Tennessee (43rd) has a lower tax burden than Virginia.

Because different levels of government fund different services in other states, Table 8 provides state and local taxes both per capita and as a percentage of personal income. The average Virginian paid $3,940 in state and local taxes in 2006. This compares with a U.S.

average of $4,006. Virginia was ranked 19th. As a percentage of income, state and local taxes equaled 9.8 percent of personal income. This was well below the U.S. average of 10.9 percent. Virginia ranked 41st among the states. Table 9 compares Virginia with neighboring states. Virginia and its neighboring states rank low relative to all other states in state and local taxes per capita. Virginia's relatively low state and local tax burden is even clearer when adjusted by personal income. Virginia and Tennessee are ranked in the bottom 10 states in state and local taxes adjusted by personal income.

TABLE 8
State and Local Tax Collections, Per Capita and as a Percentage of Personal Income, 2006

State	State and Local Taxes Per Capita	Rank	State and Local Taxes as a % of Income	Rank
Alabama	$2,783	50	9.0%	47
Alaska	$5,419	5	14.1%	2
Arizona	$3,228	39	10.0%	38
Arkansas	$3,119	44	11.0	19
California	$4,533	9	11.3%	16
Colorado	$3,625	28	9.2%	45
Connecticut	$5,697	3	11.0%	19
Delaware	$4,255	14	10.9%	23
Florida	$3,701	26	10.0%	38
Georgia	$3,329	35	10.3%	32
Hawaii	$4,861	6	13.1%	5
Idaho	$3,081	45	10.1%	36
Illinois	$4,087	15	10.6%	27
Indiana	$3,646	27	11.4%	14
Iowa	$3,457	31	10.6%	27
Kansas	$3,792	22	11.0%	19
Kentucky	$3,229	38	10.9%	23
Louisiana	$3,705	25	11.3%	16
Maine	$4,420	11	13.7%	4
Maryland	$4,603	8	10.5%	29
Massachusetts	$4,755	7	10.3%	32
Michigan	$3,572	30	10.8%	25
Minnesota	$4,373	13	11.2%	18
Mississippi	$2,824	49	10.4%	31
Missouri	$3,139	43	9.7%	42
Montana	$3,194	41	10.3%	32
Nebraska	$3,906	21	11.5%	12
Nevada	$3,930	20	10.1%	36
New Hampshire	$3,451	32	8.7%	50
New Jersey	$5,475	4	11.7%	8
New Mexico	$3,599	29	12.3%	7
New York	$6,385	1	14.6%	1
North Carolina	$3,393	33	10.5%	29
North Dakota	$3,720	24	11.5%	12
Ohio	$3,774	23	11.4%	14
Oklahoma	$3,155	42	9.6%	43
Oregon	$3,369	34	10.0%	38
Pennsylvania	$3,960	17	10.8%	25
Rhode Island	$4,419	12	11.7%	8

TABLE 8 (con't)
State and Local Tax Collections, Per Capita and as a Percentage of Personal Income, 2006

State	State and Local Taxes Per Capita	Rank	State and Local Taxes as a % of Income	Rank
South Carolina	$2,877	46	9.6%	43
South Dakota	$2,846	47	8.8%	48
Tennessee	$2,841	48	8.8%	48
Texas	$3,241	37	9.2%	45
Utah	$3,204	40	11.0%	19
Vermont	$4,439	10	12.6%	6
Virginia	**$3,940**	**19**	**9.8%**	**41**
Washington	$3,957	18	10.2%	35
West Virginia	$3,256	36	11.7%	8
Wisconsin	$4,005	16	11.6%	11
Wyoming	$6,118	2	14.1%	2
U.S. AVG.	**$4,006**		**10.9%**	

SOURCE: Bureau of Economic Analysis, U.S. Department of Commerce and the U.S. Bureau of the Census

TABLE 9
State and Local Tax Burden (Selected States)--2006 Per Capita and as a Percent of Personal Income

State	Per Capita	Rank	% Personal Income	Rank
Kentucky	$3,229	38	10.9%	23
Maryland	$4,603	8	10.5%	29
North Carolina	$3,393	33	10.5%	29
Tennessee	$2,841	48	8.8%	48
VIRGINIA	**$3,940**	**19**	**9.8%**	**41**
West Virginia	$3,256	36	11.7%	8

SOURCE: Bureau of Economic Analysis, U.S. Department of Commerce and U.S. Bureau of the Census.

Summary

Virginia has a relatively large population that has grown rapidly during the past few decades, making it the 12th most populous state. Virginia has the 10th largest amount of aggregate personal income among the states and the eighth largest amount of per capita personal income. Compared to the other states in the South, only Maryland has a higher amount of per capita personal income. In terms of gross domestic product, Virginia is ranked 11th.

General fund taxes comprise 41 percent of the Commonwealth's $77.1 billion biennial budget for 2008-10. The individual income tax and the sales and use tax comprise in excess of 86 percent of total general fund revenue. Virginia has a relatively low state tax burden, especially when compared to neighboring states. On a per capita basis, Virginia ranked 29th among the 50 states. When state taxes are adjusted by personal income, that is, by ability to pay, Virginia was ranked 41st. In short, despite different periods of growth and recession during the past decade, the Commonwealth's tax burden on its citizens has remained relatively low compared to other states.

Individual Income Tax

Individual Income Tax

History

Virginia enacted an individual income tax in 1843. The tax and collection practices have since changed; the inclinations of many taxpayers have not. One observer has noted that the individual income tax had "always been 'a tax on the honesty of the citizens' -- or if put more justly and more exactly, a tax on the conception of honesty as existing in the community." Because "it may not be the custom of [the] community to obey the law in this particular at all," for in 1912, Middlesex County, along with 14 other counties, claimed no resident admitting an annual income of more than $2,000, which just happened to be the exemption limit. Shenandoah County residents, either more honest or less wily, remitted a total of $30 to the Commonwealth in income taxes for that same year.[1]

Despite the vagaries of individual and community conscience, the individual income tax originated as and remains not only a source for increased government revenue, but an attempt to create a system of taxation whereby those most able to bear the cost of government pay the greatest share for the services provided by government.

From its inception in 1843, the Virginia individual income tax has undergone three major changes, all to expand Virginia's tax base and thereby increase its revenues. Prior to 1843, taxes, in the form of tangible property taxes, fell most heavily on eastern Virginia planters, who also controlled the legislature, and "the income tax appealed to them, in the dire need for more money with which to carry on the continually expanding system of internal improvements, as a tax which would not burden them, but which would cause the nonpropertied wage-earners and salaried individuals, to bear a share of the burden."[2] Hence, before the constitutional convention of 1850-51, the legislature imposed a uniform tax of one percent on the incomes of a growing class of salaried workers and wage earners whose annual incomes exceeded $400, and a 2.5 percent tax on interest on investments belonging to another growing class, the "capitalists." This powerful new group initiated the first change to the individual income tax: it opposed the tax so successfully that by 1850 the tax was levied only on "salaries."

By 1851, the date of the constitutional convention, reapportionment of the legislature based upon white male suffrage had shifted political and economic control from eastern to western Virginia and from "the plantation owner to the small farmer."[3] As a result of the power shift, the legislature introduced a graduated income tax schedule that exempted "all laborers engaged in mechanic arts, trade, handicraft or manufacture, and ministers of the gospel,"[4] but taxed all other incomes, regardless of their size. For example, incomes below $250 annually were taxed at 0.25 percent and interest from stock at 3.33 percent. Regardless of reforms, however, Virginia income tax revenues for 1855 reached only $19,188.

Between 1860 and 1863, income tax revenues proved insufficient to meet the financial demands of waging war. The legislature abandoned the graduated tax scale, taxed incomes over $500 at 2.5 percent, and taxed interest at 17 percent. The flat rate system of taxation remained in effect after the Civil War and was incorporated into the 1869 Underwood Constitution, which taxed incomes exceeding $600. Until the enactment of the federal income tax provisions in 1913, individual income taxation changed little, with only periodic fluctuations in taxable income levels and taxation percentages. In 1912, Virginia realized only $102,678 in individual income tax revenues, "just enough" for Virginia "to be unwilling to do away with it, and not enough to render it an important enough source of revenue to become an object of serious reform."[5]

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[1] Sydenstricker, Edgar. *A Brief History of Taxation in Virginia.* Richmond: The Legislative Reference Bureau of Virginia, 1915, pp. 52-53.
[2] *Id*.
[3] *Id.*, p. 50.
[4] *Id.*
[5] *Id.*, p. 53.

The two most significant developments surrounding the income tax since its inception were the movement in 1870 to define income as "all income" (from whatever source derived) and the relative importance the tax now plays in the overall funding for state government.

From these modest beginnings, the Virginia individual income tax has grown and will continue to be the single most important source of general fund revenue to the Commonwealth. In fiscal year 2009, the Commonwealth collected $9.5 billion in individual income tax revenue, which comprised 66.2 percent of the Commonwealth's general fund. To place this amount in perspective, the individual and corporate income taxes and the sales and use tax comprise more than 91.0 percent of the total general fund, and the income taxes generate almost three and one-half times the revenue of the sales and use tax.

Until the 1989 Session, the individual income tax had been segregated for state taxation only. However, legislation passed during the 1989 Session authorizes the Northern Virginia localities, as well as the Cities of Norfolk and Virginia Beach, to impose a local income tax of up to one percent for transportation purposes, if such local tax was approved at a referendum. The tax would expire five years after its enactment.[6] At this time, no locality has placed this tax on the ballot.

The Commonwealth's individual income tax revenues have grown more rapidly during the past decade than any other tax, because the income tax captures the income resulting from real economic growth, population growth, and inflation, at a somewhat progressive tax rate. In fiscal year 1999, the individual income tax comprised 62.7 percent of the general fund; 10 years later, it comprised 66.2 percent. Despite the impressive growth in individual income tax revenues, these revenues declined sharply (by 6.3 percent) in fiscal year 2009, reflecting the deep recession that the Commonwealth was mired in during that time frame. (See Table 1)

TABLE 1
Individual Income Tax Revenues
Fiscal Years 2000 - 2009
(in thousands)

Fiscal Year Ending June 30	Tax	% Increase Over Previous Year
2000	$6,828,907	12.2%
2001	$7,226,309	5.8%
2002	$6,710,772	-7.1%
2003	$6,775,746	1.0%
2004	$7,384,888	9.0%
2005	$8,352,366	13.1%
2006	$9,308,570	11.4%
2007	$9,787,592	5.1%
2008	$10,114,833	3.3%
2009	$9,481,110	-6.3%

SOURCE: Department of Accounts, *Summary Report on General Fund and Lottery Revenue Collections (2000-2009).*

[6] Chapter 245, 1989 Acts of Assembly.

As a result of legislation enacted by the 1971 Session of the General Assembly, Virginia conformed its income tax law, in large part, to the federal individual income tax structure.[7] Conformity was adopted on the recommendations of the Virginia Income Tax Study Commission to the 1968 Session and the Income Tax Conformity Statute Study Commission to the 1971 Session. Both commissions reasoned that conformity would benefit the taxpayer as well as the Commonwealth by establishing a state income tax structure similar to the federal income tax, thereby reducing the administrative and compliance burden of the tax. Previously, Virginia had its own definition of income, its own standard deduction and exemption amounts, and its own rules and regulations to interpret its statutes, as well as its own audit function.

However, the 2003 Session of the General Assembly began a movement that still is in effect in which conformity of Virginia's income tax laws to federal law is determined on a year-to-year basis. Since 2003, each year the General Assembly has considered conformity legislation that determines the extent to which Virginia's income tax laws conform to federal income tax laws.[8] This so-called rolling conformity allows the legislature to review federal income tax changes passed by Congress while the General Assembly is not in session. Thus, rolling conformity allows the General Assembly to pass legislation to conform to only those federal income tax changes that are in accordance with the tax and fiscal policy of the Commonwealth.

Individual Income Tax Structure

Conformity

Federal adjusted gross income (AGI) is the starting point in the determination of Virginia taxable income. Federal AGI includes wages and salaries, dividends, interest, unemployment compensation, capital gains and losses, rental income, and such adjustments as IRA contributions, alimony, interest on educational loans, and depreciation. The major benefit of rolling conformity is simply that Virginia, by conforming to federal AGI, allows the taxpayer for the most part to use the same starting point in the computation of both state and federal income taxes. The Commonwealth benefits in the administration of the tax, including compliance efforts, by relying on the federal government for computer tapes of federal returns to verify certain information. Both the Commonwealth and the taxpayer have the benefit of reliance on the rules and regulations promulgated by the Internal Revenue Service. The key is to have the same starting point.

While the starting point in computing Virginia income taxes is federal AGI, the actual amount of income tax owed to Virginia is calculated in a manner that deviates from the computation of federal income tax liability. Virginia allows certain subtractions from federal AGI and requires certain additions to federal AGI, the net effect of which results in Virginia adjusted gross income. In short, certain items of income are either subtracted from or added to federal adjusted gross income to arrive at Virginia adjusted gross income. Once Virginia adjusted gross income is determined, the taxpayer may then claim certain deductions unrelated to income

[7] Chapter 170, 1971 Acts of Assembly.
[8] Chapters 2 and 163, 2003 Acts of Assembly.

in arriving at Virginia taxable income. The Commonwealth's income tax rate is then imposed on the Virginia taxable income to determine the amount of income tax owed.

Virginia allows a subtraction from federal AGI for unemployment compensation, social security income, and up to $20,000 of disability income.[9] These are just some of the subtractions to federal AGI that may be taken by taxpayers in arriving at Virginia AGI. The next step in the process for the taxpayer is to claim any applicable deductions to Virginia adjusted gross income to arrive at Virginia taxable income. Current deductions to Virginia adjusted gross income include, but are not limited to, a deduction equal to the amount of itemized deductions claimed on the federal income tax return but excluding state income taxes, a deduction of $6,000 for married persons and $3,000 for single persons, and a deduction of $930 for each personal exemption claimed on the federal income tax return.[10]

As more modifications to federal AGI and Virginia AGI are passed by the General Assembly, some of the benefits of using federal AGI as a starting point are gradually lost. The administration of the individual income tax becomes more complex as modifications to federal AGI and Virginia AGI are made, and compliance and auditing efforts become more complicated because federal AGI no longer serves as a barometer of the income subject to Virginia individual income taxes. Federal AGI is merely the starting point in determining the base income amount subject to tax.

Exemptions

The Virginia individual income tax currently provides an exemption of $930 for each personal exemption allowed for federal income tax purposes. Virginia provides an additional $800 exemption for each taxpayer who is age 65 or over or blind.[11] The 2009 federal personal exemption amount is $3,500 for each personal and dependent exemption (indexed starting in taxable year 1990).[12] Moreover, the federal income tax no longer provides an additional personal exemption for taxpayers who are age 65 or over or blind, allowing instead an increased standard deduction of $1,050 for each category for married taxpayers, $1,350 for each category for unmarried taxpayers, and no additional deduction for taxpayers who itemize.[13]

Standard and Itemized Deductions

A federal taxpayer may claim either a standard deduction or itemized deductions. Virginia conforms its itemized deductions with the major exception of the federal deduction for state income taxes. If the taxpayer claims itemized deductions on the federal return, he must also itemize on the Virginia income tax return, even if such amount is less than the standard deduction. Since taxable year 1989, the standard deduction in Virginia has been $3,000 for single taxpayers.[14] The standard deduction for married persons was increased from $5,000 to $6,000 beginning with taxable year 2005 to eliminate the marriage penalty (i.e., prior to 2005 the

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[9] Va. Code § 58.1-322.
[10] *Id.*
[11] *Id.*
[12] Internal Revenue Code, § 151.
[13] Internal Revenue Code, § 63.
[14] Va. Code § 58.1-322.

standard deduction per person for married persons was $2,500 and the standard deduction for a single person was $3,000).[15] At the federal level, the 2008 standard deduction is $5,450 for a single person and $10,900 for a married couple.[16] For 1989 and after, these federal standard deduction amounts are indexed to the annual increase in the consumer price index.

Subtractions, Other Deductions, and Tax Credits

During the past 15 to 20 years, Virginia's individual income tax structure has undergone a major change. In the early 1990s the foundation of Virginia's income tax structure included three major components: federal AGI, standard or itemized deductions, and personal exemptions. By taxable year 1999, new subtractions from federal AGI, deductions (other than the standard or itemized deductions), and tax credits assumed a major role in determining individual income tax liability. All three operate to reduce income tax paid to the Commonwealth.

Since 1994, there have been at least 62 new subtractions, deductions, and tax credits enacted into law. By comparison, in 1971 when Virginia conformed, Virginia provided only a very limited credit for taxes paid to other states. During the 1970s, the General Assembly adopted only one new credit -- the retirement income tax credit for taxpayers age 62 or over, which was enacted by the 1976 Session of the General Assembly.

A number of factors might account for the increase in the number of new subtractions, deductions, and tax credits. One possibility is that Virginia is following the lead of Congress and several other states in granting more tax preferences. In addition, the new subtractions, deductions, and tax credits have generally come at a time of tremendous growth in general fund revenues. Table 2 highlights the growth in general fund revenues for fiscal years 1990 through 2009, with much of the growth attributable to increases in individual income tax revenues. Subtractions, deductions, and tax credits are one means of returning surplus revenues back to Virginia citizens.

[15] Chapter 3, 1971 Acts of Assembly, Special Session I.
[16] Internal Revenue Code, § 63.

TABLE 2
Growth in General Fund Revenues
Fiscal Years 2000 - 2009

Fiscal Year Ending June 30	% Increase Over Previous Year
1990	0.3%
1991	(0.4)%
1992	2.8%
1993	9.1%
1994	6.0%
1995	5.8%
1996	6.9%
1997	8.1%
1998	10.4%
1999	10.6%
2000	11.2%
2001	2.9%
2002	(3.8)%
2003	1.8%
2004	9.7%
2005	14.8%
2006	8.4%
2007	4.9%
2008	1.3%
2009	(9.2)%

SOURCE: Department of Accounts, *Summary Report on General Fund and Lottery Revenue Collections (2000-2009).*

Minimum Filing Level

In order to reduce the burden of the income tax on lower income individuals and to eliminate some returns where the cost of processing is greater than the tax revenue, Virginia established a minimum filing level for single and married persons. The minimum filing level is based on a modified Virginia adjusted gross income. In 2007 the General Assembly enacted legislation providing for a phased-in increase in the minimum filing level.[17] Table 3 shows that the phased-in increase will end in 2012 with a minimum filing level of $11,950 in modified Virginia adjusted gross income for single persons and $23,900 in modified Virginia adjusted gross income for married persons.

[17] Chapters 527 and 543, 2007 Acts of Assembly.

TABLE 3
Minimum Filing Level for Individual Income Taxes

Taxable Years	Single Persons	Married Persons
2005, 2006, and 2007	< $7,000	< $14,000
2008 and 2009	< $11,250	< $22,500
2010 and 2011	< $11,650	< $23,300
2012 and thereafter	< $11,950	< $23,900

SOURCE: VA Code § 58.1-321.

Filing by Married Taxpayers

Under Virginia law, if a husband and wife file a joint federal income tax return, they may elect to file separate Virginia income tax returns on a combined form. This method of filing represents a tax reduction for most married persons where both have income. By separating the incomes and deductions on a combined return, a lower income tax rate is applied to the first $17,000 of each spouse's income.

Tax Rate

The present individual income tax rate schedule became effective for all taxable years beginning with 1972 and has remained unchanged except that the top income tax rate bracket was modified by the Virginia Tax Reform Act of 1987. This modification made the top rate bracket of 5.75 percent applicable to taxable income greater than $17,000. Prior to this change, all income over $12,000 was taxed at 5.75 percent. The tax rate schedule is as follows:

Net Taxable Income	Rate
First $3,000	2%
$3,001 - $5,000	3%
$5,001 - $17,000	5%
Greater than $17,000	5.75%

SOURCE: VA Code § 58.1-320.

Virginia's income tax rate schedule prior to conformity was identical to that adopted effective taxable year 1972, except that the 1972 Session added the 5.75 percent bracket.[18]

[18] Chapter 563, 1972 Acts of Assembly.

Tax Computation

Step One

Federal AGI is determined from the federal individual income tax return. From that amount, there are certain items of income added to federal AGI, such as interest on obligations from other states, and certain items of income subtracted from federal AGI. The subtractions include:

- The portion of social security taxed for federal income tax purposes;
- Up to $20,000 of disability income for a permanent and total disability;
- Lottery prizes less than $600;
- A portion of National Guard wages and salaries (maximum subtraction is $3,000);
- Crime Solver rewards up to $1,000;
- Qualified research expenses not deducted on a federal income tax return;
- Refunds from a prepaid tuition contract or savings trust account with the Virginia College Savings Plan;
- Gains on the sale of real property, which is held for open-space use as a result of the sale;
- Up to the first $15,000 of military basic pay for military service personnel on active duty;
- The first $15,000 of salary of federal and state employees whose annual salary is $15,000 or less;
- Unemployment compensation income;
- Certain reparation payments to Holocaust victims;
- Income received as a result of the Master Settlement Agreement reached between tobacco companies and the states, the National Tobacco Grower Settlement Trust dated July 19, 1999, and the Tobacco Loan Assistance Program;
- Any gain recognized as a result of the Peanut Quota Buyout Program of the Farm Security and Rural Investment Act of 2002;
- Any indemnification payments received by contract poultry growers and table egg producers from the U.S. Department of Agriculture as a result of the depopulation of poultry flocks because of low pathogenic avian influenza in 2002;
- Any gain from the sale of launch services to space flight participants; and
- Any gain as a result of resupply services for delivering payload launched from an airport or spaceport in Virginia.

The result of these additions and subtractions to federal adjusted gross income equals Virginia adjusted gross income (AGI). If Virginia AGI with certain modifications is less than the minimum filing level set forth in Table 3, then the taxpayer need not file an individual income tax return.

Step Two

Step Two involves deducting from Virginia AGI certain amounts or transactions that are not income to arrive at Virginia taxable income. These deductions include:

- The amount of itemized deductions claimed on the federal income tax return (less income taxes imposed by the Commonwealth) if the taxpayer itemized deductions, or if the taxpayer did not itemize deductions on the federal income tax return, then a standard deduction of $3,000 for single persons and $6,000 for married persons;
- $930 for each personal exemption allowable for federal income taxes;
- An additional personal exemption of $800 for each taxpayer age 65 or older;
- An additional personal exemption of $800 for each taxpayer who is blind;
- An amount for child care expended by the taxpayer based on the federal child care credit allowance;
- A $1,000 deduction for each child residing in a home under permanent foster care placement;
- An amount paid or contributed to a prepaid tuition contract or savings trust account up to $4,000 per contract or savings trust account, provided that such payment or contribution is not deducted on a federal income tax return (the $4,000 limit does not apply to persons age 70 or older); and
- The amount paid by a living donor of an organ or other living tissue for unreimbursed out-of-pocket expenses directly related to the donation, up to $5,000.

Once Virginia taxable income is determined, the tax rate schedule is then applied to determine the Virginia individual income tax.

Step Three

Before calculating the final tax liability, Virginia grants a number of individual income tax credits that reduce the Virginia individual income tax. The resulting net tax liability is the amount of income tax due to the Commonwealth. These tax credits include, but are not limited to:

- Neighborhood Assistance Act tax credit;
- Conservation tillage equipment tax credit;
- Low-income housing tax credit;
- Purchase of advanced technology pesticide and fertilizer application equipment tax credit;
- Purchase of machinery and equipment for processing recyclable materials tax credit;
- Rent reduction tax credit;
- Historic rehabilitation tax credit;
- Daycare facility investment tax credit;
- Agricultural best management practices tax credit;
- Long-term care insurance tax credit; and
- Livable home tax credit.

In contrast to the subtractions and deductions described in Steps One and Two, tax credits offer a greater financial incentive than a flat subtraction or deduction. For example, the credit for the purchase of conservation tillage equipment provides a credit of 25 percent of all expenditures for the purchase and installation of conservation tillage equipment used in agricultural production. In the case of a $10,000 piece of equipment, the Virginia income tax credit would equal $2,500 (25 percent x $10,000), compared to a maximum savings of $575 (5.75 percent x $10,000) under a deduction, assuming the taxpayer was at the top tax rate. This is because a subtraction or deduction reduces Virginia taxable income, which is subject to a maximum tax rate of 5.75 percent, while an income tax credit reduces the amount of income tax due on a dollar-for-dollar basis. This example highlights different levels of incentives and the major difference between a credit and a subtraction or deduction. A credit can be constructed to provide the desired incentive, while the value of a subtraction or deduction depends on the taxpayer's situation.

Comparison with Other States

In 2007, 41 states plus the District of Columbia imposed a broad-based income tax on individuals. Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming impose no income tax and Tennessee and New Hampshire limit their income tax to interest and dividends.[19] Most states have conformed their income taxes to the federal tax laws during the 1960s and 1970s. For example, in 1958, only four states conformed generally to the federal income tax; by 1976, 19 of the 35 states with broad-based income taxes conformed. The trend continues today, with some states conforming to the point of computing their state taxes as a percentage of federal liability. Currently, 39 of the 41 states that impose a broad-based income tax plus the District of Columbia conform their income tax, in general, to the federal tax laws.[20]

Most states, however, do not exercise complete conformity. Many states provide modifications to the federal provisions due to specific state considerations. A major drawback to conformity occurs if a state conforms to the federal definition of "adjusted gross income" (AGI), personal exemption amounts, and standard deduction amounts. The state then becomes dependent on federal law and forfeits much of its independence. Changes in the federal income tax law would directly affect, either positively or negatively, state revenue collections, absent definitive state intervention. As discussed above, the General Assembly of Virginia has adopted rolling conformity to give it the greatest degree of flexibility in deciding which federal tax changes the Commonwealth will conform to.

Table 4 compares the personal exemption amounts permitted by the states in 2007 under their income tax structures. In terms of the personal exemption amount, New York and Pennsylvania do not provide an amount for personal exemptions and thus have the lowest personal exemption amount of any state imposing a broad-based individual income tax. Wisconsin provides the next lowest personal exemption amount at $700 followed by Virginia at $900 (currently Virginia's personal exemption amount is $930). Indiana, Louisiana, New Jersey, and Oklahoma grant a $1,000 personal exemption amount. The table also shows that nine states provide a credit against the tax in lieu of a personal exemption. Federal income tax laws allow a personal exemption of $3,400.

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[19] Reinhardt, Rob. *Individual Income Tax Provisions in the States,* Wisconsin Legislative Fiscal Bureau, 2007.
[20] *2007 All States Tax Handbook*, RIA, 2007.

TABLE 4

State Individual Income Taxes, Personal Exemptions, 2007

State	Single	Married
Alabama	$1,500	$3,000
Alaska		No State Income Tax
Arizona	$2,100	$4,200
Arkansas	$23c	$46c
California	$94c	$188c
Colorado	$3,400	$6,800
Connecticut	$12,750c (1)	$24,000c (1)
Delaware	$110c	$220c
District of Columbia	$1,500	$3,000
Florida		No State Income Tax
Georgia	$2,700	$5,400
Hawaii	$1,040	$2,080
Idaho	$3,400	$6,800
Illinois	$2,000	$4,000
Indiana	$1,000	$2,000
Iowa	$40c	$80c
Kansas	$2,250	$4,500
Kentucky	$20c	$40c
Louisiana	$1,000 (2)	$2,000 (2)
Maine	$2,850	$5,700
Maryland	$2,400	$4,800
Massachusetts	$4,125	$8,250
Michigan	$3,400	$6,800
Minnesota	$3,400	$6,800
Mississippi	$6,000	$12,000
Missouri	$2,100	$4,200
Montana	$2,040	$4,080
Nebraska	$111c	$222c
Nevada		No State Income Tax
New Hampshire	$2,400	$4,800
New Jersey	$1,000	$2,000
New Mexico	$3,400 (3)	$6,800 (3)
New York	$0	$0
North Carolina	$2,500/$2,000 (4)	$5,000/$4,000 (4)
North Dakota	$3,400	$6,800
Ohio	$1,450 exemption/$20c (5)	$2,900 exemption/$40c (5)
Oklahoma	$1,000	$2,000
Oregon	$165c (6)	$330c (6)
Pennsylvania	$0	$0
Rhode Island	$3,400	$6,800
South Carolina	$3,400	$6,800

TABLE 4 (con't)
State Individual Income Taxes, Personal Exemptions, 2007

State	Single	Married
South Dakota		No State Income Tax
Tennessee	$1,250	$2,500
Texas		No State Income Tax
Utah	$2,550	$5,100
Vermont	$3,400	$6,800
Virginia	**$900**	**$1,800**
Washington		No State Income Tax
West Virginia	$2,000	$4,000
Wisconsin	$700	$1,400
Wyoming		No State Income Tax
Federal	**$3,400**	**$6,800**

(1) Personal exemption amount phases out as Connecticut adjusted gross income increases.
(2) These are the personal exemption amounts included in the state's combined standard deduction and personal exemption amounts.
(3) An additional personal exemption of $2,500 for each federal exemption may be claimed by low- and middle-income taxpayers.
(4) The higher exemption amount may be claimed by low- and middle-income taxpayers.
(5) The credit phases out as income increases.
(6) The credit phases down to $55 for single persons and $110 for married taxpayers as income increases.
c denotes credit
SOURCE: Reinhardt, Rob. *Individual Income Tax Provisions in the States,* Wisconsin Legislative Fiscal Bureau, 2007.

Table 5 compares the standard deduction permitted by the states. In 1989, Virginia compared favorably by providing what was considered a very generous standard deduction of $3,000 for each single taxpayer and $5,000 for each married couple. Twelve other states also provided a standard deduction of $3,000 for each single taxpayer and $5,000 for each married couple. In each of these 12 states, however, the state standard deduction was linked (indexed) to the federal deduction, and as the federal standard deduction increased to $4,300 for single persons and $7,200 for married persons for tax year 1999, due to indexing, these states' standard deductions also increased automatically. Thus, what was a generous Virginia standard deduction in 1989 in 2007 is a middle of the road standard deduction due to the lack of indexing Virginia's standard deduction.

Virginia adjusts its standard deduction periodically as conditions warrant with the latest change enacted in 2004 to increase the standard deduction for married persons to $6,000 effective beginning with taxable year 2005 (the 2004 increase in the standard deduction for married persons was intended to eliminate the marriage penalty).[21] With this change, Virginia's standard deduction in 2007 was $3,000 for single taxpayers and $6,000 for each married couple. In part because of the lack of indexing in Virginia, of the 34 states that granted a standard deduction for tax year 2007, 19 granted a standard deduction for single and married persons that were higher than the standard deduction granted by Virginia. Iowa has the lowest standard deduction for single persons ($1,700), and Kentucky has the lowest standard deduction for married persons ($2,050).

[21] Chapter 3, 2004 Acts of Assembly, Special Session I.

TABLE 5
State Individual Income Taxes, Standard Deductions 2007

State	Percent Limit of AGI	Single	Married, Joint Return
Alabama		$2,000/$2,500 [(1)]	$4,000/$7,500 [(1)]
Alaska			No State Income Tax
Arizona		$4,373	$8,745
Arkansas		$2,000	$4,000
California		$3,516	$7,032
Colorado		$5,350	$10,700
Connecticut		$12,750 [(2)]	$24,000 [(2)]
Delaware		$3,250	$6,500
District of Columbia		$2,500 [(3)]	$2,500 [(3)]
Florida			No State Income Tax
Georgia		$2,300 [(3)]	$3,000 [(3)]
Hawaii		$2,000	$4,000
Idaho		$5,350	$10,700
Illinois			Standard Deduction Not Available
Indiana			Standard Deduction Not Available
Iowa		$1,700	$4,200
Kansas		$3,000 [(3)]	$6,000 [(3)]
Kentucky		$2,050	$2,050
Louisiana		$4,500 [(4)]	$9,000 [(4)]
Maine		$5,350 [(3)]	$8,900 [(3)]
Maryland	15.0	$1,500/$2,000 [(5)]	$3,000/$4,000 [(5)]
Massachusetts			Standard Deduction Not Available
Michigan			Standard Deduction Not Available
Minnesota		$5,350	$10,700
Mississippi		$2,300	$4,600
Missouri		$5,350	$10,700
Montana	20.0	$1,690/$3,810 [(5)]	$3,380/$7,620 [(5)]
Nebraska		$5,350	$10,700
Nevada			No State Income Tax
New Hampshire			Standard Deduction Not Available
New Jersey			Standard Deduction Not Available
New Mexico		$5,350	$10,700
New York		$7,500	$15,000
North Carolina		$3,000 [(3)]	$6,000 [(3)]
North Dakota		$5,350	$10,700
Ohio			Standard Deduction Not Available
Oklahoma		$2,750	$5,500
Oregon		$1,825 [(3)]	$3,650 [(3)]
Pennsylvania			Standard Deduction Not Available
Rhode Island		$5,350 [(3)]	$8,900 [(3)]
South Carolina		$5,350	$10,700

TABLE 5 (con't)
State Individual Income Taxes, Standard Deductions 2007

State	Percent Limit of AGI	Single	Married, Joint Return
South Dakota	No State Income Tax		
Tennessee	Standard Deduction Not Available		
Texas	No State Income Tax		
Utah		$5,350	$10,700
Vermont		$5,350	$10,700
Virginia		**$3,000**	**$6,000**
Washington	No State Income Tax		
West Virginia	Standard Deduction Not Available		
Wisconsin		$8,790 (2)	$15,830 (2)
Wyoming	No State Income Tax		
FEDERAL		**$5,350**	**$10,700**

(1) The standard deduction ranges from a minimum to a maximum amount based upon income.
(2) The standard deduction is a sliding scale standard deduction that phases out at higher income levels.
(3) Additional standard deduction if age 65 or over or blind.
(4) Combined standard deduction and personal exemption amounts.
(5) These are minimum and maximum standard deductions tied to a percentage of adjusted gross income.
SOURCE: Reinhardt, Rob. *Individual Income Tax Provisions in the States,* Wisconsin Legislative Fiscal Bureau, 2007.

Table 6 compares the Virginia individual income tax rate schedule to those in other states. As the table demonstrates, the states vary greatly in their tax rate structure, with Colorado, Illinois, Indiana, Michigan, Pennsylvania, and Tennessee, which impose one flat tax rate regardless of taxable income, at one end of the spectrum, and Missouri with 10 different tax rate brackets at the other end. This table reveals that Virginia's top marginal income tax rate is relatively low compared to the other states. Of the 41 states plus the District of Columbia with broad-based income taxes, 29 have a higher top tax rate than Virginia, with only 12 lower.

TABLE 6
2007 State Individual Income Tax Rates

State	Taxable Income	Rate
Alabama (1)	$1 - $500	2.0%
	$501 - $3,000	4.0%
	$3,001 - and over	5.0%
Arizona (1)	$1 - $10,000	2.59%
	$10,001 - $25,000	2.88%
	$25,001 - $50,000	3.36%
	$50,001 - $150,000	4.24%
	$150,001 - and over	4.54%
Arkansas	$1 - $3,699	1.0%
	$3,700 - $7,399	2.5%
	$7,400 - $11,099	3.5%
	$11,100 - $18,599	4.5%
	$18,600 - $30,999	6.0%
	$31,000 - and over	7.0%

TABLE 6 (con't)
2007 State Individual Income Tax Rates

State	Taxable Income	Rate
California [1]	$1 - $6,827	1.0%
	$6,828 - $16,185	2.0%
	$16,186 - $25,544	4.0%
	$25,545 - $35,460	6.0%
	$35,461 - $44,814	8.0%
	$44,815 - and over	9.3%
Colorado	ALL	4.63%
Connecticut [1]	$1 - $10,000	3.0%
	$10,001 - and over	5.0%
Delaware	$1 - $2,000	0.0%
	$2,001 - $5,000	2.2%
	$5,001 - $10,000	3.9%
	$10,001 - $20,000	4.8%
	$20,001 - $25,000	5.2%
	$25,001 - $60,000	5.55%
	$60,001 - and over	5.95%
District of Columbia	$1 - $10,000	4.0%
	$10,001 - $40,000	6.0%
	$40,001 - and over	8.5%
Georgia [2]	$1 - $750	1.0%
	$751 - $2,250	2.0%
	$2,251 - $3,750	3.0%
	$3,751 - $5,250	4.0%
	$5,251 - $7,000	5.0%
	$7,001 - and over	6.0%
Hawaii [1]	$1 - $ 2,400	1.4%
	$2,401 - $4,800	3.2%
	$4,801 - $9,600	5.5%
	$9,601 - $14,400	6.4%
	$14,401 - $19,200	6.8%
	$19,201 - $24,000	7.2%
	$24,001 - $36,000	7.6%
	$36,001 - $48,000	7.9%
	$48,001 - and over	8.25%
Idaho [1]	$1 - $1,237	1.6%
	$1,238 - $2,474	3.6%
	$2,475 - $3,710	4.1%
	$3,711 - $4,947	5.1%
	$4,948 - $6,184	6.1%
	$6,185 - $9,276	7.1%
	$9,277 - $24,736	7.4%
	$24,737 - and over	7.8%

TABLE 6 (con't)
2007 State Individual Income Tax Rates

State	Taxable Income	Rate
Illinois	ALL	3.0%
Indiana	ALL	3.4%
Iowa	$1 - $1,343	.36%
	$1,344 - $2,686	.72%
	$2,687 - $5,372	2.43%
	$5,373 - $12,087	4.5%
	$12,088 - $20,145	6.12%
	$20,146 - $26,860	6.48%
	$26,861 - $40,290	6.8%
	$40,291 - $60,435	7.92%
	$60,436 - and over	8.98%
Kansas (1)	$1 - $15,000	3.5%
	$15,001 - $30,000	6.25%
	$30,001 and over	6.45%
Kentucky	$1 - $3,000	2.0%
	$3,001 - $4,000	3.0%
	$4,001 - $5,000	4.0%
	$5,001 - $8,000	5.0%
	$8,001 - $75,000	5.8%
	$75,001 - and over	6.0%
Louisiana (1)	$1 - $12,500	2.0%
	$12,501 - $25,000	4.0%
	$25,001 - and over	6.0%
Maine (3)	$1 - $4,749	2.0%
	$4,750 - $9,449	4.5%
	$9,450 - $18,949	7.0%
	$18,950 - and over	8.5%
Maryland	$1 - $1,000	2.0%
	$1,001 - $2,000	3.0%
	$2,001 - $3,000	4.0%
	$3,001 - and over	4.75%
Massachusetts	Interest and dividends;	5.3%
	earned income	
	Short-term capital gains	12.0%
	All other taxable income	5.3%
Michigan	ALL	4.01%
Minnesota (4)	$1 - $21,310	5.35%
	$21,311 - $69,990	7.05%
	$69,991 - and over	7.85%
Mississippi	$1 - $5,000	3.0%
	$5,001 - $10,000	4.0%
	$10,001 and over	5.0%

TABLE 6 (con't)
2007 State Individual Income Tax Rates

State	**Taxable Income**	**Rate**
Missouri	$1 - $1,000	1.5%
	$1,001 - $2,000	2.0%
	$2,001 - $3,000	2.5%
	$3,001 - $4,000	3.0%
	$4,001 - $5,000	3.5%
	$5,001 - $6,000	4.0%
	$6,001 - $7,000	4.5%
	$7,001 - $8,000	5.0%
	$8,001 - $9,000	5.5%
	$9,001 and over	6.0%
Montana	$1 - $2,500	1.0%
	$2,501 - $4,400	2.0%
	$4,401 - $6,600	3.0%
	$6,601 - $9,000	4.0%
	$9,001 - $11,600	5.0%
	$11,601 - $14,900	6.0%
	$14,901 - and over	6.9%
Nebraska (5)	$1 - $2,400	2.56%
	$2,401 - $17,000	3.57%
	$17,001 - $27,000	5.1%
	$27,001 - and over	6.84%
New Hampshire	Interest and dividends	5.0%
New Jersey (6)	$1 - $20,000	1.4%
	$20,001 - $35,000	1.75%
	$35,001 - $40,000	3.5%
	$40,001 - $75,000	5.525%
	$75,001 - $500,000	6.37%
	$500,001 and over	8.97%
New Mexico (7)	$1 - $5,500	1.7%
	$5,501 - $11,000	3.2%
	$11,001 - $16,000	4.7%
	$16,001 - and over	5.3%
New York (1)	$1 - $8,000	4.0%
	$8,001 - $11,000	4.5%
	$11,001 - $13,000	5.25%
	$13,001 - $20,000	5.9%
	$20,001 - and over	6.85%
North Carolina (8)	$1 - $12,750	6.0%
	$12,751 - $60,000	7.0%
	$60,001 - $120,000	7.75%
	$120,001 - and over	8.0%
North Dakota (9)	$1 - $31,850	2.1%

TABLE 6 (con't)
2007 State Individual Income Tax Rates

State	Taxable Income	Rate
	$31,851 - $77,100	3.92%
	$77,101 - $160,850	4.34%
	$160,851 - $349,700	5.04%
	$349,701 - and over	5.54%
Ohio	$1 - $5,000	0.649%
	$5,001 - $10,000	1.299%
	$10,001 - $15,000	2.598%
	$15,001 - $20,000	3.247%
	$20,001 - $40,000	3.895%
	$40,001 - $80,000	4.546%
	$80,001 - $100,000	5.194%
	$100,001 - $200,000	6.031%
	$200,001 and over	6.555%
Oklahoma (10)	$1 - $1,000	0.5%
	$1,001 - $2,500	1.0%
	$2,501- $ 3,750	2.0%
	$3,751 - $4,900	3.0%
	$4,901 - $7,200	4.0%
	$7,201 - $8,700	5.0%
	$8,701 - and over	6.65%
Oregon	$1 - $2,850	5.0%
	$2,851 - $7,150	7.0%
	$7,151 - and over	9.0%
Pennsylvania	ALL	3.07%
Rhode Island (11)	$1 - $31,850	3.75%
	$31,851 - $77,100	7.0%
	$77,101 - $160,850	7.75%
	$160,851 - $349,700	9.0%
	$349,701 - and over	9.9%
South Carolina	$0 - $2,530	0.0%
	$2,531 - $5,060	3.0%
	$5,061 - $7,590	4.0%
	$7,591 - $10,120	5.0%
	$10,121 - $12,650	6.0%
	$12,651 - and over	7.0%
Tennessee	ALL	6.0%
Utah (12)	$1 - $1,000	2.3%
	$1,001 - $2,000	3.3%
	$2,001 - $3,000	4.2%
	$3,001 - $4,000	5.2%
	$4,001 - $5,000	6.0%
	$5,001 - and over	7.0%

TABLE 6 (con't)
2007 State Individual Income Tax Rates

State	Taxable Income	Rate
Vermont (13)	$1 - $31,850	3.6%
	$31,851 - $77,100	7.2%
	$77,101 - $160,850	8.5%
	$160,851 - $349,700	9.0%
	$349,701 - and over	9.5%
Virginia	$1 - $3,000	2.00%
	$3,001 - $5,000	3.00%
	$5,001 - $17,000	5.00%
	$17,001 and over	5.75%
West Virginia	$1 - $9,999	3.0%
	$10,000 - $24,999	4.0%
	$25,000 - $39,999	4.5%
	$40,000 - $59,999	6.0%
	$60,000 - and over	6.5%
Wisconsin (14)	$1 - $9,510	4.6%
	$9,511 - $19,020	6.15%
	$19,021 - $142,650	6.5%
	$142,651 - and over	6.75%

(1) Rates are the same for married persons filing jointly except income brackets are doubled.
(2) The income brackets and tax rates for married persons filling jointly are $1 - $1,000 (1%); $1,001 - $3,000 (2%); $3,001 - $5,000 (3%); $5,001 - $7,000 (4%); $7,001 - $10,000 (5%); and $10,001 - and over (6%).
(3) The income brackets and tax rates for married persons filling jointly are $1 - $9,499 (2%); $9,500 - $18,949 (4.5%); $18,950 - $37,949 (7%); and $37,950 - and over (8.5%).
(4) The income brackets and tax rates for married persons filling jointly are $1 - $31,150 (5.35%); $31,151 - $123,750 (7.05%); and $123,751 - and over (7.85%).
(5) The income brackets and tax rates for married persons filling jointly are $1 - $4,800 (2.56%); $4,801 - $35,000 (3.57%); $35,001 - $54,000 (5.1%); and $54,001 - and over (6.84%).
(6) The income brackets and tax rates for married persons filling jointly are $1 - $20,000 (1.4%); $20,001 - $50,000 (1.75%); $50,001 - $70,000 (2.45%); $70,001 - $80,000 (3.5%); $80,001 - $150,000 (5.525%); $150,001 - $500,000 (6.37%); and $500,001 - and over (8.97%).
(7) The income brackets and tax rates for married persons filling jointly are $1 - $8,000 (1.7%); $8,001 - $16,000 (3.2%); $16,001 - $24,000 (4.7%); and $24,001 - and over (5.3%).
(8) The income brackets and tax rates for married persons filling jointly are $1 - $21,250 (6%); $21,251 - $100,000 (7%); $100,001 - $200,000 (7.75%); and $200,001 - and over (8%).
(9) The income brackets and tax rates for married persons filling jointly are $1 - $53,200 (2.1%); $53,201 - $128,500 (3.92%); $128,501 - $195,850 (4.34%); $195,851 - $349,700 (5.04%); and $349,701 - and over (5.54%). North Dakota also provides an optional method, which utilizes different income brackets and income tax rates.
(10) The income brackets and tax rates for married persons filling jointly are $1 - $2,000 (0.5%); $2,001 - $5,000 (1%); $5,001 - $7,500 (2%); $7,501 - $9,800 (3%); $9,801 - $12,200 (4%); $12,201 - $15,000 (5%); and $15,001 and over (6.65%).
(11) The income brackets and tax rates for married persons filling jointly are $1 - $53,150 (3.75%); $53,151 - $128,500 (7%); $128,501 - $195,850 (7.75%); $195,851 - $349,700 (9%); and $349,701 - and over (9.9%).
(12) The income brackets and tax rates for married persons filling jointly are $1 - $2,000 (2.3%); $2,001 - $4,000 (3.3%); $4,001 - $6,000 (4.2%); $6,001 - $8,000 (5.2%); $8,001 - $11,000 (6%); and $11,001 - and over (7%).
(13) The income brackets and tax rates for married persons filling jointly are $1 - $53,150 (3.6%); $53,151 - $128,500 (7.2%); $128,501 - $195,850 (8.5%); $195,851 - $349,700 (9%); and $349,701 - and over (9.5%).
(14) The income brackets and tax rates for married persons filling jointly are $1 - $12,680 (4.6%); $12,681 - $25,360 (6.15%); $25,361 - $190,210 (6.5%); and $190,211 - and over (6.75%).
SOURCE: Reinhardt, Rob. *Individual Income Tax Provisions in the States,* Wisconsin Legislative Fiscal Bureau, 2007.

Generally, there are two ways to compare the burden or utilization of taxes among the states. The first method is to divide tax collections by populations to determine average tax collection per resident (per capita). The other method is to calculate the tax burden by stating the tax as a percentage of personal income, thus eliminating the distortion caused by differing per capita income levels among states. An average tax of $1,000, for example, represents a much heavier burden in a state with average per capita income of $12,000 than in a state with an average income of $20,000. Table 7 shows per capita income tax and income taxes as a percentage of personal income for Virginia and selected other states.

TABLE 7
Income Tax Per Capita and as a Percent of Income, Selected States, 2007

State	**Income Tax Per Capita**	**Rank (Total = 51)**	**Tax as a Percent of Personal Income**	**Rank (Total = 51)**
Alabama	$654.53	38	2.02%	35
District of Columbia	$2,381.97	1	3.81%	3
Georgia	$950.40	23	2.84%	17
Indiana	$740.76	35	2.23%	33
Kentucky	$747.77	34	2.43%	31
Maryland	$1,276.11	10	2.75%	20
North Carolina	$1,207.48	12	3.58%	6
Ohio	$858.33	26	2.49%	29
South Carolina	$767.90	32	2.47%	30
VIRGINIA	**$1,355.82**	**9**	**3.25%**	**10**
West Virginia	$791.95	30	2.70%	21
U.S. Average	$904.85		2.34%	

SOURCE: Bureau of Economic Analysis, U. S. Department of Commerce, State Annual Personal Income Tables.

On a per capita basis, Virginia collected $1,355.82 of individual income tax per person, the ninth highest collection in the country. Virginia's income tax in aggregate is 3.25 percent of personal income, which ranks Virginia 10th in the country. When collections are adjusted on a personal income basis, Virginia ranks behind the District of Columbia (third) and North Carolina (sixth). Virginia ranks ahead of Georgia (seventeenth), Maryland (twentieth), West Virginia (twenty-first), Ohio (twenty-ninth), South Carolina (thirtieth), Kentucky (thirty-first), Indiana (thirty-third), and Alabama (thirty-fifth).

It is also important to examine how heavily different states rely on the individual income tax to generate state tax revenue. In 2007, states received, on the average, 35.7 percent of their total state tax revenue from the individual income tax. Virginia received 54.9 percent of its total state revenues from individual income tax. Only three states (Oregon, New York, and Massachusetts) rely more on the individual income tax. The top 10 states are as follows:

1.	Oregon	68.5%
2.	Massachusetts	57.2%
3.	New York	55.9%
4.	**Virginia**	**54.9%**
5.	Colorado	52.7%
6.	Connecticut	52.4%
7.	Georgia	48.6%
8.	North Carolina	48.3%
9.	California	47.5%
10.	Maryland	47.2%
	U.S. Average	35.7%

SOURCE: U.S. Bureau of the Census.

Individual Income Tax Base

For the latest available year (taxable year 2006), Virginians incurred a Virginia individual income tax liability of $9.132 billion, which can be broken down by the distribution of Virginia adjusted gross income (VAGI) and the individual income tax liability by different adjusted gross income categories.

Table 8 shows the distribution of VAGI, Virginia taxable income, and Virginia individual income tax liability and illustrates the distribution of income and tax liability. An examination of each level of Virginia taxable income, its percentage of total taxable income, and its comparison to that level's percentage of individual income tax highlights the progressive nature of Virginia's income tax. For example, taxpayers at the $20,000 - $24,999 income level comprise 1.9 percent of total taxable income, while paying 1.5 percent of the total Virginia individual income tax. This contrasts sharply to the highest Virginia taxable income level, where taxpayers had 60 percent of the total taxable income, and paid 63.3 percent of the total individual income tax.

Table 9 provides information regarding the distribution of Virginia individual income tax returns, personal and dependent exemptions, and the age exemption. Clearly, the number of returns is skewed toward the lower income levels. For example, 44.7 percent of all the returns came from VAGI levels of less than $30,000. This group also claimed 36.7 percent of personal and dependent exemptions. In contrast, taxpayers in the VAGI range of $40,000 - $74,999 filed 21.5 percent of the returns and claimed 22.8 percent of the personal and dependent exemptions.

Table 10 examines by VAGI level the distribution of itemized deductions compared to standard deductions. The table clearly shows that taxpayers with higher VAGI levels itemize their deductions. For each VAGI level that is at least $30,000, at least 75 percent of the taxpayers in each VAGI level itemize deductions (99.4 percent at the highest level). The same cannot be said for taxpayers falling in VAGI levels below $30,000.

TABLE 8
Distribution of Virginia Adjusted Gross Income, Virginia Taxable Income, and Virginia Individual Income Tax, Taxable Year 2006

Range	Virginia Adjusted Gross Income	Amount % of Total	Virginia Taxable Income	Amount % of Total	Virginia Individual Income Tax	Amount % of Total
$0 - $4,999	$ 741,821,869	0.3%	$ 61,477,769	0.0%	$ 1,263,547	0.0%
$5,000 - $9,999	$ 2,054,027,057	0.9%	$ 626,247,585	0.4%	$ 15,678,971	0.2%
$10,000 - $14,999	$ 3,138,802,249	1.4%	$ 1,555,011,394	0.9%	$ 52,963,172	0.6%
$15,000 - $19,999	$ 4,343,321,714	2.0%	$ 2,485,153,795	1.4%	$ 97,085,854	1.1%
$20,000 - $24,999	$ 5,266,192,976	2.4%	$ 3,226,431,114	1.9%	$ 135,060,485	1.5%
$25,000 - $29,999	$ 5,773,905,002	2.6%	$ 3,696,683,873	2.1%	$ 164,001,817	1.8%
$30,000 - $34,999	$ 6,041,511,354	2.7%	$ 3,983,541,764	2.3%	$ 183,641,753	2.0%
$35,000 - $39,999	$ 6,244,213,607	2.8%	$ 4,219,916,771	2.4%	$ 199,518,811	2.2%
$40,000 - $44,999	$ 6,232,655,181	2.8%	$ 4,316,659,492	2.5%	$ 207,290,429	2.3%
$45,000 - $49,999	$ 6,176,900,067	2.8%	$ 4,355,480,029	2.5%	$ 211,870,696	2.3%
$50,000 - $74,999	$ 29,159,464,072	13.1%	$ 21,383,783,272	12.3%	$ 1,067,446,097	11.7%
$75,000 - $99,999	$ 25,477,762,373	11.5%	$ 19,617,856,512	11.3%	$ 1,012,478,554	11.1%
$100,000 and over	$ 121,345,763,586	54.7%	$ 104,438,246,688	60.0%	$ 5,783,961,064	63.3%
Total	**$ 221,996,341,107**	100%	**$ 173,966,490,057**	100%	**$ 9,132,261,251**	100%

SOURCE: Virginia Department of Taxation Annual Report, Fiscal Year 2008.

TABLE 9
Distribution of Virginia Individual Income Tax Returns, Personal and Dependent Exemptions, and Virginia Age Exemptions, Taxable Year 2006

Virginia AGI	# of Returns	% of Total	Personal Dependent Exemptions	% of Total	Age Exemption	% of Total
$0 - $4,999	342,621	9.8%	509,138	7.2%	35,874	6.1%
$5,000 - $9,999	276,129	7.9%	411,476	5.8%	31,473	5.3%
$10,000 - $14,999	251,384	7.2%	424,025	6.0%	43,573	7.4%
$15,000 - $19,999	248,395	7.1%	438,990	6.2%	47,800	8.1%
$20,000 - $24,999	234,489	6.7%	425,726	6.0%	47,287	8.0%

TABLE 9 (con't)
Distribution of Virginia Individual Income Tax Returns, Personal and Dependent Exemptions, and Virginia Age Exemptions, Taxable Year 2006

Virginia AGI	# of Returns	% of Total	Personal Dependent Exemptions	% of Total	Age Exemption	% of Total
$25,000 - $29,999	210,372	6.0%	389,815	5.5%	42,103	7.1%
$30,000 - $34,999	186,196	5.4%	347,855	4.9%	36,672	6.2%
$35,000 - $39,999	166,768	4.8%	315,063	4.4%	33,281	5.6%
$40,000 - $44,999	146,831	4.2%	287,610	4.0%	28,841	4.9%
$45,000 - $49,999	130,165	3.7%	266,210	3.7%	24,681	4.2%
$50,000 - $74,999	474,198	13.6%	1,076,697	15.1%	85,940	14.6%
$75,000 - $99,999	294,468	8.5%	755,368	10.6%	46,846	7.9%
$100,000 and over	517,904	14.9%	1,466,546	20.6%	86,039	14.6%
Total	**3,479,920**	100%	**7,114,519**	100%	**590,410**	100%

SOURCE: Virginia Department of Taxation Annual Report, Fiscal Year 2008.

TABLE 10
Comparison of Virginia Itemized Deductions and Standard Deductions by Virginia Adjusted Gross Income Levels, Taxable Year 2006

Virginia AGI	Itemized Deductions Claimed	% of Deductions	Standard Deductions Claimed	% of Deductions
$0 - $4,999	$ 4,998,535,658	89.2%	$602,664,116	10.8%
$5,000 - $9,999	$ 760,634,512	54.4%	$636,524,736	45.6%
$10,000 - $14,999	$ 701,567,197	53.3%	$615,028,993	46.7%
$15,000 - $19,999	$ 837,914,154	57.8%	$611,967,559	42.2%
$20,000 - $24,999	$ 925,060,296	62.4%	$557,664,591	37.6%

TABLE 10 (con't)
Comparison of Virginia Itemized Deductions and Standard Deductions by Virginia Adjusted Gross Income Levels, Taxable Year 2006

Virginia AGI	Itemized Deductions Claimed	% of Deductions	Standard Deductions Claimed	% of Deductions
$25,000 - $29,999	$ 1,043,200,218	68.8%	$472,532,637	31.2%
$30,000 - $34,999	$ 1,333,621,314	77.4%	$390,008,215	22.6%
$35,000 - $39,999	$ 1,168,323,737	78.1%	$327,732,409	21.9%
$40,000 - $44,999	$ 1,192,654,639	81.5%	$269,978,156	18.5%
$45,000 - $49,999	$ 1,145,987,977	83.6%	$225,241,852	16.4%
$50,000 - $74,999	$5,420,661,121	88.9%	$674,144,405	11.1%
$75,000 - $99,999	$4,560,584,637	95.2%	$232,350,429	4.8%
$100,000 and over	$17,094,422,750	99.4%	$108,194,926	0.6%
Total	**$41,183,168,210**	87.8%	**$5,724,033,024**	12.2%

SOURCE: Virginia Department of Taxation Annual Report, Fiscal Year 2008.

Issues

Local Income Taxes

Until the 1989 Session, the Virginia individual income tax has been segregated for the exclusive use of the state. However, the 1989 Session enacted legislation that allowed the Northern Virginia jurisdictions, as well as the Cities of Norfolk and Virginia Beach, to impose up to a one percent local income tax. The legislation requires passage at a local referendum and restricts the use of the revenue to transportation purposes.

Among the 41 states that have a broad-based income tax, 13 states allow at least some of their localities to impose a local tax.[22] The income tax imposed by the District of Columbia is also treated as a local income tax. In 2007, the local governments in these 12 states (excluding Virginia) and the District of Columbia collected approximately $24.0 billion in local income tax revenue, or about 8.8 percent of total state and local individual income tax revenue.[23] Of these states and the District of Columbia, however, the local governments in Maryland, New York,

[22] Alabama, Delaware, District of Columbia, Indiana, Iowa, Kentucky, Maryland, Michigan, Missouri, New York, Ohio, Oregon, Pennsylvania, and Virginia. Source: Bureau of Economic Analysis, U.S. Department of Commerce, State Annual Personal Income Tables.
[23] *Id*.

Pennsylvania, and Ohio collected over 80.9 percent of this $24.0 billion total. As a result, it is fair to say that except for these four states, local governments rely very little on an income tax.

Over-Withholding

Historically, the Virginia individual income tax has over-withheld income from taxpayers, especially those who itemize their deductions, by basing the amount withheld on the assumption that each taxpayer takes the standard deduction. This system is identical to the federal withholding system, except that under the federal withholding system, the taxpayer can adjust his withholding for the excess of itemized deductions by claiming additional personal exemptions. In the Commonwealth, this can only be done if the taxpayer requests permission, in writing, from the State Tax Commissioner. According to the State Tax Commissioner, very few taxpayers request this authority.

To address the over-withholding problem, the 1989 Session of the Virginia General Assembly adopted legislation (Chapter 289, *Acts of Assembly, 1989*) to allow taxpayers to claim additional personal exemptions when determining withholding. This procedure more closely aligns withholding to income tax liability. However, after the passage of the 1989 legislation, the General Assembly deferred conforming its withholding structure to the federal structure by delaying the implementation date of the 1989 legislation and by subsequently repealing the 1989 legislation in 2008.[24]

Adjusting withholding is optional for the taxpayer. Some taxpayers choose not to change their withholding because they view withholding as a form of forced savings.

Indexing

The federal Tax Reform Act of 1986 restructured the federal individual income tax by broadening the tax base, reducing individual income tax rates, and attempting to simplify the income tax, at least for moderate and lower income taxpayers who do not itemize. Another significant feature of the tax reform was that the federal income tax structure was indexed to the inflation rate.

Beginning in taxable year 1989, the federal standard deduction was indexed from the 1988 taxable year amount of $3,000 for a single person and $5,000 for a married couple. Moreover, the income tax rate structure was also indexed by adjusting the break points of taxable income that separate the 15 percent, 28 percent, and 33 percent rate brackets. Also, since taxable year 1990, personal and dependent exemptions have been indexed from the 1989 amount of $2,000 per taxpayer, spouse, and dependent.

Proponents of indexing argue that it prevents taxpayers from paying progressively higher income tax rates on income increases that are strictly caused by inflation.

[24] Chapter 228, 2008 Acts of Assembly.

Standard Deduction

	Single	Married	
Federal	$3,000	$5,000	1988
	$5,350	$10,700	Indexed, 2007
Virginia	$3,000	$6,000	2007

SOURCE: Va. Code § 58.1-322.

As federal indexing of the standard deduction causes it to increase, the future costs of conforming to the federal standard deduction amount would be significant for Virginia. Currently, 10 states conform their standard deduction to the federal level.[25]

The Virginia personal exemption amount is in sharp contrast to the federal personal exemption amount.

Personal and Dependent Exemption

Federal	$2,000	1989
	$3,400	Indexed, 2007
Virginia	$900	2007

Source: § 151 of the Internal Revenue Code and Va. Code § 58.1-322.

The federal personal exemption amount is significantly greater than Virginia's. This disparity will continue to increase as inflation automatically increases the federal personal exemption amount. Currently, eight states conform their personal exemption amounts to the federal level.[26]

The federal tax rate structure is also indexed. Since Congress accepted the premise for indexing, the rate structure is indexed to prevent inflation alone from pushing a taxpayer into a higher tax bracket. A number of states have also indexed their income tax rate structures.

Valid arguments against indexing exist. For example, indexing reduces the ability of states to change personal exemption amounts, standard deductions, and tax rate schedules on an ad hoc basis to respond to available revenue and current conditions, because revenues are automatically used for indexing. Moreover, indexing could reduce revenues, thereby obstructing modifications to another tax that may be in more critical need of amendment. Indexing does lead to a loss of state revenue, even during those times when a state can least afford tax revenue loss. Finally, even if the arguments for indexing at the federal level are valid, there is little concern with pushing a taxpayer into a higher tax bracket in Virginia: Virginia's top tax rate of 5.75 percent remains small compared to the top federal rate of 35 percent, and a move to a higher bracket in Virginia means only a one percent or two percent tax increase.

Flat Tax

Some in the Commonwealth have argued for a flat tax on individual income, or a single income tax rate applied to all income. Currently, Virginia uses four income tax rates: two percent on income between $1 and $3,000; 3 percent on income between $3,001 and $5,000; five

[25] Reinhardt, Rob. *Individual Income Tax Provisions in the States,* Wisconsin Legislative Fiscal Bureau, 2007.
[26] *Id*.

percent on income between $5,001 and $17,000; and 5.75 percent on income over $17,000. This is generally known as a progressive income tax.

Others argue that Virginia's income tax rates and income tax brackets, while modestly progressive, also closely resemble a flat tax. This is because the average income tax paid by Virginians in 2006 was 5.25 percent, which is fairly close to the 5.75 percent top marginal income tax rate. Because Virginia's top marginal rate is imposed on all income over $17,000, this means that much of the income earned by the average Virginian is taxed at the highest income tax rate. As a result, the actual individual income tax paid by Virginians is fairly close to the top marginal rate of 5.75 percent.

Reliance on the Income Tax

In 1998, Virginia received 51.3 percent of its total state revenues from the individual income tax. This increased to 54.9 percent in 2007. As discussed above, only three states (Oregon, New York, and Massachusetts) rely more on the individual income tax. In good economic times it may be expected that Virginia's revenue growth outpaces that of many of the states because of its heavy reliance on the individual income tax. Conversely, if Virginia's reliance on the individual income tax for revenues continues to increase, it may be that the Commonwealth's revenues are disproportionately affected in bad economic times.

Summary

The Virginia individual income tax continues to be the largest source of general fund revenue for the Commonwealth. It accounted for 66.2 percent of all general fund revenue in fiscal year 2009 and generated more than $9.4 billion. However, individual income tax revenues actually decreased by 6.3 percent from fiscal year 2008. The decrease has been attributed to the deep recession in the Virginia and national economies.

As the Commonwealth becomes increasingly dependent on the individual income tax and less dependent on other state taxes, Virginia becomes more susceptible to changes in the economy. This is because the Commonwealth's revenue base is becoming less diversified and heavily reliant on a single source of revenue.

Indeed, the more the Commonwealth becomes reliant on individual income taxes, the General Assembly has less flexibility to make major tax changes. Any major modifications would most likely impact the Commonwealth's largest source of tax revenue, the individual income tax.

Virginia Sales and Use Tax

Virginia Sales and Use Tax

History

The Virginia retail sales and use tax was enacted in 1966 at a rate of two percent of the sales price of each item of tangible personal property sold at retail. In addition, localities were authorized to levy a one percent local sales and use tax. All localities soon imposed the tax, which is collected and remitted by retailers to the Department of Taxation along with the state tax, and then returned to localities based on point of sale. From the inception of the tax, the state tax revenue generated by a one percent rate (i.e. half of the original two percent rate) has been dedicated to localities for education purposes, and apportioned according to school-age population.

The state sales tax rate has been increased three times: to three percent in 1968, to 3.5 percent in 1987, and to four percent in 2004. Currently, the combined state and local sales and use tax rate is five percent (state rate of four percent and local rate of one percent).

Like other states, Virginia imposed a corresponding use tax with the sales tax. The use tax is imposed on all items of personal property used in the state on which the sales tax has not been paid, but would have been paid if the items were purchased from a Virginia dealer. If sales tax has been paid to another state, then a full "dollar-for dollar" credit is given to the taxpayer. For example, if a Virginia resident buys a computer while in one of the few states that has no sales tax, when he returns to the Commonwealth with the computer he owes state and local use taxes at the rate of five percent of the retail price of the computer. If the same resident buys the computer in a state that imposes a sales tax at a rate of three percent, then the resident owes state and local use taxes at the rate of two percent.

The two primary purposes of the use tax are to prevent residents from avoiding the sales tax, and to prevent retailers in another state whose sales tax is less than Virginia's from having a competitive advantage over in-state retailers. The "Issues" section of this chapter discusses the difficulty in collecting the use tax.

Comparison with Other States

Table 1 shows the state and local sales and use tax rates in each state. Assuming all localities across the country impose the maximum rate authorized, of the 45 states imposing a sales tax, only Hawaii and New Mexico have lower combined state and local tax rates.[1] The tax rates in Maine, Maryland, Massachusetts, and Wyoming are the same as in Virginia. Looking solely at state tax rates (i.e. excluding local taxes), only Colorado (2.9 percent) and Nevada (two percent) have lower rates than Virginia (four percent), while seven states' rates are the same as Virginia's.

TABLE 1
State General Sales and Use Tax Rates

Maximum Local Tax Rate	State Tax Rate	Combined State & Local Rate
Alabama (4.5%)	4.00%	8.5%
Alaska	No Tax	No Tax
Arizona	5.60%	5.60%
Arkansas (5.5%)	6.00%	11.5%
California (2.50%)	6.25%	8.75%
Colorado (5.0%)	2.90%	7.90%
Connecticut	6.00%	6.00%
Delaware	No Tax	No Tax
Florida	6.00%	6.00%
George (3.0%)	4.00%	7.00%
Hawaii	4.00%	4.00%
Idaho	6.00%	6.00%
Illinois (3.0%)	6.25%	9.25%
Indiana	6.00%	6.00%
Iowa (2.0%)	5.00%	7.00%
Kansas (2.0%)	5.30%	7.30%
Kentucky	6.00%	6.00%
Louisiana (6.0%)	4.00%	10.00%
Maine	5.00%	5.00%
Maryland	5.00%	5.00%
Massachusetts	5.00%	5.00%
Michigan	6.00%	6.00%
Minnesota (1.0%)	6.50%	7.50%
Mississippi	7.00%	7.00%

[1] Because New Mexico imposes a tax rate of 4.5 percent within municipalities, and five percent elsewhere, the former rate is lower than Virginia's, and the latter is the same.

TABLE 1 (con't)
State General Sales and Use Tax Rates

Maximum Local Tax Rate	State Tax Rate	Combined State & Local Rate
Missouri (5.3125%)	4.225%	9.5375%
Montana	No Tax	No Tax
Nebraska (2.6875%)	5.50%	8.1875%
Nevada (5.75%)	2.00%	7.75%
New Hampshire	No Tax	No Tax
New Jersey	7.00%	7.00%
New Mexico	4.5% in municipalities, 5% elsewhere	4.5% in municipalities, 5% elsewhere
New York (4.75%)	4.00%	8.75%
North Carolina (3.0%)	4.25%	7.25%
North Dakota (2.0%)	5.00%	7.0%
Ohio (3.0%)	5.50%	8.5%
Oklahoma (5.0%)	4.50%	9.5%
Oregon	No Tax	No Tax
Pennsylvania (1.0%)	6.00%	7.00%
Rhode Island	7.00%	7.00%
South Carolina	6.00%	6.00%
South Dakota (2.0%)	4.00%	6.00%
Tennessee (2.75%)	7.00%	9.75%
Texas (2.0%)	6.25%	8.25%
Utah (1.85%)	4.75%	6.6%
Vermont	6.00%	6.00%
Virginia (1.0%)	4.00%	5.00%
Washington (2.5%)	6.50%	9.00%
West Virginia	6.00%	6.00%
Wisconsin (.6%)	5.00%	5.6%
Wyoming (1.0%)	4.00%	5.00%

SOURCE: Government of the District of Columbia, Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison (2008).

Amount of Revenue and its Distribution

Table 2 shows the general fund revenue generated by Virginia's **state** sales and use tax for fiscal years 2000 through 2009. Such amount excludes the amounts deposited into the Transportation Trust Fund and into a special fund to be paid to localities and credited against the Commonwealth's responsibility for Standards of Quality (these amounts are explained on the next page).

TABLE 2
State Retail Sales and Use Tax
Fiscal Years 2000-2009

Fiscal Year Ending June 30	State Sales and Use Tax	Percentage Change
2000	$2,201,533,000	+6.6
2001	$2,272,954,000	+3.2
2002	$2,429,845,000	+6.9
2003	$2,235,958,000	-3.9
2004	$2,562,334,000	+9.7
2005	$2,946,096,000	+15
2006	$2,812,749,000	-4.5
2007	$3,049,133,000	+8.4
2008	$3,075,528,000	+0.9
2009	$2,903,443,000	-5.6

SOURCE: Virginia Department of Taxation.

The state sales and use tax revenues comprise approximately 20 percent of the Commonwealth's general fund revenues, second only to the income tax as the largest source of tax revenue. The revenues are distributed as follows:

1. Revenues attributable to a rate of one percent (i.e. one-fourth of the total state tax revenues) are distributed to counties and cities on the basis of the number of school-age children in each locality.[2] The revenues must be used for the maintenance, operation, capital outlay, debt, and other expenses incurred in the operation of public schools. The total share of the state sales and use tax distributed to localities for fiscal year 2009 was approximately $968 million.

In addition, revenues generated by a 0.25 percent rate are deposited into a special fund and distributed to localities and credited against the Commonwealth's responsibility for the Standards of Quality. Table 3 shows the combined amount of both of these sources of revenue distributed to each locality in fiscal year 2008.

2. Revenues generated by a 0.5 percent rate are distributed to the Transportation Trust Fund. For fiscal year 2009 this distribution totaled $499,356,000. Out of this amount, there are required distributions of (i) 4.2 percent to the Commonwealth Port Fund; 2.4 percent to the Commonwealth Airport Fund; and (iii) 14.7 percent to the Commonwealth Mass Transit Fund.[3]

3. Sales tax revenues generated by the remaining two percent rate are expended as the General Assembly deems fit, along with all other amounts in the general fund.

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[2] Va. Code § 58.1-638 B, C, and D.
[3] Va. Code § 58.1-638 A.

TABLE 3

State Retail Sales and Use Tax Distributed by Locality - Fiscal Year 2008

County	Share of State Tax	County	Share of State Tax
Accomack	$4,505,659	King George	2,665,761
Albemarle	10,667,992	King William	2,175,818
Alleghany	2,163,971	Lancaster	1,194,540
Amelia	1,444,041	Lee	3,266,515
Amherst	3,850,544	Loudoun	41,513,389
Appomattox	1,816,202	Louisa	3,942,538
Arlington	15,232,820	Lunenburg	1,566,701
Augusta	9,782,123	Madison	1,673,331
Bath	655,115	Mathews	983,370
Bedford	8,126,912	Mecklenburg	3,564,802
Bland	701,113	Middlesex	1,114,393
Botetourt	4,337,698	Montgomery	9,055,224
Brunswick	2,057,340	Nelson	1,917,954
Buchanan	2,718,031	New Kent	2,331,234
Buckingham	1,979,981	Northampton	1,610,607
Campbell	7,517,794	Northumberland	1,285,838
Caroline	4,080,531	Nottoway	1,982,769
Carroll	3,457,474	Orange	3,851,937
Charles City	711,567	Page	2,785,633
Charlotte	1,663,574	Patrick	2,166,061
Chesterfield	45,027,315	Pittsylvania	7,798,657
Clarke	1,795,294	Powhatan	3,467,928
Craig	663,478	Prince Edward	2,670,639
Culpeper	5,477,180	Prince George	5,031,841
Cumberland	1,269,808	Prince William	56,697,424
Dickenson	1,795,991	Pulaski	4,132,104
Dinwiddie	3,432,385	Rappahannock	995,217
Essex	$1,369,469	Richmond	931,100
Fairfax	140,014,822	Roanoke	12,940,614
Fauquier	10,129,891	Rockbridge	2,443,440
Floyd	1,778,568	Rockingham	10,422,602
Fluvanna	2,735,454	Russell	3,518,107
Franklin	6,507,244	Scott	2,975,895
Frederick	9,704,763	Shenandoah	4,953,033
Giles	2,156,304	Smyth	3,746,701
Gloucester	5,403,306	Southampton	2,858,114
Goochland	1,883,804	Spotsylvania	19,778,203
Grayson	1,946,528	Stafford	22,021,624
Greene	2,246,905	Surry	920,646
Greensville	1,284,444	Sussex	2,176,419
Halifax	5,114,079	Tazewell	5,868,856
Hanover	15,418,203	Warren	4,695,224
Henrico	40,788,581	Washington	5,974,092
Henry	7,382,590	Westmoreland	1,899,137
Highland	256,471	Wise	5,422,123
Isle of Wight	4,923,120	Wythe	3,532,046
James City	7,770,083	York	9,867,845
King and Queen	784,047	**Total Counties**	**$713,918,642**

TABLE 3 (con't)

State Retail Sales and Use Tax Distributed by Locality - Fiscal Year 2008

City	Share of State Tax	City	Share of State Tax
Alexandria	$9,667,129	Martinsville	2,341,688
Bedford	628,632	Newport News	29,225,799
Bristol	2,030,857	Norfolk	29,062,718
Buena Vista	847,468	Norton	587,513
Charlottesville	4,436,662	Petersburg	3,729,974
Covington	527,577	Poquoson	1,971,618
Danville	6,097,449	Portsmouth	11,127,896
Emporia	816,803	Radford	1,067,698
Fairfax	2,428,107	Richmond	24,148,657
Falls Church	1,606,426	Roanoke	10,989,207
Franklin	1,048,184	Salem	2,939,655
Fredericksburg	2,165,364	Staunton	3,234,457
Galax	906,707	Suffolk	12,865,345
Hampton	20,592,916	Virginia Beach	65,777,737
Harrisonburg	3,270,697	Waynesboro	2,799,572
Hopewell	2,990,521	Williamsburg	646,055
Lexington	462,065	Winchester	3,096,464
Lynchburg	8,015,403	**Total Cities**	**$320,987,579**
Manassas	6,040,998	**Total Counties**	**$713,918,642**
Manassas Park	1,763,235		
		Aggregate	**$1,034,906,221**

SOURCE: Virginia Department of Taxation.

Exemptions

There are many exemptions to the sales and use tax, and they are organized as follows:

1. Government and commodities (e.g. tangible property bought by the Commonwealth, political subdivisions, or the United States; and gas, electricity, and water delivered through mains, lines, or pipes);[4]

2. Agricultural (e.g. agricultural supplies, including livestock, bought by farmers);[5]

3. Commercial and industrial (e.g. machinery, tools, and other inputs used directly in manufacturing products);[6]

4. Media-related (e.g. broadcasting equipment used by commercial radio and television companies);[7]

5. Certain nonprofit entities -- Nonprofit entities that apply to the Department of Taxation, and meet certain criteria established by law are exempt from paying sales tax on their

[4] Va. Code § 58.1-609.1.
[5] Va. Code § 58.1-609.2.
[6] Va. Code § 58.1-609.3.
[7] Va. Code § 58.1-609.6.

purchases. The criteria include: (i) tax exemption under § 501(c)(3) or § 501(c)(4) of the Internal Revenue Code; (ii) administrative costs not in excess of 40 percent; and (iii) for large entities, either a financial review or a financial audit by an independent certified public accountant;[8] and

6. Miscellaneous (e.g. items purchased at yard sales, and medicine, whether prescribed or not).[9]

In addition to the foregoing categories that are **completely** exempt from all state and local sales and use taxes year round, there are four categories that are partially exempt:

1. Food purchased for human consumption -- Food purchased for human consumption is taxed at a reduced state rate of 1.5 percent, and at the full one percent local rate. Two-thirds of the revenue from the state tax is distributed to localities based on school-age population, and the remaining one-third goes to the Transportation Trust Fund.[10]

2. Certain school supplies, clothing, and footwear -- For three days each year, beginning on the first Friday in August, the following are completely exempt from state and local sales tax: (i) any article of school supplies costing $20 or less, and (ii) any article of clothing or footwear costing $100 or less.[11]

3. Certain energy-efficient and water-efficient products -- For four days each year, beginning on the Friday before the second Monday in October, certain specified energy-efficient and water-efficient products costing $2,500 or less used for noncommercial purposes are exempt from sales and use tax (e.g. Energy Star qualified dishwashers, clothes washers, and air conditioners; and any product that qualifies under the WaterSense program of the federal Environmental Protection Agency.) This partial exemption is currently due to expire in 2012.[12]

4. Certain hurricane preparedness equipment -- For seven days each year, beginning on May 25, certain equipment related to hurricane preparedness is completely exempt from state and local sales and use taxes (e.g. portable generators, batteries, and flashlights). This partial exemption is currently due to expire in 2012.[13]

Ordinarily, retail dealers are prohibited from absorbing the cost of the sales and use tax for their customers. However, during the periods of time set forth above in the final three categories of partial exemptions, any retailer may absorb the cost of sales and use tax, and advertise such.

Although not set out as a specific exemption like the foregoing items, services are generally excluded from sales tax by virtue of various definitions that states the tax is only imposed on the sale of tangible personal property. Some states, however, impose the sales tax on numerous services. For example, according to the Federation of Tax Administrators' survey of

[8] Va. Code § 58.1-609.11.
[9] Va. Code § 58.1-609.10.
[10] Va. Code § 58.1-611.1.
[11] Va. Code § 58.1-611.2.
[12] Va. Code § 58.1-609.1, subdivision 18.
[13] Va. Code § 58.1-611.3.

states' taxation of 168 specific services, Hawaii and New Mexico tax 160 and 158 services, respectively.[14]

Dealers' Compensation

Every retail dealer is required to collect the sales and use tax from the purchaser and remit the taxes collected to the Department of Taxation. As compensation for collecting and remitting the state sales tax, dealers are entitled to keep a portion of the first three percent of the state sales and use tax remitted to the Department of Taxation.[15]

The amount of the discount is based on a sliding scale, ranging from a minimum of two percent to a maximum of four percent, depending upon the dealer's monthly taxable sales, with the dealer discount rate reduced as the dealer's taxable sales increase. The primary reason for providing a discount is to compensate dealers for the increased administrative costs of remitting the sales and use tax. Because these costs do not increase as taxable sales increase, small dealers incur greater administrative costs as a percentage of taxable sales. Accordingly, the sliding scale method for computing the discount gives small dealers a larger discount.

Issue

Services and Internet and Mail Order Sales

Two major factors operate to reduce Virginia's sales and use tax base. The first is the gradual but persistent evolution of an economy from one based primarily on goods to one based primarily on services. Virginia generally imposes the sales and use tax on the sale of tangible goods, not on services. At the time Virginia's sales and use tax was first imposed, the value of goods produced in Virginia, and the nation, exceeded the value of services rendered. This ratio is now reversed and continues to widen, reducing the base on which the sales and use tax otherwise would be imposed. Taking three services by way of examples, according to rough estimates by the Department of Taxation, taxing admissions to events; hairdressing, nail care, diet, and weight reduction programs; and laundry and dry cleaning, would generate annual revenues of $40 million, $27.5 million, and $16.6 million, respectively.

The second factor is the ever-increasing sale of goods carried out over the Internet (e-commerce). The United States Supreme Court has ruled that the Constitution's interstate commerce clause prohibits a state from requiring an out-of-state seller to collect and remit sales and use taxes, unless he has a sufficient "nexus" with the state in the form of some physical presence in the state (e.g. offices or employees).[16] However, the Court also held that Congress has the ultimate power to resolve such issues concerning interstate commerce. Thus, for example, Congress could enact legislation modifying the "physical presence" requirement. To date, Congress has not enacted such legislation.

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[14] Federation of Tax Administrators, Sales Taxation of Services: 2007 Update, October 2008.
[15] Va. Code § 58.1-622.
[16] Quill Corp. v. North Dakota, 112 S. Ct. 1904 (1992).

Accordingly, when goods are sold over the Internet, by phone, or by mail order, by an out-of-state seller without a physical presence in the purchaser's state, the transaction triggers no sales and use tax collection duties for the seller. Such a sale is deemed to occur in the state where the purchaser receives the goods. Thus, the seller collects no sales and use tax for his own state, and cannot be required to collect the tax for the purchaser's home state. Combining this fact with the virtual impossibility of the Department of Taxation finding out about such purchases, results in a very small amount of use tax paid by individuals. In 2009, only $1,973,447 use tax was paid by individuals. On the other hand collecting the full amount of use tax from businesses is the norm for a variety of reasons (e.g. audits are much easier and can be heavily utilized on very large businesses; and businesses that collect sales tax must file use tax returns on their own purchases along with the sales tax collected from customers).

E-commerce in the United States has been increasing at a very fast pace. In 2001 the total value of e-commerce in the United States was approximately $754 billion. By 2007, it had reached $2.5 trillion, and, by 2012, it is estimated to reach $4 trillion. One study[17] estimates that for the three-year period 2007 through 2009, that Virginia's loss of sales and use tax revenue on e-commerce trade totaled approximately $400 million, and will grow to $550 million for the three-year period 2010 through 2012.[18]

Summary

Retail sales and use tax revenues represent the second largest source of revenues to the Commonwealth's general fund, comprising about 20 percent. The Commonwealth's sales and use tax rates are among the lowest in the country. For fiscal year 2009, the state sales and use tax generated $2,903,443,000. Twenty-five percent of the revenue goes to localities for education purposes according to school-age population, and twelve and one-half percent is dedicated to the Transportation Trust Fund. The two biggest issues facing the Commonwealth regarding sales and use taxes are: (i) the continuous movement in commerce from goods to services, and (ii) the spiraling value of goods sold over the Internet. The former impacts sales and use tax because goods, not services, are taxed; and the latter because out-of-state sellers cannot be required to collect the tax, unless they have a physical presence in-state.

[17] State and Local Government Sales Tax Revenue Losses from Electronic Commerce, by Bruce, Stokely, and Luna, University of Tennessee, April 13, 2009.

[18] The study included the amount of unpaid use taxes by businesses as well as individuals. Some critics think that the methodology overstates the amount of uncollected use tax from businesses.

Corporate Income Tax

Corporate Income Tax

History

The corporate income tax is an outgrowth of a license tax, which was a payment imposed for the privilege of doing business. The tax evolved from its earliest form when, in 1842-43, the Commonwealth imposed a 1.5 percent tax on all "dividends of profit." At that time many public service corporations had exemptions to encourage public works, and very few of the remaining corporations were profitable enough to pay dividends, with the result that very little tax revenue was generated. However, this tax formed the basis of our current net earnings tax.[1] Corporate taxation in Virginia evolved through a number of different tax philosophies during the next 70 years, including the taxation of computed rent, gross earnings, and bonded indebtedness as a measure of wealth, and attempts to tax the owners of a corporation.[2] Since the early 1900s, however, Virginia has based its corporate income tax on net income and has focused on more accurately determining income.

The Virginia corporate income tax is the third largest source of general fund revenue, comprising approximately five percent of the Commonwealth's general fund. In fiscal year 2009, the Commonwealth collected $648 million from this tax, a 19.8 percent decrease over the previous fiscal year. Until the 1989 Session, the corporate income tax had been segregated for

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[1] Sydenstricker, Edgar. *A Brief History of Taxation in Virginia*. Richmond: The Legislative Reference Bureau of Virginia, 1915.
[2] *Id.*

state taxation only; the 1989 General Assembly, however, passed legislation that allows the Northern Virginia localities, as well as the Cities of Norfolk and Virginia Beach, to impose up to a one percent local income tax on individuals and corporations for transportation purposes, conditional upon its approval by local referendum. Further, the local tax would expire five years after its adoption.[3] Through 2009, no locality had placed a local income tax on its ballot.

The Commonwealth's corporate income tax is the most volatile of all general fund taxes. Corporate income taxes reflect a corporation's bottom line -- profits -- which can fluctuate dramatically from year to year.

Table 1 sets forth Virginia's annual corporate income tax collections for the past 10 fiscal years and the percentage change for each year. Revenues actually decreased in four of the 10 years and increased in the remaining six years. This volatility is highlighted by the changes in collections for fiscal years 2001 and 2002 and again in 2008 and 2009. Collections increased more than 34 percent in 2000 and decreased more than 35 percent in 2001. Then in 2002, they dropped 20.2 percent and rose more than 18 percent in 2003. According to the Department of Taxation, a broad-based recovery in corporate earnings drove the increase in 2003.

TABLE 1
Corporate Income Tax, Fiscal Years 2000 - 2009

Fiscal Year Ending June 30	Tax Collections	% Increase/Decrease from Previous Year
2000	$565,909,000	+34.6
2001	$363,757,000	-35.7
2002	$290,215,000	-20.2
2003	$343,319,000	+18.3
2004	$425,716,000	+24.0
2005	$616,690,000	+44.9
2006	$871,554,000	+41.3
2007	$879,575,000	+ 0.9
2008	$807,852,000	- 8.2
2009	$648,033,000	-19.8

SOURCE: Virginia Department of Taxation, *Annual Report, 2000-2009.*

The Commonwealth's corporate income tax has grown 14.5 percent during this 10-year period, while the general fund has grown 33.5 percent during the same period. The corporate income tax has decreased significantly as a component of the general fund, comprising 5.3 percent in 2000 and only 4.5 percent in 2009.

Virginia conformed its corporate income tax to the federal system in 1971.[4] The Virginia tax is currently imposed at a flat rate of six percent on Virginia taxable income. This rate has not changed since January 1, 1972, when it increased from five percent to the current level.

[3] Va. Code §§ 58.1-540 through 58.1-549.
[4] Chapter 171, 1971 Acts of Assembly. This legislation was effective for taxable years 1972 and after.

Corporate Tax Structure

The Virginia corporate income tax applies to all domestic (incorporated in Virginia) and foreign (incorporated outside Virginia) corporations doing business in the state except:

- Public service corporations other than telecommunications corporations;
- Insurance companies;
- Inter-insurance exchanges;
- State and national banks;
- Banking associations;
- Electing small business corporations (S corporations);
- Any company that does business on a mutual basis;
- Credit unions; and
- Religious, educational, benevolent, and other nonprofit corporations.

Corporations exempt from the corporate income tax are either exempt or subject to other forms of taxation.

Virginia's six percent corporate income tax applies to a corporation's Virginia taxable income, which is computed by using federal taxable income as the base. Most states (39 of the 45 states that impose a corporate income tax) conform their corporate tax, in general, to the federal system for much the same reason most states conform their individual income tax. For Virginia tax returns, modifications are made to federal taxable income. These include (i) the addition of income taxes imposed by Virginia or any other taxing jurisdiction (because such income taxes are deductible when computing federal taxable income); (ii) the addition of certain interest and dividends; (iii) a special depreciation allowance for certain property; and (iv) the carry-back of certain net operating losses for five years.

Virginia permits most corporations engaged in multistate activities that have income taxable by Virginia and out-of-state political subdivisions to apportion their Virginia taxable income through the following three-factor formula, so that different states do not impose a tax on the same income:

1. **A Property Factor (25 percent):** A ratio of the average real and tangible personal property value of the firm in Virginia to the firm's total average real and tangible personal property value.
2. **A Payroll Factor (25 percent):** A ratio of the payroll in Virginia to the firm's total payroll.
3. **A Sales Factor (50 percent):** A ratio of the sales in Virginia to the firm's total sales.

These ratios are added together with the sales factor doubled and divided by a denominator of four to determine the portion of total taxable income subject to the Virginia corporate income tax. However, if there is no sales factor, then the denominator will be the number of existing factors and where there is a sales factor but no payroll or property factor, the denominator will be the existing factors plus one. All three factors do not necessarily pertain to all corporations, although this occurrence appears to be the exception rather than the rule. Also, a corporation can petition the Tax Commissioner to use a different allocation formula if the three-factor formula is inherently unfair to the particular corporation. Special apportionment factors exist for motor carriers, financial corporations, construction companies, and railway companies. A corporation's dividends are allocated to the state of commercial domicile of the taxpaying corporation. Moreover, Virginia prohibits consolidation or combination of an affiliated group that includes any controlled foreign corporation whose income derives from sources outside the United States.

Beginning July 1, 2011, certain corporations may elect to apply an apportionment formula that multiplies their income only using the sales factor or using the three-factor formula described above. This new option is for manufacturers only and will be phased in with the 100 percent single sales factor formula taking effect July 1, 2014.

A corporation's taxable year for purposes of Virginia's corporate income tax is the same as the corporation's federal taxable year. Corporations utilizing a calendar year reporting basis must file their corporate tax return by April 15 of the following year. Each corporation may elect whether to file separately, file separately on a combined return, or file on a consolidated return, which is a single return for a group of affiliated corporations. Once an election is made, however, it is generally irrevocable.

Comparison with Other States

Table 2 lists the corporate income tax rates in other states. Five states have no corporate income tax: Nevada, South Dakota, Texas, Washington, and Wyoming. The table also shows that 13 states impose a progressive tax rate on corporate income, while the majority of states impose a flat corporate income tax rate, as does Virginia. Iowa has the highest state corporate tax rate at 12 percent; Pennsylvania has the next highest at 9.99 percent; and Minnesota has the third highest at 9.8 percent.

An examination of Table 2 shows Virginia's corporate income tax rate compares very favorably with the rates of other states. Of the 45 other states that impose a broadbased corporate income tax, only eight impose a lower rate than Virginia, and 34 impose a higher rate. Virginia also ranks well when comparing its corporate tax rate to the top rate of its neighboring and competing states.

State	**Rate**
Georgia	6.00%
South Carolina	5.00%
Kentucky	4.00% on first $50,000; 5% on next $50,000; 6% over $100,000
Tennessee	6.50%
Maryland	7.00%
Virginia	**6.00%**
North Carolina	6.90%
West Virginia	8.75%

SOURCE: Virginia Division of Legislative Services

Of the Southern states shown in the table above, only South Carolina has a lower corporate income tax rate than Virginia, while Georgia has an equal rate. Kentucky has lower rates on the first $100,000 and the same rate as Virginia on everything over $100,000. The remainder of Virginia's neighboring states have higher rates than Virginia.

In contrast to Virginia's corporate income tax rate of six percent, the federal corporate income tax rate schedule, according to I.R.C. § 11 (b), is as follows:

Taxable Income	Rate
$50,000 or less	15%
$50,001 but not over $75,000	25%
$75,001 but not over $100,000	34%
$100,001 but not over $335,000	39%
$335,001 but not over $10,000,000	34%
$10,000,001 but not over $15,000,000	35%
$15,000,001 but not over $18,333,333	38%
$18,333,334 and over	35%

Personal service corporations are subject to a flat federal tax rate of 35 percent, regardless of their taxable income amount. Finally, in addition to the regular federal tax, a corporation may be liable for an additional tax at 15 percent on accumulated taxable income in excess of $250,000 ($150,000 for personal service corporations), as provided in IRC § 531.

As with individual income tax comparisons, it may be helpful to examine corporate income tax collections on both a per capita and per $100 of personal income basis. An examination of these two measures clearly shows that Virginia places a very modest burden on its corporate citizens. As Table 3 shows, Virginia collected an average of $166.00 per capita in corporate income tax in 2006 (which was 23rd among the 50 states), compared to the U.S. per capita average of $201.00.

TABLE 2
State Corporate Income Tax Rates, Fall, 2008

State	Taxable Income	Rates & Minimum Tax
Alabama		6.5%
Alaska	$10-20K	2.00%
	$20-30K	3.00%
	$30-40K	4.00%
	$40-50K	5.00%
	$50-60K	6.00%
	$60-70K	7.00%
	$70-80K	8.00%
`	$80-90K	9.00%
	Over $90K	9.47%
Arizona		6.968%; $50 minimum
Arkansas	1st $3K	1.00%
	2nd $3K	2.00%
	Next $5K	3.00%
	Next $14K	5.00%
	Next $75K	6.00%
	If net income over $100,000	6.5%
California		8.84% (S corps - 1.5%); $800 minimum
Colorado		4.63%
Connecticut		7.50% (S corps - no tax); $250 minimum and $1M maximum

TABLE 2 (con't)

State Corporate Income Tax Rates, Fall, 2008

State	Taxable Income	Rates & Minimum Tax
Delaware		8.70%
District of Columbia		9.75%; $100 minimum (6% for "qualified" high tech cos.)
Florida		5.50% (3.3% for TX Pusing Fed Amr)
Georgia		6.00%
Hawaii	1st $25K	4.40%
	Next $75K	5.40%
	Over $100K	6.40%
Idaho		7.6%; $20 minimum
Illinois		4.8%
Indiana		8.5%
Iowa	1st $25K	6.00%
	Next $75K	8.00%
	Next $150K	10.00%
	Over $250K	12.00%
Kansas		4.00% + 3.35% surtax on over $50K
Kentucky	1st $50K	4.00%
	2nd $50K	5.00%
	Over $100,000	6.00%
Louisiana	1st $25K	4.00%
	2nd $25K	5.00%
	Next $50K	6.00%
	Next $100K	7.00%
	Over $200K	8.00%
Maine	1st $25M	3.50%
	Next $50K	7.93%
	Next $175K	8.33%
	Over $250K	8.93%
Maryland		7.00%
Massachusetts		9.50% + $2.60 per $1,000 on tangible values or net worth ($456 minimum)
Michigan		4.95% on bus. inc. and 0.8% on gross receipts
Minnesota		9.80%
Mississippi	1st $5K	3.00%
	Next $5K	4.00%
	Over $10K	5.00%
Missouri		6.25%
Montana		6.75% ($50 minimum)
Nebraska	1st $50K	5.58%
	Over $50K	7.81%
Nevada	No Tax	
New Hampshire		8.5%
New Jersey		9.00%
New Mexico	1st $500K	4.80%
	Next $500K	6.40%
	Over $1 Million	7.60%
New York		7.1%
North Carolina		6.9%
North Dakota	1st $3K	2.6%
	Next $5K	4.1%
	Next $12K	5.6%

TABLE 2 (con't)
State Corporate Income Tax Rates, Fall, 2008

State	Taxable Income	Rates & Minimum Tax
	Next $10K	6.4%
	Over $30K	7.00%
Ohio	1st $50K	5.10%
	Over $50K	8.50% ($50 minimum)
Oklahoma		6.00%
Oregon		6.60% ($10 minimum)
Pennsylvania		9.99%
Rhode Island		9.00% ($500 minimum)
South Carolina		5.00%
South Dakota	No Tax	
Tennessee		6.5%
Texas	No Tax	
Utah		5.00% ($100 minimum)
Vermont	1st $10K	6.00%
	Next $15K	7.00%
	Over $25K	8.5% ($250 minimum)
Virginia		**6.00%**
Washington	No Tax	
West Virginia		8.75%
Wisconsin		7.90%
Wyoming	No Tax	

K = thousands
SOURCE: Research Institute of America, *All States Tax Guide*.

TABLE 3
State Corporate Income Tax Per Capita Collections Ranking of States - 2007

Rank	State	Per Capita
1.	Alaska	$1,195
2.	New Hampshire	454
3.	Delaware	351
4.	New Jersey	332
5.	Massachusetts	326
6.	California	307
7.	West Virginia	298
8.	New York	279
9.	Connecticut	236
10.	Kentucky	233
11.	Illinois	229
12.	Minnesota	228
13.	New Mexico	216
14.	North Dakota	214
15.	Kansas	190
16.	Montana	187
17.	Pennsylvania	184
18.	Tennessee	182
19.	Michigan	178
20.	North Carolina	173
21.	Louisiana	172
22.	Rhode Island	170
23.	**Virginia**	**166**
24.	Wisconsin	165
25.	Indiana	156

TABLE 3 (con't)
State Corporate Income Tax Per Capita
Collections Ranking of States - 2007

Rank	State	Per Capita
25.	Oklahoma	156
27.	Arizona	155
28.	Utah	149
29.	Maine	140
30.	Maryland	139
31.	Florida	134
31.	Vermont	134
33.	Arkansas	128
34.	Idaho	126
34.	Mississippi	126
36.	Nebraska	120
37.	Ohio	113
38.	Alabama	109
38.	Iowa	109
38.	Oregon	109
41.	Georgia	107
42.	Colorado	99
43.	South Dakota	96
44.	Hawaii	79
45.	South Carolina	71
46.	Missouri	66
47.	Nevada	0
47.	Texas	0
47.	Washington	0
47.	Wyoming	0
	U.S. AVERAGE	***$201***

SOURCE: Research Institute of America, *All States Tax Guide*.

Corporate Tax Base

For fiscal year 2006, Virginia corporations filed 157,013 returns with an actual tax liability of $848.5 million. Table 4 shows that 204 corporations with taxable incomes of greater than $10 million filed returns. These corporations comprise 0.3 percent of all corporate returns in Virginia, yet they paid 68.7 percent of the total corporate income tax. This amounts to an average payment of $2.85 million per corporation for those corporations with taxable income of greater than $10 million. The 626 corporations with taxable income of greater than $2 million but less than $10 million comprised approximately 0.9 percent of all corporate tax returns, yet they paid over 18.6 percent of the entire corporate income tax.

At the other end of the spectrum, almost 84.6 percent of the returns were filed by corporations with Virginia taxable income of less than $25,000, and these corporations only paid 3.3 percent of the entire state corporate tax. The average tax payments by these smaller corporations amounted to $100.27 per return. Clearly, a handful of corporations paid the lion's share of Virginia's corporate income tax, while thousands of small corporations paid either no tax or very small amounts of tax in fiscal year 2006.

TABLE 4
Number of Corporate Returns by Taxable Income and Tax Assessed
Fiscal Year 2006

Taxable Income From Virginia Sources	Number of Corporate Returns	Percent of Total	Corporate Income Tax Assessed	Percent of Total
UP to $24,999	61,234	84.6	$ 6,139,891	3.3
$25,000 to $49,999	3,156	4.4	$ 6,870,719	0.8
$50,000 to $99,999	2,544	3.5	$ 10,774,544	1.3
$100,000 to $499,999	3,214	4.4	$ 42,657,374	5.0
$500,000 to $999,999	817	1.1	$ 34,954,314	4.1
$1,000,000 to $1,999,999	537	0.7	$ 45,368,027	5.3
$2,000,000 to $9,999,999	626	0.9	$157,975,531	18.6
$10,000,000 and Over	204	0.3	$582,987,336	68.7
Totals Before Adjustments	**157,013**	**100.0**	**$909,780,365**	**107.2**
Departmental Adjustments	**1,897**	**-----**	**<$61,285,920>**	**-7.2**
Totals	**155,116**	**100**	**$848,494,445**	**100**

SOURCE: Virginia Department of Taxation, *Annual Report, Fiscal Year* (2008).

Issues

Corporate Income Tax Growth

As this report has noted, the general fund has grown approximately 33.5 percent since fiscal year 2000, while the corporate income tax has grown by only 14.5 percent. Virginia's increase in corporate income tax collections follows the pattern of federal corporate income tax collections. Since corporate collections are based on profits, actual collections will be volatile. For instance, look at Table 1 in this chapter to see the extreme differences in each year's collections from 2000 through 2009. Moreover, corporate profits generally do not grow as quickly as personal income; therefore, growth in corporate tax collections will continue to lag behind individual income tax collections.

Broadening of the Corporate Income Tax

The corporate income tax extends to all corporations organized under the laws of the Commonwealth and all foreign corporations having income from Virginia sources, with the following exceptions:

- Public water companies and telegraph companies (currently there is only one telegraph company). Beginning in 2001 and 2002, electricity and gas firms, respectively, were phased into a corporate income tax from a gross receipts tax basis;
- Insurance companies that pay a gross receipts license tax based on gross receipts;

- Banks, banking associations, and trust companies that pay a bank franchise tax on net capital;
- S corporations, whose shareholders pay an individual income tax when the proceeds are distributed to the shareholders of the S corporations;
- Credit unions; and
- Nonprofit corporations.

These exempted corporations make up a significant percentage of all corporations. It could be argued that these corporations were either different or regulated and therefore not typical corporations striving to maximize profits. However, as the economy has changed, and with less regulation and an increase in the diversity of corporations into other areas, some argue that there is less justification for treating one corporation differently from another for tax purposes.

Summary

Although the Virginia corporate income tax remains a source of general fund revenue to the Commonwealth, it's volatility makes it difficult to count on from year to year. As with the Virginia individual income tax, the corporate income tax generally conforms to the federal income tax system, and benefits from federal rules, regulations, and audits. The corporate income tax is the most volatile component of the general fund, since it depends on net corporate profits.

Virginia's six percent corporate tax rate compares favorably to other states; and comparisons of states' corporate income tax collections, on a per capita basis, reveal that Virginia's tax burden is somewhere in the middle of the pack.

Communications Sales and Use Tax

Communications Sales and Use Tax

History

Joint Subcommittee Work

A joint subcommittee studying the state and local taxation of the telecommunications industry and its customers began its work in 2002 (HJR 209) and concluded its deliberations in 2003 (HJR 651). The joint subcommittee's charge was to "examine state and local taxes imposed on the telecommunications industry and its customers to ensure that the taxes...are fair and equitable to all elements of the...industry, and its customers, and are relatively easy to administer and collect." Any changes that the joint subcommittee might propose were to be as revenue neutral as possible while allowing for future revenue growth and preserving the ability of local governments that have chosen not to impose some of the telecommunications taxes to impose such taxes in the future.

A review of the state and local taxes and fees allowed to be imposed on the telecommunications industry and its customers revealed that such taxes and fees at the state level included the corporate income tax, the minimum tax on telecommunications firms, and the relay center assessment. Local taxes included the local consumer utility tax, the local utility license (gross receipts) tax, the E-911 system tax, the public rights-of-way use fee, and the video programming excise tax.

Early in the study process, representatives from the telecommunications' industry, the Virginia Municipal League (VML), and the Virginia Association of Counties (VACo) were encouraged by the joint subcommittee to meet and work jointly on suggestions of how to improve the system for taxing telecommunications services and its customers. That group met several times during the two years of the study, separate from the joint subcommittee, in an effort to develop a system of taxation that would be fair to all (customers and the industry) and, at the same time, raise the same amount of revenues as raised under the system when the study began. The group also met for a third year at the behest of the joint subcommittee to continue its work on a communications services tax plan.

Several national organizations (National Conference of State Legislatures, National Association of Counties, the National League of Cities, the Multistate Tax Commission, American Legislative Exchange Council, and the National Governors Association) as well as major telecommunications companies had been working on the issue of telecommunications taxation when the joint subcommittee began its deliberations. According to testimony by telecommunications industry representatives, Virginia had the highest combined (state and local) telecommunications tax rate in the country at that time; about three percent in state taxes and 25 percent in local taxes for a total average of 28 percent. The tax burden varied between competing communications companies. For example, long-distance, satellite, and paging companies did not pay or collect from customers any of the local telecommunications-related taxes while wireline, wireless, and cable television companies did. In addition, not all of the taxes and fees were imposed by all localities. For example, the public rights-of-way use fee was only authorized in localities where the public streets and roads are maintained by the Virginia Department of Transportation. Also, not all localities chose to impose the local utility license tax.

The telecommunications industry supported tax simplification through a reduction in the compliance burden, consolidation of the taxes, and state administration of all telecommunications taxes. Two states that provided guidance were North Carolina and Florida. Both states made significant changes to their respective telecommunications tax systems during 2001-2002.

Florida's telecommunications tax law combined seven different state and local taxes/fees and replaced them with a two-tiered tax system composed of a state tax and a local option sales tax on communications services. The Department of Revenue administered the state and local Communications Sales Tax. Under North Carolina's law, there was one tax imposed at one rate that was a six percent state sales tax in 2002 (similar to Virginia's current system). The new system continued to be administered at the state level, as it was before.

At the conclusion of the study, the joint subcommittee approved the following set of guiding principles for the interested parties to follow in developing the framework for changing the way communications and video services were taxed:

- Reduce consumer confusion.
- Consolidate taxes.
- Make taxes uniform statewide.
- Reduce tax rate on the vast majority of Virginians.
- Establishment of competitively neutral taxes.
- Preserve state and local government revenues.
- Establish a single point of administration.

Industry/Local Government Follow-up Work

The joint subcommittee approved the continuation of the negotiating team (industry and local government representatives) in an effort to work out all of the details in order for proposed legislation to be drafted for introduction. Following the 2004 General Assembly Session, the negotiating group met and worked on the remaining issues.

The proposed framework under which discussions continued was comprised of the following five components:

1. The simplified plan would impose a statewide sales and use tax of 4.5 percent (the retail sales and use tax rate at the time) on communications and video services, and an E-911 fee not to exceed $0.75 on wireline and wireless.

2. Tax revenues collected would be remitted to a single point of administration, possibly a third-party administrator.

3. Localities would be kept whole based on (i) tax rates adopted no later than a certain date, and (ii) revenues from such rates collected beginning and ending by certain dates, as determined by the Auditor of Public Accounts (APA).

4. The sales and use tax imposed on communications and video services was to be in lieu of the state retail sales and use tax; however, the rate of such tax was not to exceed the state retail sales and use tax rate.

5. The distribution of revenues under the plan was to be determined by the local governments and approved by the General Assembly.

The group reported its recommendations in the form of legislation to the chairmen of the House and Senate Finance Committees in November 2004. The legislation introduced during the 2005 General Assembly (HB 2880) actually contained the provisions necessary to change the way telecommunications were taxed. However, that legislation was amended because the legislators thought more information concerning collections was needed. Instead, the Auditor of Public Accounts was directed to review and collect information in 2005 regarding certain local communications taxes and report to the chairmen of the House and Senate Finance Committees and the Department of Taxation no later than December 1, 2005 (Chapter 126, *Acts of Assembly, 2005*). This information was needed in order to determine what percentage of the new communications services sales taxes collected that each locality would receive. Based on this information, the local representatives developed the formula currently used to distribute the revenues back to the localities. The legislation introduced and enacted in 2006 (Chapter 780, 2006 Acts of Assembly) created the current Communications Sales and Use Tax (Va. Code § 58.1-645 et seq.) and took effect January 1, 2007.

Communications Sales Tax - How it Works

The communications sales tax applies a statewide tax to retail communication and video services on a competitively neutral basis. The communications sales and use tax rate is five percent, the same as the retail sales and use tax rate, and is applied to local exchange, paging, inter-exchange (both interstate and intrastate), cable television, satellite television, wireless, and Voice-over-Internet (VoIP).[1]

A $0.75 "911 Tax" is applied to each local exchange line (landline).[2] The $0.75 "911 Fee" is applied to each wireless number, as it was under prior law.[3]

The state communications sales and use tax, and state 911 fees and taxes replaced the Local Consumer Utility Tax (LCUT), local gross receipts tax (BPOL - but only the portion above 0.5 percent currently billed to customers, where applicable), local E-911, Virginia relay fee, and the cable franchise fee.

A statewide rights-of-way use fee is applied to all cable TV service lines and is applied on all local exchange telephone lines and the fee rate is the same as determined annually by the Virginia Department of Transportation in accordance with § 56-468.1 of the Virginia Code.[4]

The sales tax, 911 tax, and the cable rights-of-way fee assessed on consumers of video services from a single provider are remitted within 30 days of receipt of the collections for a given month to the Virginia Department of Taxation, which administers the distribution of the Communications Sales and Use Tax Trust Fund.[5] The rights-of-way use fee assessed on consumers of both cable video services and voice services from a single provider is remitted in accordance with subsection I of § 56-468.1. The 911 fees are remitted directly to the Wireless 911 Board for administration.

[1] Va. Code § 58.1-648.
[2] Va. Code § 58.1-1730.
[3] Va. Code § 56-484.12.
[4] Va. Code § 56-468.1.
[5] Va. Code § 58.1-662.

Compensation for Communications Services Providers

Every communications services provider is required to collect the communications sales and use tax from the consumer and remit the taxes collected to the Department of Taxation on or before the 20th day of each month following the month of collection.[6]

As compensation for collecting the communications sales and use tax, providers are entitled to a discount in the form of a deduction from the amount of communications sales tax remitted to the Department of Taxation.[7] The amount of the discount is based on a sliding scale, ranging from a minimum of two percent to a maximum of four percent, depending upon the dealer's monthly taxable sales, with the dealer discount rate reduced as the dealer's taxable sales increase.[8] This is the same discount provided to dealers under Virginia's retail sales and use tax.

The primary reason for providing a discount is to compensate communications services providers for the administrative costs of collecting the tax. Because these costs do not increase as communications services sales increase, smaller providers incur greater administrative costs as a percentage of taxable sales when collecting the tax. Accordingly, the sliding scale method for computing the discount gives the smaller providers a greater discount.

Penalties

Any communications services provider who intentionally neglects, fails, or refuses to collect the tax on every sale of taxable communications services that he makes to consumers will be liable for and have to pay the tax himself and will be guilty of a Class 1 misdemeanor.[9] The revenues collected by the providers are deemed to be held in trust for the Commonwealth.

Collection and Distribution of the Tax

Although the revenue from the communications sales tax is collected by the communications services providers and remitted to the Department of Taxation, all of the revenue is distributed to the localities (except for administrative costs incurred by the Department and a discount paid to communications services providers) from the Communications Sales and Use Tax Trust Fund. Table 1 shows the total revenues collected and distributed to each locality for fiscal years 2007, 2008, and 2009.

[6] Va. Code § 58.1-654.
[7] Va. Code § 58.1-656.
[8] *Id.*
[9] Va. Code § 58.1-659.

TABLE 1
Comparison of Communications Tax Revenues

Locality	FY 2007	FY 2008	FY 2009
Abingdon	59,607.43	138,973.38	126,298.53
Accomac	2,645.61	6,169.88	5,607.20
Accomack	467,600.87	1,090,199.63	990,774.02
Albemarle	2,278,921.08	5,313,252.02	4,828,684.31
Alberta	5,998.36	13,984.11	12,708.78
Alexandria	5,318,252.71	12,399,379.41	11,268,559.84
Alleghany	203,788.07	475,128.93	431,797.07
Altavista	19,999.34	46,626.48	42,374.20
Amelia	124,946.00	291,307.65	264,740.72
Amherst County	622,847.02	1,452,151.71	1,319,715.89
Amherst	50,330.32	117,342.83	106,641.25
Appalachia	19,481.31	45,418.39	41,276.91
Appomattox County	277,221.75	646,337.19	587,391.33
Appomattox	3,110.19	7,253.33	6,591.87
Arlington	3,698,082.48	8,621,992.00	7,835,669.07
Ashland	134,362.89	313,264.18	284,694.84
Augusta	1,230,044.44	2,867,821.06	2,606,276.47
Bath	0.00	21,281.45	120,347.81
Bedford City	69,361.45	161,716.13	146,967.19
Bedford County	942,363.59	2,197,096.77	1,996,722.10
Berryville	45,953.86	107,141.19	97,370.02
Big Stone Gap	94,096.99	219,383.21	199,375.74
Blacksburg	607,847.00	1,417,179.46	1,287,933.02
Blackstone	8,769.37	20,446.43	18,581.73
Bland	51,421.87	119,888.45	108,954.76
Bluefield	24,360.10	50,049.40	45,484.95
Boones Mill	1,646.57	3,840.00	3,489.80
Botetourt	352,049.15	820,795.79	745,939.49
Bowling Green	20,067.17	46,784.68	42,517.96
Boyce	1,382.12	2,852.43	2,591.63
Boydton	7,381.81	17,210.47	15,640.90
Boykins	1,792.52	4,180.37	3,799.11
Bridgewater	44,889.04	104,657.90	95,113.24
Bristol	298,324.96	695,538.05	632,105.13
Broadnax	5,106.21	11,903.51	10,818.57
Broadway	23,471.31	54,723.55	49,732.84
Brookneal	9,133.21	21,294.97	19,352.87
Brunswick	206,028.72	480,349.60	436,542.25
Buchanan County	415,531.47	968,801.07	880,446.85
Buchanan	1,410.17	3,288.69	2,988.76
Buckingham	208,370.09	485,809.97	441,503.99
Buena Vista	155,102.26	361,616.51	328,637.48
Burkeville	873.65	2,037.45	1,851.64
Campbell	685,153.51	1,597,419.62	1,451,735.51
Cape Charles	23,197.91	54,085.95	49,153.41
Caroline	386,086.46	900,150.93	818,057.56
Carroll	497,713.96	1,160,407.81	1,054,579.28
Cedar Bluff	18,585.05	43,333.00	39,380.46
Charles City	76,103.96	177,435.67	161,253.07
Charlotte	63,215.09	147,386.86	133,944.70
Charlotte Court House	1,233.38	2,876.40	2,614.07
Charlottesville	1,575,698.49	3,673,702.70	3,338,661.99
Chase City	26,010.03	60,644.15	55,112.82
Chatham	36,604.81	85,342.86	77,559.70

TABLE 1 (con't)
Comparison of Communications Tax Revenues

Locality	FY 2007	FY 2008	FY 2009
Chesapeake	5,852,357.68	13,644,636.30	12,400,248.86
Chesterfield	7,164,342.04	16,703,488.83	15,180,135.54
Chilhowie	20,996.32	48,951.57	44,487.26
Chincoteague	83,722.16	195,197.46	177,395.64
Christiansburg	436,472.29	1,017,623.20	924,816.46
Clarke	211,309.66	492,665.40	447,734.28
Clarksville	17,290.00	40,312.78	36,635.67
Cleveland	826.37	1,927.19	1,751.44
Clifton	1,686.28	3,518.80	3,617.75
Clifton Forge	46,239.60	107,807.56	97,975.64
Clintwood	35,922.33	83,751.25	76,113.23
Coeburn	22,712.78	52,954.57	48,125.19
Colonial Beach	99,930.90	232,988.59	211,740.31
Colonial Heights	342,426.69	798,359.85	725,549.68
Courtland	2,927.23	6,826.66	6,203.47
Covington	152,797.88	356,242.43	323,753.55
Craig	56,799.43	132,424.77	120,347.79
Crewe	20,866.82	48,649.55	44,212.76
Culpeper County	1,001,181.65	2,334,229.25	2,121,348.27
Culpeper	63,470.93	140,910.16	128,058.66
Cumberland	188,300.87	439,020.49	398,981.70
Damascus	12,231.07	28,514.74	25,914.20
Danville	1,584,245.84	3,693,631.37	3,356,773.17
Dayton	12,545.58	29,248.22	26,580.80
Dickenson	242,800.03	566,080.77	514,454.83
Dillwyn	1,917.91	4,472.81	4,064.88
Dinwiddie	453,688.28	1,057,763.40	961,295.94
Drakes Branch	696.86	1,625.17	1,476.34
Dublin	45,670.19	106,479.62	96,768.16
Dumfries	92,092.74	214,713.85	195,131.55
Edinburg	4,822.53	11,241.94	10,216.68
Elkton	25,936.03	60,471.56	54,956.00
Emporia	131,318.49	306,164.26	278,242.42
Essex	173,272.07	403,981.12	367,137.89
Fairfax County	1,118,427.22	2,607,588.15	2,369,776.48
Fairfax	38,903,145.49	90,701,762.30	82,429,786.54
Falls Church	423,090.06	986,423.83	896,462.47
Farmville	257,175.13	599,595.65	544,913.20
Fauquier	1,424,567.73	3,321,348.21	3,018,441.83
Fincastle	1,615.94	3,255.13	2,958.29
Floyd	305,242.19	711,665.08	646,761.42
Floyd	228.18	532.13	483.63
Fluvanna	412,289.72	961,245.72	873,580.57
Franklin City	273,342.75	637,290.91	579,170.07
Franklin County	1,092,400.74	2,546,905.64	2,314,628.81
Frederick	664,438.81	1,549,124.82	1,407,844.47
Fredericksburg	875,834.81	2,041,986.77	1,855,758.60
Fries	6,286.15	14,655.27	13,318.75
Front Royal	86,100.94	195,374.83	177,556.21
Galax	114,957.64	268,023.17	243,579.13
Gate City	19,446.37	45,336.89	41,202.20
Giles	124,508.15	290,286.52	263,812.73
Glade Spring	14,294.93	33,327.91	30,288.44

TABLE 1 (con't)
Comparison of Communications Tax Revenues

Locality	FY 2007	FY 2008	FY 2009
Glasgow	10,300.82	24,017.96	21,827.53
Gloucester	752,042.03	1,753,368.57	1,593,462.04
Goochland	420,789.80	981,059.33	891,587.20
Gordonsville	14,987.68	34,943.49	31,756.70
Goshen	3,722.77	8,677.15	7,886.44
Grayson	187,310.05	436,709.78	396,881.73
Greene	242,436.18	565,232.23	513,683.66
Greensville	87,210.59	203,328.09	184,784.78
Gretna	12,932.04	30,149.49	27,399.87
Grottoes	17,030.99	39,708.73	36,086.71
Grundy	9,745.80	22,723.58	20,650.60
Halifax County	571,776.66	1,333,083.04	1,211,506.11
Halifax	50,326.21	117,333.24	106,632.57
Hamilton	8,101.28	18,888.38	17,165.77
Hampton	4,501,971.89	10,496,241.37	9,538,986.49
Hanover	2,449,921.67	5,711,935.77	5,191,008.59
Harrisonburg	796,223.93	1,856,377.33	1,687,075.89
Haymarket	61,895.36	144,309.10	131,147.64
Haysi	7,293.42	17,004.33	15,453.58
Henrico	6,470,221.83	15,085,172.14	13,709,408.14
Henry	1,142,578.95	2,663,893.72	2,420,947.71
Herndon	847,892.47	1,976,841.06	1,796,554.12
Highland	37,135.16	86,579.71	78,683.75
Hillsville	9,055.10	21,112.79	19,187.33
Honaker	7,636.71	17,804.93	16,180.52
Hopewell	415,013.45	967,592.98	879,348.95
Hurt	11,698.66	27,273.09	24,786.42
Independence	16,899.43	39,401.92	35,807.89
Iron Gate	7,914.22	18,452.12	16,769.28
Irvington	1,673.02	2,842.84	2,583.62
Isle Of Wight	655,620.11	1,528,563.34	1,389,158.82
Ivor	914.76	2,133.33	1,938.77
James City	838,837.37	1,955,728.26	1,777,366.14
Jarratt	2,277.65	5,311.76	4,826.69
Jonesville	9,873.25	23,020.81	20,921.30
Kenbridge	15,478.98	36,089.26	32,797.33
Keysville	1,165.55	2,718.20	2,470.28
Kilmarnock	37,492.84	87,413.87	79,441.84
King And Queen	86,410.94	201,463.22	183,090.00
King George	190,403.79	443,919.96	403,434.94
King William	176,376.09	411,215.27	373,712.91
La Crosse	6,014.81	14,022.46	12,743.63
Lancaster	39,850.66	92,912.59	84,439.07
Lawrenceville	25,477.62	59,402.50	53,984.40
Lebanon	39,850.66	92,912.59	84,438.42
Lee	207,146.99	482,957.54	438,911.73
Leesburg	1,064,589.97	2,482,066.74	2,255,703.16
Lexington	158,198.05	368,836.28	335,198.83
Loudoun	5,723,222.29	13,343,558.48	12,126,629.59
Louisa County	171,054.03	398,808.39	362,436.90
Louisa	4,127.61	8,221.72	7,471.93
Lovettsville	6,569.83	15,316.84	13,919.96
Lunenburg	101,546.63	236,751.88	215,160.37
Luray	38,017.03	88,636.34	80,552.81

TABLE 1 (con't)
Comparison of Communications Tax Revenues

Locality	FY 2007	FY 2008	FY 2009
Lynchburg	1,669,437.79	3,892,256.54	3,537,283.31
Madison	285,814.33	666,371.33	605,597.80
Manassas	1,420,444.11	3,311,731.43	3,009,702.10
Manassas Park	359,868.81	839,027.38	762,507.76
Marion	64,115.46	149,481.83	135,849.23
Martinsville	447,297.30	1,042,863.63	947,754.37
Mathews	220,712.16	514,583.58	467,654.12
McKenney	4,483.35	10,450.93	9,497.83
Mecklenburg	283,847.08	661,783.47	601,428.95
Melfa	2,018.64	4,707.71	4,278.37
Middleburg	22,301.65	51,995.77	47,253.83
Middlesex	216,037.64	503,686.81	457,751.10
Middletown	7,054.96	16,448.23	14,948.16
Mineral	958.54	2,066.22	1,877.81
Monterey	3,389.75	7,905.31	7,183.70
Montgomery	501,101.65	1,168,308.33	1,061,759.29
Montross	6,859.68	15,992.80	14,534.25
Mount Jackson	11,032.63	25,724.62	23,378.56
Narrows	21,869.97	50,989.03	46,338.90
Nelson	233,134.41	543,548.95	493,977.30
New Castle	1,217.73	2,665.47	2,422.38
New Kent	293,356.48	683,955.74	621,579.13
New Market	25,257.67	58,889.54	53,518.88
Newport News	5,732,297.95	13,364,719.21	12,145,859.86
Newsoms	633.14	1,476.55	1,341.89
Norfolk	10,774,833.64	25,121,265.85	22,830,213.81
Northampton	239,286.94	557,892.61	507,012.79
Northumberland	188,169.30	438,713.68	398,703.50
Norton	103,877.73	242,188.28	220,100.97
Nottoway	170,916.31	398,487.19	362,144.99
Occoquan	22,813.51	53,189.47	48,338.65
Onancock	48,309.63	112,635.12	102,362.26
Onley	2,061.81	4,808.39	4,369.91
Orange County	704,486.82	1,642,492.84	1,492,698.06
Orange	86,937.19	202,690.48	184,205.35
Page	240,830.73	561,492.91	510,284.72
Painter	1,200.49	2,799.70	2,544.39
Parksley	10,586.55	24,684.33	22,433.14
Patrick	240,462.77	560,634.78	509,504.87
Pearisburg	12,138.56	28,299.00	25,718.17
Pembroke	3,837.88	8,945.61	8,130.40
Pennington Gap	23,169.13	54,018.84	49,091.71
Petersburg	904,852.24	2,109,639.76	1,917,241.11
Phenix	682.47	1,591.61	1,446.45
Pittsylvania	1,117,354.17	2,605,085.68	2,367,502.29
Pocahontas	9,730.80	20,690.92	18,803.95
Poquoson	202,918.53	473,101.07	429,954.16
Portsmouth	4,085,112.48	9,524,343.38	8,655,725.77
Pound	16,151.17	37,656.90	34,222.63
Powhatan	423,745.81	987,953.11	897,851.65
Prince Edward	153,198.73	357,177.26	324,603.10
Prince George	627,106.31	1,462,084.89	1,328,742.49
Prince William	9,532,582.80	22,224,987.58	20,198,074.76
Pulaski County	405,347.82	945,061.16	858,871.42

TABLE 1 (con't)
Comparison of Communications Tax Revenues

Locality	FY 2007	FY 2008	FY 2009
Pulaski	223,355.72	520,748.67	473,257.00
Purcellville	79,249.09	184,765.70	167,915.29
Quantico	13,951.64	32,527.32	29,560.86
Radford	367,168.39	856,046.10	777,974.39
Rappahannock	170,681.96	397,940.67	361,648.30
Remington	9,301.78	21,688.07	19,710.16
Rick Creek	3,854.33	8,983.96	8,164.65
Richmond City	10,093,511.84	23,532,782.25	21,386,598.76
Richmond County	151,313.71	352,785.95	320,611.58
Ridgeway	9,501.17	22,153.09	20,132.73
Roanoke City	3,421,409.58	7,976,934.81	7,249,440.35
Roanoke County	1,938,926.21	4,520,558.69	4,108,285.02
Rockbridge	458,911.67	1,069,940.17	972,362.20
Rockingham	783,941.47	1,827,742.74	1,661,052.77
Rocky Mount	96,265.69	224,440.88	203,972.14
Round Hill	6,874.06	16,026.35	14,564.78
Rural Retreat	19,635.49	45,777.94	41,603.06
Russell	423,667.70	987,770.94	897,686.68
Saint Charles	688.64	1,605.99	1,459.54
Saint Paul	11,863.11	27,656.61	25,134.36
Salem	525,855.69	1,226,018.55	1,114,206.45
Saltville	23,689.21	55,231.72	50,193.98
Scott	381,510.60	889,484.27	808,363.10
Scottsville	8,705.64	20,297.81	18,446.68
Shenandoah County	586,969.91	1,368,505.93	1,243,698.47
Shenandoah	13,707.02	31,956.83	29,042.39
Smithfield	116,482.92	271,575.53	246,808.17
Smyth	289,627.54	675,259.42	613,675.87
Southampton	274,181.45	639,246.86	580,947.63
South Boston	384,809.91	897,173.86	815,351.98
South Hill	87,305.15	203,548.61	184,985.21
Spotsylvania	2,319,004.04	5,406,701.54	4,913,612.02
Stafford	2,851,285.66	6,647,706.15	6,041,437.17
Stanardsville	2,074.39	4,309.81	3,916.12
Stanley	8,179.40	19,070.55	17,331.33
Staunton	688,019.07	1,604,102.46	1,457,808.21
Stephens City	13,443.89	31,343.20	28,484.72
Strasburg	40,995.66	95,578.06	86,862.06
Stuart	1,560.23	3,638.65	3,306.82
Suffolk	1,723,626.55	4,018,592.92	3,652,098.61
Surry	25,284.39	58,951.87	53,575.49
Sussex	86,250.60	201,089.29	182,750.16
Tappahannock	31,186.14	72,710.66	66,078.90
Tazewell County	198,122.72	461,916.66	419,790.37
Tazewell	15,505.76	31,602.07	28,720.02
Timberville	16,118.28	37,580.20	34,152.87
Troutville	1,181.28	2,555.20	2,321.54
Urbanna	2,431.08	4,161.20	3,781.69
Victoria	25,233.00	58,832.02	53,465.98
Vienna	525,358.22	1,224,858.40	1,113,151.44
Vinton	167,251.10	389,944.28	354,381.19
Virginia Beach	12,852,297.75	29,964,825.34	27,232,041.07
Wachapreague	1,247.77	2,909.96	2,644.55
Wakefield	8,734.42	20,364.93	18,507.04

TABLE 1 (con't)
Comparison of Communications Tax Revenues

Locality	FY 2007	FY 2008	FY 2009
Warren	438,268.92	1,021,813.16	928,624.31
Warrenton	265,079.07	618,023.80	561,660.10
Warsaw	23,177.36	54,038.01	49,109.81
Washington County	795,354.39	1,854,349.46	1,685,233.00
Washington	2,078.65	4,209.14	3,825.25
Waverly	15,719.49	36,650.16	33,307.70
Waynesboro	638,517.17	1,488,686.82	1,352,919.01
Weber City	11,182.69	26,069.79	23,692.30
Westmoreland	313,156.41	730,117.20	663,530.07
West Point	42,557.94	99,221.50	90,172.62
White Stone	2,066.03	3,792.06	3,446.21
Williamsburg	353,701.89	824,645.37	749,438.63
Winchester	1,051,466.75	2,451,471.41	2,227,898.07
Windsor	32,847.09	76,584.21	69,599.82
Wise County	494,087.81	1,151,955.99	1,046,897.63
Wise	53,023.21	123,622.98	112,348.69
Woodstock	46,266.32	107,869.88	98,032.25
Wythe	375,259.40	874,910.50	795,119.04
Wytheville	210,082.44	489,803.38	445,133.23
York	647,120.03	1,508,744.93	1,371,147.83
Statewide Distribution Total	**205,564,142.31**	**479,400,387.49**	**435,679,611.84**

SOURCE: Virginia Department of Taxation

Thus far, the amount of revenues collected has been revenue neutral for the most part, which was a major goal of the joint subcommittee.

Each locality's share of the revenues is based on the amount of telecommunications and television cable funds (LCUT on landlines and wireless, E-911 fees, BPOL tax exceeding 0.5 percent, cable franchise fees, video programming excise tax, and LCUT on cable television) they collected in 2006 as compared to the statewide total of such revenues collected.[10]

Other States Tax Communications Services

Most states (and the District of Columbia) impose sales or similar excise taxes on communications services. Several, including Virginia, levy the tax on both interstate and intrastate telecommunications. Table 2 shows a list of state sales taxes on telephone calls and other taxable communications.

TABLE 2
List of State Sales Taxes on Telephone Calls & Other Taxable Communications

State	State Tax Rate	Service Taxed
Alabama	6%	Inter- and intrastate; mobile telecommunications
Alaska	Not Taxed	

[10] *Id.*

TABLE 2 (con't)
List of State Sales Taxes on Telephone Calls & Other Taxable Communications

State	State Tax Rate	Service Taxed
Arizona	5.6%	Intrastate
Arkansas	6%	Inter- and intrastate
California	0.50% (eff. 11/1/2007 to 10/31/2008; pre- 11/1/2007, 0.65%)	Intrastate
Colorado	2.9%	Intrastate
Delaware	Not Taxed	
D.C.	5.75%	Local, "900" -type phone services, and other specified services
Florida	9.17%	Inter- and intrastate
Georgia	4%	Local
Hawaii	4%	Interstate
Idaho	Not Taxed	
Illinois	7%	Inter- and intrastate
Indiana	6%	Intrastate
Iowa	5%	Intrastate
Kansas	5%	Inter- and intrastate
Kentucky	6%	Inter- and intrastate
Louisiana	3%	Inter- and intrastate
Maine	5%	Intrastate
Maryland	5%	Mobile telecommunications, "900" -type phone services, and other specified services
Massachusetts	5%	Inter- and intrastate
Michigan	6%	Inter- and intrastate; mobile telecommunications, and air-ground radiotelephone services
Minnesota	6.5%	Inter- and intrastate; mobile telecommunications
Mississippi	7%	Inter- and intrastate
Missouri	4.225%	Intrastate
Montana	3.75%	Inter- and intrastate
Nebraska	5.5%	Intrastate; mobile telecommunications
Nevada	Not Taxed	
New Hampshire	7%	Inter- and intrastate
New Jersey	7%	Inter- and intrastate
New Mexico	5% 4.25%	Intrastate Interstate
New York	4%	Intrastate
North Carolina	4.5%	Intrastate
North Dakota	5%	Intrastate
Ohio	5.5%	Inter- and intrastate
Oklahoma	4.5%	Inter- and intrastate
Oregon	Not Taxed	
Pennsylvania	6%	Inter- and intrastate
Rhode Island	7%	Inter- and intrastate
South Carolina	10%	"900" or "976" phone service
South Dakota	4%	Intrastate
Tennessee	7%	Inter- and intrastate
Texas	6.25%	Inter- and intrastate
Utah	5.75%	Intrastate
Vermont	6%	Inter- and intrastate
Virginia	**5%**	**Inter- and intrastate**
Washington	6.5%	Inter- and intrastate
West Virginia	Not Taxed	

TABLE 2 (con't)
List of State Sales Taxes on Telephone Calls & Other Taxable Communications

State	State Tax Rate	Service Taxed
Wisconsin	5%	Inter- and intrastate
Wyoming	4%	Intrastate; intrastate calls using mobile telecommunications services

SOURCE: Research Institute of America, *All States Tax Guide*.

Issue

Distributions to Localities

Prior to the communications sales and use tax taking effect, localities were told that in order to receive a share of the revenues from the tax, they needed to enact by a certain date the local consumer utility tax (LCUT). Otherwise, their share would be smaller. Most localities did impose the LCUT but some did not so as the legislation's effective date drew near, those localities that had failed to enact the LCUT began to complain and asked to be included in the formula that was done through legislation in 2008 and 2009. By doing this, the original group of localities saw their shares slightly reduced.

Summary

The communications sales and use tax applies a statewide tax to retail communication and video services on a competitively neutral basis at a rate of five percent, the same as the retail sales and use tax rate. It is applied to local exchange, paging, inter-exchange (both interstate and intrastate), cable television, satellite television, wireless, and Voice-over-Internet (VoIP).

The goals of the new tax are to:

- Reduce consumer confusion;
- Consolidate taxes;
- Make taxes uniform statewide;
- Reduce tax rate on the vast majority of Virginians;
- Make taxes competitively neutral;
- Preserve state and local government revenues; and
- Establish a single point of administration.

The tax is collected from customers by communications services providers and remitted to the Department of Taxation. The revenues from the tax (minus the Department's administrative costs and a discount for providers) are held temporarily in the Communications Sales and Use Tax Trust Fund and distributed to the localities on a monthly basis.

Thus far, the amount of collections for 2007, 2008, and 2009 has been well within the range of what was expected when the tax was created.

ABC Taxes

History

Current System of Taxing

Disposition of ABC Tax Revenues and Net Profits

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ABC Taxes

History

On August 17, 1933, Governor Garland Pollard convened the Virginia General Assembly in a special session to respond to federal legislation legalizing the sale and taxation of beer and repealing the 18th Amendment to the United States Constitution.[1] The Virginia General Assembly enacted the following legislation at the 1933 Special Session:

1. Legalized the sale of beer and imposed a state excise tax of $2.75 per 31-gallon barrel on manufacturers and bottlers and a one-cent tax on beverages in 12-ounce bottles;
2. Authorized a general referendum on the question of ratifying the repeal of the 18th amendment; and
3. Established a joint subcommittee, the Liquor Control Committee, to examine and propose a plan for liquor control in the Commonwealth in case the 18th Amendment was repealed.[2]

On October 3, 1933, Virginia voted to repeal the 18th Amendment and to establish a plan of liquor control in the Commonwealth. On December 5, 1933, the 18th Amendment was officially repealed by ratification of the 21st Amendment, and national prohibition ended.[3]

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[1] Address of Governor Pollard to the General Assembly (August 17, 1933).
[2] Chapters 3 and 4, 1933 Acts of Assembly.
[3] "Liquor Tax" 13 *Congressional Digest* 61 (1934). The states that ratified were Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Idaho, Illinois, Indiana, Iowa, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Nevada, New Hampshire, New Jersey, New Mexico, New York, Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming.

On December 13, 1933, the Liquor Control Committee submitted its report to the General Assembly of Virginia and recommended adoption of the Virginia Alcoholic Beverage Control Act. The act authorized the state government, through the Alcoholic Beverage Control Board, to sell liquor at retail and to regulate the hours and conditions of alcoholic beverage sales. The legislation authorized private licensees to sell wine and beer for on-premises or off-premises consumption, depending on the type of license. Additionally, the act included a local option provision, which allowed any political subdivision of the state to petition the local court for a referendum on the question of whether the sale of alcoholic beverages should be permitted in the county, city, or town.

Nationally, revival of the liquor industry was viewed as an essential tool to economic recovery in the United States because new jobs would be created, purchasing power would increase, and new taxes would generate revenues for federal, state, and local governments to provide needed services.[4] In setting tax rates on alcoholic beverages, Virginia, like other alcohol beverage control states, has consistently tried to balance the conflicting requirements of the state and localities for revenues from taxes on alcoholic beverages with the need to keep the products priced at a competitive level to discourage bootlegging -- all without encouraging consumption.[5]

Virginia's policy relating to the taxation of alcoholic beverages was best summarized in the 1933 Report of the Liquor Control Committee:

> *Temperance, social betterment, and respect for law should be the prime objectives of any system of liquor control. Taxes should be levied as a method of promoting social control and not primarily raising State or local revenues. The system should not have for its object the rehabilitation of the finances of any class of citizens, type of industry or locality.*[6]

Virginia's liquor control plan, enacted in 1934, provided a fairly low tax rate on alcoholic beverages to maintain the retail price as low as possible to discourage the illegal manufacture of alcoholic beverages. Originally, taxes on alcoholic beverages were limited to a state and local license tax that varied based on the type of license and included a state excise tax on beer. Virginia did not impose a state excise tax on wine or distilled spirits until 1980.[7] All tax revenues collected were deposited into the state's general fund, with a portion of net profits distributed to localities based on population. Additionally, a portion of ABC revenues were to be used for operating expenses of the Alcoholic Beverage Control (ABC) Department.[8]

Tax increases on alcoholic beverages have been infrequent in the Commonwealth. In 1982, the state tax on distilled spirits was increased from 15 percent to 20 percent. In 1986, fees charged for licenses to sell alcoholic beverages were increased slightly. In 1988, the General Assembly transferred the administration and collection of the beer and beverage excise tax from the Tax Department to the ABC Department to centralize ABC tax collection procedures. In

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[4] "The Role Occupied by Repeal in the Drama of Economic Recovery Is Gradually Becoming Apparent As Remote Ramifications of Beer Industry Are Being Affected," 117 *Literary Digest* 10 (1933).
[5] *Report of the Commission to Study the Alcoholic Beverage Control System* (Senate Document No. 15, 1953).
[6] *Report of the Liquor Control Committee* (Senate Document No. 5, December, 1933).
[7] Chapter 624, 1980 Acts of Assembly.
[8] Chapter 94, 1934 Acts of Assembly.

1992, the sales and use tax exemption for alcoholic beverages sold in Virginia ABC stores was eliminated.

Current System of Taxing

The present alcoholic beverage control system is basically the same as that enacted in 1934, except for the adoption of the mixed beverage laws in 1968. The ABC Board's mission is to regulate and control the possession, sale, transportation, and delivery of alcoholic beverages into and within the Commonwealth. Raising revenues for the Commonwealth is a secondary goal of the Department, and this is consistent with the fact that ABC taxes comprise a mere 1.2 percent of the Commonwealth's general fund, compared to the sales tax and income tax, which combined comprise almost 87 percent of the general fund revenues.[9]

The Department, which operates 332 retail stores across the Commonwealth, administers and collects four types of state taxes on alcoholic beverages:

1. Liter tax on wine (40 cents per liter sold);[10]
2. Distilled spirits tax (four percent of the sales price on wine from state vineyards sold through state stores and 20 percent of the sales price on distilled spirits);[11]
3. License tax (amount varies depending on type of license);[12] and
4. Beer and beverage excise tax ($7.95 per 31-gallon barrel; two cents per bottle of seven ounces or less; 2.65 cents per bottle of seven to 12 ounces; and 2.22 mills per ounce for bottles of more than 12 ounces).[13]

In fiscal year 2009, alcoholic beverage taxes generated $173,227,000 in general fund revenues for the Commonwealth.[14]

In addition to taxing authority, the ABC Department can impose a reasonable markup on the sale price for alcoholic beverages.[15] This mark-up covers the Department's costs of purchasing and transporting the beverages for sale at the state liquor stores. The total price charged in Virginia for distilled spirits is the delivered cost plus (i) a reasonable mark-up, with bottle price rounded to the next highest nickel, (ii) 20 percent state tax rounded again to the next highest nickel, and (iii) five percent sales tax. However, the Board is responsible for setting the retail prices of the various classes, varieties, and brands of alcoholic beverages sold in government stores. Differences in the cost of operating stores, and market competition and conditions may be reflected in the sale price of alcoholic beverages sold at government stores.[16]

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[9] Department of Accounts Summary Report on General Fund Revenue Collections for Fiscal Year 2009.
[10] Va. Code § 4.1-234. The wine liter tax was enacted in 1980 and combined the following previous taxes: the state wine tax, the state sales tax on wine, and the Department's markup on wine sold through distributors.
[11] Id.
[12] Va. Code § 4.1-231; local governments can impose local license tax under Va. Code § 4.1-233.
[13] Va. Code § 4.1-236; Chapter 261, 1988 Acts of Assembly, changed administration of the beer and beverage tax from the Tax Department to the ABC Department.
[14] Department of Accounts Summary Report on General Fund Revenue Collections for Fiscal Year 2009.
[15] Va. Code § 4.1-235.
[16] Va. Code § 4.1-119

Disposition of ABC Tax Revenues and Net Profits

The following table (Table 1) shows the ABC taxes that are deposited into the general fund. In fiscal year 2009, $129.6 million was collected under the Alcoholic Beverage Excise Tax. This figure includes the 20 percent state tax, ABC license taxes, and a portion of the wine liter tax.

By statute, the wine liter tax (40 cents per liter) is required to be distributed according to the following formula: 44 percent is distributed to localities on the basis of general population, 44 percent to the general fund, and the remaining 12 percent to the Alcoholic Beverage Control Department for operating expenses. However, Chapter 781 of the 2009 Acts of Assembly (the Appropriations Act) adjusted the wine tax by transferring $9,886,363 in fiscal year 2009 to be used for the expenses incurred for care, treatment, study, and rehabilitation of alcoholics by the Department of Behavioral Health and Developmental Services. In fiscal year 2009, the wine liter tax generated $32,808,757. After the above distribution, 44 percent or $10,085,853 was transferred to the general fund for the Commonwealth and 44 percent was also transferred to be distributed to localities based on general population. This is included in the Alcoholic Beverage Excise Tax.

TABLE 1
Alcoholic Beverage Excise Tax and Beer and Beverage Excise Tax Revenue Deposited into General Fund

Fiscal Year	Alcoholic Beverage Excise Tax	Percentage Change	Beer & Beverage Excise Tax	Percentage Change
2000	$ 77,289,000		$39,915,000	
2001	$ 82,842,000	+7.2%	$40,145,000	+0.6%
2002	$ 86,324,000	+4.2%	$41,131,000	+2.5%
2003	$ 87,802,000	+1.7%	$40,921,000	-0.5%
2004	$ 95,851,000	+9.2%	$42,189,000	+3.1%
2005	$102,693,000	+7.1%	$41,773,000	-1.0%
2006	$110,025,000	+7.1%	$42,938,000	+2.8%
2007	$118,714,000	+7.9%	$43,131,000	+0.4%
2008	$125,339,000	+5.6%	$43,523,000	+0.9%
2009	$129,626,000	+3.4%	$43,601,000	+0.2%

SOURCE: Virginia Department of Accounts

The other components of the Alcoholic Beverage Excise Tax are the distilled spirits tax and the various ABC license taxes. The other tax listed in Table 1 is the Beer and Beverage Excise Tax that is imposed on all beer sold, in different amounts based on the size of the container.

In fiscal year 2009, total net profits from ABC sales were $111,751,021. By statute, the net profits are distributed to the general fund and two-thirds is distributed to localities on the basis of population. However, Chapter 781 of the 2009 Acts of Assembly (the Appropriations Act) made two transfers before net profits were transferred into the general fund. In fiscal year 2009, $65,375,769 was transferred to the Department of Behavioral Health and Developmental Services for the care, treatment, study, and rehabilitation of alcoholics. A second transfer in fiscal year 2009 was made in the amount of $580,679 for expenses incurred by the Virginia Wine Board. A total of $36.6 million was transferred to the general fund in fiscal year 2009.

Comparison with Other States

Table 2 provides a listing of the beer and beverage excise tax rates and the wine excise tax rates imposed by other states. In terms of the beer and beverage tax, Virginia imposes a tax of 26 cents per gallon. Beer excise taxes range from a low of two cents per gallon in Wyoming to a high of $1.07 in Alaska. Nineteen states have a higher beer tax than Virginia. Table 2 also provides the wine tax rates for all states. Virginia's wine tax rate is $1.51 per gallon. Only five states have wine excise tax rates that exceed Virginia's.

Virginia is one of 18 states that have established state alcoholic beverage control agencies to administer sales of alcoholic beverages. Table 3 provides the state liquor excise tax rates for the other states.

TABLE 2
State Beer Excise Tax Rates and State Wine Excise Tax Rates
November 2008 - Tax Per Gallon

State	Beer Excise Tax Rate	Wine Excise Tax Rate
Alabama	$0.53	$1.70
Alaska	1.07	2.50
Arizona	0.16	0.84
Arkansas	0.23	0.75
California	0.20	0.20
Colorado	0.08	0.277
Connecticut	0.20	0.60
Delaware	0.16	0.97
Florida	0.48	2.25
Georgia	0.48	0.42
Hawaii	0.93	1.38
Idaho	0.15	0.45
Illinois	0.185	0.73
Indiana	0.115	0.47
Iowa	0.19	1.75
Kansas	0.18	0.30
Kentucky	0.08	0.50
Louisiana	0.32	0.11
Maine	0.35	0.60
Maryland	0.09	0.40
Massachusetts	0.11	0.55
Michigan	0.20	0.51
Minnesota	0.15	0.30
Mississippi	0.4268	1.00
Missouri	0.06	0.36
Montana	0.14	1.02
Nebraska	0.31	0.95
Nevada	0.16	0.70
New Hampshire	0.30	n/a
New Jersey	0.12	0.70
New Mexico	0.41	1.70
New York	0.11	0.19
North Carolina	0.53	0.79
North Dakota	0.16	0.50
Ohio	0.18	0.32
Oklahoma	0.40	0.72
Oregon	0.08	0.67
Pennsylvania	0.08	n/a
Rhode Island	0.10	0.60

TABLE 2 (con't)
State Beer Excise Tax Rates and State Wine Excise Tax Rates
November 2008 - Tax Per Gallon

State	Beer Excise Tax Rate	Wine Excise Tax Rate
South Carolina	0.77	0.90
South Dakota	0.27	0.93
Tennessee	0.138	1.21
Texas	0.19	0.20
Utah	0.4129	n/a
Vermont	0.265	0.55
Virginia	**0.26**	**1.51**
Washington	0.261	0.87
West Virginia	0.18	1.00
Wisconsin	0.06	0.25
Wyoming	0.02	n/a

SOURCE: Federation of Tax Administrators

TABLE 3
State Liquor Excise Tax Rates
January 1, 2008 ($ Per Gallon)

State	Excise Tax Rates
Alabama	*
Alaska	$12.80
Arizona	3.00
Arkansas	2.50
California	3.30
Colorado	2.28
Connecticut	$ 4.50
Delaware	5.46
Florida	6.50
Georgia	3.79
Hawaii	5.98
Idaho	*
Illinois	4.50
Indiana	2.68
Iowa	*
Kansas	2.50
Kentucky	1.92
Louisiana	2.50
Maine	*
Maryland	1.50
Massachusetts	4.05
Michigan	*
Minnesota	5.03
Mississippi	*
Missouri	2.00
Montana	*
Nebraska	3.75
Nevada	3.60
New Hampshire	*
New Jersey	4.40
New Mexico	6.06
New York	6.44
North Carolina	*
North Dakota	2.50
Ohio	*
Oklahoma	5.56

TABLE 3 (con't)
State Liquor Excise Tax Rates
January 1, 2008 ($ Per Gallon)

State	Excise Tax Rates
Oregon	*
Pennsylvania	*
Rhode Island	3.75
South Carolina	2.72
South Dakota	3.93
Tennessee	4.40
Texas	2.40
Utah	*
Vermont	*
Virginia	*
Washington	*
West Virginia	*
Wisconsin	3.25
Wyoming	*

SOURCE: Compiled by Federation of Tax Administrators from various sources.
*In 18 states, the government directly controls the sales of distilled spirits. Revenue in these states is generated from various taxes, fees and net liquor profits.

Issues

Privatization

There has been increasing discussion since the 1990's regarding the possibility of eliminating state-operated liquor stores and allowing privately operated retail stores to sell distilled spirits. A House General Laws subcommittee as well as a joint subcommittee of the House and Senate have studied the privatization of the sale of distilled spirits but the General Assembly has handily rejected privatization bills. However, interest in this option continues especially since state budgets have suffered during the current recession.

Summary

Alcoholic beverage taxes are unique to the Commonwealth's tax structure because, unlike most other taxes, they are not levied for the primary purpose of producing revenues. Instead, alcoholic beverage taxes are merely one component of the Commonwealth's overall alcoholic beverage control policy, which has the three goals of service, control, and revenues. Virginia's alcoholic beverage excise tax generated \$129.6 million and the beer and beverage excise tax generated \$43.6 million in general fund revenues in fiscal year 2009. Combined these sources comprised 1.2 percent of the Commonwealth's general fund revenue. Moreover, in fiscal year 2009, \$36.6 million of net ABC profits were transferred to the general fund.

The Code of Virginia dedicates two-thirds of net ABC profits and 44 percent of the wine liter tax to localities to help meet their budget needs. Increasingly in recent years, appropriation acts have diverted some of the revenue earmarked for localities to help meet state needs.

Periodically the General Assembly has considered the issue of privatizing the sale of distilled spirits in the Commonwealth. However, to date, sufficient support for such measures has been lacking.

Recordation Taxes

Recordation Taxes

History

A tax on deeds involving real estate was first enacted on March 28, 1843, and was imposed at the rate of 50 cents per deed. Thereafter the tax was increased to one dollar per deed, and then to one dollar for the first $1,000 of consideration and 10 cents for every $100 of consideration in excess of $1,000. The state recordation tax assumed its present form in this century and except for numerous exemptions from the tax passed by the General Assembly, the recordation tax has remained relatively unchanged. Major recordation tax law changes may be summarized as follows:

1922 10 cents per $100 of consideration or actual value.
1926 12 cents per $100 of consideration or actual value.
1948 15 cents per $100 of consideration or actual value.
1958 Local option tax equal to one-third of the state tax.
1966 Recordation taxes no longer apply to documents relating to personal property because the Uniform Commercial Code superseded the recordation system for almost all property except real estate.
1968 Additional tax imposed at rate of 50 cents per $500 (also known as the grantor's tax), followed language of the federal stamp tax, which was repealed effective January 1, 1968. The local option tax authorization was not extended to this "additional" (grantor's) tax.
1989 Chapter 286, *Acts of Assembly, 1989,* provided for annual distributions of $40 million to the U.S. Route 58 Corridor Development Fund, effective January 1, 1990. Chapter 713, *Acts of Assembly, 1989,* provided for annual distributions of $40 million to counties and cities based on point of origin, effective July 1, 1990, with a June 30, 1995, expiration date. Both distributions were subject to future appropriation by the General Assembly and neither action was fully funded by the 1990 Session of the General Assembly. The 1990 Session delayed funding the Chapter 713 distribution and funded the Chapter 286 distribution only to the extent necessary to fund debt service on bonds issued to build the first part of the U.S. Route 58 Corridor

Development Program. Subsequent annual debt service requirements have been funded, as necessary, by the General Assembly from the general fund.

1993 Chapter 391, *Acts of Assembly, 1993,* created the Northern Virginia Transportation District Fund and the Transportation Improvement Program Set-aside Fund and funded the former with $9.5 million in recordation taxes attributable to the Cities of Alexandria, Fairfax, Falls Church, Manassas, and Manassas Park and the Counties of Arlington, Fairfax, Loudoun, and Prince William. See Item 274 of § 1-77 of Chapter 994, *Acts of Assembly, 1993,* at page 1818. The Set-aside Fund received no distribution. The 1993 legislation also eliminated the five-year sunset provision on annual distributions of $40 million to localities and made the program permanent.

1994 Chapter 597, *Acts of Assembly, 1994,* provides for an additional $19 million from recordation taxes to the Northern Virginia Transportation District Fund.

2004 Chapter 3, *Acts of Assembly, 2004,* Special Session I, increased the state recordation tax from 15 cents to 25 cents per $100, effective October 1, 2004.

2007 Effective July 1, 2008, Chapter 896, *Acts of Assembly, 2007,* provided that two cents of the existing recordation tax be deposited into the Commonwealth Mass Transit Fund and one cent be deposited into the Highway Maintenance and Operating Fund.

From 2000 through 2009, the revenues derived from the state recordation tax have more than doubled, with tremendous fluctuations from year to year depending upon changes in the economy, interest rates, and tax policy (matters inherently interrelated). Because the tax is based on the sales price of real estate, it is extremely sensitive to fluctuations in the economy, particularly the real estate market. For example, between 2006 and 2009 revenues fell by more than one-half. Moreover, two additional factors are at work: (i) the state of the economy (which affects the number of new housing units being built), and (ii) the effects of inflation in general. The volatility of the state recordation tax is amply demonstrated by the revenue generated by the tax during the past 10 fiscal years, as shown in Table 1.

TABLE 1

State Recordation Taxes, Fiscal Years 2000-2009

Fiscal Year Ending June 30	Amount	% Variation From Previous Year
2000	$146,288,000	-7.3
2001	$167,622,000	+14.6
2002	$214,422,000	+27.9
2003	$285,841,000	+33.3
2004	$340,578,000	+19.1
2005	$596,058,000	+75.0
2006	$694,713,000	+16.6
2007	$582,946,000	-16.0
2008	$456,348,000	-21.7
2009	$314,264,000	-31.1

SOURCE: Department of Accounts *Summary Report on General Fund and Lottery Revenue Collections*.

During the period of 2000 through 2006, recordation tax collections increased by a factor of almost four. During this period, the Virginia and U.S. economies recovered from the 2000 and 2001 recession and Virginia's recordation tax collections increased by very robust, double digit levels each year. The 75 percent increase in fiscal year 2005 is an anomaly that reflects the increase in the recordation tax from 15 cents to 25 cents per $100 of actual value. These increases in recordation tax revenue reflect strong economic growth after recovering from the recession, and strong refinancing activity as well as rapid escalation in housing prices. However, the housing bubble finally burst and the deepest recession since the Great Depression caused recordation tax collections to decline by almost 55 percent over the next three fiscal years ending with fiscal year 2009.

In summary, Table 1 demonstrates the volatility of the recordation tax as a revenue source. Despite the possibility of such dramatic fluctuations, the Commonwealth Transportation Board, as of the summer of 2009, had sold almost $606 million in debt for the U.S. Route 58 Corridor Development Program (approximately $493 million of outstanding debt as of June 30, 2008) and more than $324 million in debt for the Northern Virginia Transportation District Program (approximately $283 million outstanding as of June 30, 2008), secured in part by a portion of recordation tax collections. A number of these bonds have terms of 25 years or more. Relying on recordation tax collections to pay debt service reduces the amount left in the general fund to fund other state programs.

The Department of Accounts Summary Report for 2009 shows general fund recordation tax collections as approximately 2.1 percent of the Commonwealth's total general fund of $14.6 billion.

Tax Base

Virginia's recordation taxes are made up of two components: the state recordation tax under §§ 58.1-801 and 58.1-803 imposed at a rate of 25 cents per $100, and the grantor's or additional tax under § 58.1-802 imposed at a rate of 50 cents per $500. The state recordation tax is imposed on the privilege of recording any deed, lease, contract, or mortgage relating to real estate and certain railroad rolling stock. On deeds of bargain and sale, the tax is imposed on the consideration of the deed (the sales price) **or** the actual value of the property conveyed, whichever is greater.[1] This option is placed in the statute as a safeguard to ensure that the consideration is not understated as a tax avoidance measure. On deeds of trust and mortgages, the tax is imposed on the amount of debt, bonds, or obligation secured by the debt instrument.[2] Special rules apply for construction loans, supplemental deeds of trust, and deeds of release, confirmation, correction, partition, or incidental to a separation or divorce.

If a contract or memorandum of contract relating to real estate is recorded, with the exception of a lease for a term of years, the tax is imposed on the consideration or value contracted for. If a lease for a term of years is involved, however, the tax is based on the consideration or value contracted for unless the lease term multiplied by the annual rental exceeds the fair market value of the property, in which case the tax is imposed on the fair market

[1] Va. Code § 58.1-801.
[2] Va. Code § 58.1-803.

value of the property.[3] Special rules apply for the recording of leases of oil and gas rights and leases of coal and other mineral rights.

Localities are authorized to impose a local recordation tax in an amount equal to one-third of the amount of the state recordation tax.[4] Almost all Virginia cities and counties have exercised this authority and enacted a local recordation tax. The grantor's or additional tax, the other component of Virginia's recordation taxes, is imposed on the consideration or value of the interest purchased, exclusive of the amount of liens. This tax does not apply to instruments securing a debt and is customarily paid by the seller.[5] However, by contract or price manipulation, the economic incidence of the tax may be passed on to the buyer. Localities are not authorized to "piggy-back" onto the grantor's tax; however, subsection B of § 58.1-802 of the Code of Virginia provides that the local circuit court clerk (the tax assessing and collecting official) shall remit one-half of the grantor's tax to the state treasury and the other half to the locality or localities where the property conveyed is located.

Exemptions from the state recordation tax (the tax imposed by §§ 58.1-801 and 58.1-803) are as follows:

1. Certain deeds to incorporated nonprofit institutions of learning;
2. Certain deeds to the trustees of a church or religious body;
3. Deeds to the United States, the Commonwealth, and political subdivisions of the Commonwealth;
4. Deeds to the Virginia Division of the United Daughters of the Confederacy;
5. Certain deeds to nonprofit hospitals or affiliated nonprofit corporations;
6. Deeds to a corporation pursuant to § 351 of the Internal Revenue Code;
7. Deeds from a corporation to its stockholders in a liquidation qualifying for favorable tax treatment under the Internal Revenue Code;
8. Deeds to a partnership, limited liability company, or corporation upon a merger or consolidation or under a transaction qualifying for favorable tax treatment under the reorganization provisions of the Internal Revenue Code;
9. Deeds between parent and subsidiary corporations qualifying for favorable tax treatment under the Internal Revenue Code;
10. Certain deeds involving transfers between a partnership and its partners or between a limited liability company and its members;
11. Certain deeds involving trusts and estates and their beneficiaries;
12. Certain deeds from a nonprofit organization organized to erect or rehabilitate low-cost homes that are sold at cost to persons who otherwise would be unable to afford to buy a home through conventional means;
13. Certain construction loan deeds of trust involving incorporated nonprofit institutions of learning, churches or religious bodies, and nonprofit hospitals, and deeds of trust given by a local government to secure a debt to another local government; and

[3] Va. Code § 58.1-807.
[4] Va. Code § 58.1-3800.
[5] Va. Code § 58.1-802.

14. Certain construction loan deeds of trust involving the securing of a loan by an organization described in Item 12.[6]

Exemptions from the grantor's tax (the tax imposed by § 58.1-802) are as follows:

1. Transactions listed in Items 6 through 11 above;
2. Instruments given to secure a debt;
3. Deeds from an incorporated nonprofit institution of learning;
4. Certain deeds to the Commonwealth and its political subdivisions; and
5. Deeds from churches or religious bodies.[7]

In addition, certain deeds of gift, leases to the United States, the Commonwealth and its political subdivisions, and deeds and leases involving The Nature Conservancy are exempt from all state and local recordation taxes, including the grantor's tax.[8]

Recordation taxes are assessed and collected at the time of recordation by the circuit court clerk. Payment of the tax is a prerequisite for recordation.[9] However, because there are more than 100 circuit court clerks of court and numerous personnel under them, uniform administration of the tax is difficult. As the real estate community develops new kinds of transactions and instruments, the tax may be subject to varying interpretations. There is no formal mechanism for central control or interpretation, and the Reports of the Attorney General contain many opinions in this area over the years. Ultimately, the Department of Taxation is empowered to seek collection or make refunds of these taxes.

Virginia's state tax burden on real estate transfers compares favorably with that of other states (See Table 2). Table 2 reveals that Virginia's state recordation tax is roughly comparable with our neighboring and surrounding states. Alabama, Georgia, Kentucky, North Carolina, and West Virginia have a lower rate than Virginia's $1.25 per $500 of consideration (the Virginia rate is the combined rate of the State Recordation and Grantor's Tax). South Carolina, Tennessee, Maryland, and the District of Columbia have a higher recordation tax.

According to a recent survey of state recordation and transfer taxes (local taxes are not included in the rankings)[10]:

- Fifteen states do not impose a tax on the transfer of real estate.
- Eleven states have rates that are lower than Virginia's rates.
- Twenty-three states and the District of Columbia have higher rates.

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[6] Va. Code § 58.1-811.
[7] *Id.*
[8] *Id.*
[9] Va. Code § 58.1-812.
[10] *Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison-2007*.

TABLE 2
Surrounding States' Real Estate Transfer Taxes
(Per $500 of Consideration)

State	Rate
Alabama	$ 0.50
Georgia	$ 0.50
Kentucky	$ 0.50
North Carolina	$ 1.00
West Virginia	$ 1.10
Virginia	**$ 1.25**
South Carolina	$ 1.85
Tennessee	$ 1.85
Maryland*	$ 2.20
District of Columbia	$11.00

*State transfer tax rate only. Rate is $1.25 for first-time homebuyers.
SOURCE: *Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison - 2007.*

Issues

Because recordation taxes are administered and collected locally, variations in interpretation are bound to occur especially because they are imposed on either the consideration for the real estate or the value of the real estate, whichever is greater. The question then is whether central control of what is ultimately a local act (the recordation of an instrument involving real estate) is necessary, and if necessary, whether central administration can be accomplished in a practical or feasible manner. Except for the Auditor of Public Accounts' review, no examination of uniformity, or the lack thereof, is made, and there can be no assurance that exemptions are being uniformly applied, or that the consideration for transactions is being accurately reported, jurisdiction by jurisdiction, or for that matter, transaction by transaction in the same jurisdiction. There have been an increasing number of bills introduced in the General Assembly recently that would change the basis on which recordation taxes are calculated to the stated consideration of the real estate rather than the greater of the stated consideration or the value of the real estate. In addition, the recordation taxes are likely to continue to provoke discussion because of the annual distribution of $40 million of recordation taxes back to the localities, as well as the annual $40 million distributed to the U.S. Route 58 Corridor Development Program, and the use of such "revenue sharing" distribution as security for debt.

Summary

There can be dramatic fluctuations in the annual amount of recordation taxes collected. This is fueled by factors beyond the control of the General Assembly -- the health of the national economy, interest rates, and inflation. Thus, over the short-term, recordation tax revenues can experience significant fluctuations from year to year.

However, at its core, recordation taxes rest on transactions in real estate. Because real estate is a scarce resource and is almost universally desired, generally over the long run there will always be a strong demand for this resource. This is even truer in Virginia as the growth in the Commonwealth's population pushes up the demand for ownership of real property. As a result, while short-term fluctuations in recordation tax revenues are not unnatural, especially during a recession, over the long-term, revenues from recordation taxes can be expected to continue to grow. Finally, to the extent that the tax is "earmarked" for redistribution to the localities, or as a funding source to support debt service for transportation bond issues, a large part of this revenue source is spent before it is collected.

Estate Tax

History

Comparison with Other States

Issue

Summary

Estate Tax

History

The predecessor of the Commonwealth's estate tax was the inheritance tax, enacted in 1844. The major difference between the two is that the estate tax is imposed on the decedent's estate, while the inheritance tax was imposed on the beneficiaries.

In 1916, Congress enacted a federal estate tax. The federal statute reduced the amount of taxes due (i.e. provided a credit) in the amount of any state estate taxes (not inheritance taxes) paid, up to certain caps. For some estates, the amount of the federal credit exceeded the amount of Virginia's inheritance tax. In such cases, Virginia, having no estate tax, forfeited the excess amount to the federal government. In other words, the difference between the amount actually paid in inheritance taxes and the amount of the federal credit essentially was paid to the federal government instead of to Virginia.

To address this, in 1926 Virginia enacted an estate tax that worked in tandem with the inheritance tax. Under this system, which of the two taxes to be imposed on an estate, depended on which one brought in more revenue. The estate tax rate was equal to the amount of the federal credit (an estate tax at that rate is referred to as a "pick-up" tax.) In those instances where the estate tax was imposed, Virginia increased its tax revenues without increasing an estate's total federal and state estate tax liability.

Spurred in part by passage of the federal Tax Reform Act of 1976, and the Act's potential impact on Virginia's inheritance and estate taxes, the General Assembly created a committee in 1977 to study the taxes (House Joint Resolution No. 34). The committee recommended repealing the inheritance tax because, among other things, (i) the tax was administratively unreasonably burdensome on the taxpayer and the Department of Taxation, (ii) the tax was financially unreasonably burdensome on the beneficiaries of small and moderate estates, (iii) the estate tax produced greater revenue from far fewer estates than the inheritance tax, and (iv) the tandem system of applying the inheritance tax to some estates and the estate tax to others often created unfair, and at times, anomalous results. The General Assembly concurred and repealed the inheritance tax in 1978, leaving the estate tax as Virginia's sole "death tax."

The federal Economic Growth and Tax Relief Act of 2001 (Act) phased in federal estate tax relief, which will culminate in complete repeal of the tax on January 1, 2010, unless Congress acts to maintain it. Among other things, the Act (i) gradually increased the amount of an estate's value that is not taxed, from $1,000,000 to $3,000,000, and (ii) gradually eliminated the "federal credit" (i.e. pick-up tax), replacing it with a deduction that reduces the value of the estate subject to the federal estate tax in an amount equal to all state estate taxes actually paid. Elimination of the federal credit would not have affected Virginia's estate tax, because § 58.1-901 of the Code of Virginia provided that the amount of the "federal credit" used in computing the state estate tax would never be less than its amount under federal law **on January 1**, **1978** (which remained the same until the Act's gradual elimination of it).

However, under this scenario, the Commonwealth's estate tax would have increased the total federal and state taxes imposed. That is, the amount of Virginia's estate tax (less the new federal deduction for state estate taxes paid) would have constituted an amount that otherwise would **not** have been paid by the estate to the federal government. Accordingly, in 2006 the General Assembly struck that portion of § 58.1-901 that prevented the amount of Virginia's estate tax from falling below what it was in 1978. Currently, because there is no federal credit for state taxes paid, no Virginia estate taxes are imposed, and the tax lies dormant.

Comparison with Other States

There are basically three categories of state "death taxes:" (i) pick-up estate tax; (ii) estate tax other than the pick-up tax; and (iii) a combined inheritance and pick-up tax.

Virginia and 37 other states and the District of Columbia impose a "pick-up" tax only; two states impose an estate and "pick-up" tax; while 10 states impose an inheritance and "pick-up" tax. Table 1 provides a comparison of Virginia's tax with other states.[1]

TABLE 1
ESTATE TAX -- 2009

STATE	ESTATE TAX
Alabama	“Pick-up” tax
Alaska	“Pick-up” tax
Arizona	“Pick-up” tax
Arkansas	“Pick-up” tax
California	“Pick-up” tax
Colorado	“Pick-up” tax
Connecticut	State estate tax; an estate tax is imposed on estates valued at more than $2 million (progressive tax from 5.085% to 16%)
Delaware	“Pick-up” tax
District of Columbia	Local estate tax; an estate tax is imposed on estates valued at more than $1 million (progressive tax from 0.8% to 16%)

[1] As noted above, at this time all "pick-up" taxes are dormant, and therefore not imposed. See the "Issue" section below regarding potential revival of the tax.

TABLE 1 (con't)
ESTATE TAX -- 2009

STATE	ESTATE TAX
Florida	"Pick-up" tax
Georgia	"Pick-up" tax
Hawaii	"Pick-up" tax
Idaho	"Pick-up" tax
Illinois	State estate tax; an estate tax is imposed on estates valued at more than $2 million (progressive tax from 0.8% to 16%)
Indiana	Inheritance and "pick-up tax"; inheritance tax rates are progressive from 1% to 20% depending on the beneficiary's relationship to the decedent
Iowa	Inheritance and "pick-up tax"; inheritance tax rates are progressive from 6% to 15% depending on the beneficiary's relationship to the decedent
Kansas	State estate tax; an estate tax is imposed on estates valued at more than $1 million (progressive tax from 0.5% to 3% for deaths in 2009); only applies to estates of decedents who have died through 2009; estates of decedents dying after 2009 are not subject to estate tax
Kentucky	Inheritance and "pick-up" tax; inheritance tax rates are progressive from 4% to 16% depending on the beneficiary's relationship to the decedent
Louisiana	"Pick-up" tax
Maine	State estate tax; an estate tax is imposed on estates valued at more than $1 million (progressive tax from 0.8% to 16%)
Maryland	Inheritance and estate tax; inheritance tax rate is 10% (certain relatives are exempt); separate estate tax of 16% is imposed on estates valued at more than $1 million
Massachusetts	State estate tax; an estate tax is imposed on estates valued at more than $1 million (progressive tax up to 16%)
Michigan	"Pick-up" tax
Minnesota	State estate tax; separate estates tax is imposed on estates valued at more than $1 million (progressive tax from 0.8% to 16%)
Mississippi	"Pick-up" tax
Missouri	"Pick-up" tax
Montana	"Pick-up" tax
Nebraska	Inheritance tax only; inheritance tax rates are progressive up to 18% depending on the beneficiary's relationship to the decedent
Nevada	"Pick-up" tax
New Hampshire	"Pick-up" tax
New Jersey	Inheritance and estate tax; inheritance tax rates are progressive from 11% to 16% (certain relatives are exempt); separate estate tax is imposed on estates valued at more than $675,000 (progressive tax up to 16%)
New Mexico	"Pick-up" tax
New York	State estate tax; an estate tax is imposed on estates valued at more than $1 million (progressive tax up to 16%)
North Carolina	State estate tax; an estate tax is imposed on estates valued at more than $3.5 million (progressive tax up to 16%)

TABLE 1 (con't)
ESTATE TAX -- 2009

STATE	ESTATE TAX
North Dakota	"Pick-up" tax
Ohio	State estate tax; an estate tax of 6% is imposed on estates valued between $338,333 and $500,000; an estate tax of 7% is imposed on estates valued at more than $500,000
Oklahoma	State estate tax; an estate tax is imposed on estate valued at more than $3 million (progressive tax of 0.5% up to 10%)
Oregon	State estate tax; an estate tax is imposed on estates valued at more than $1 million (progressive tax of 0.8% up to 16%).
Pennsylvania	Inheritance and "pick-up" tax; inheritance tax rates are 0%, 4.5%, 12%, or 15%, depending on the beneficiary's relationship to the decedent
Rhode Island	State estate tax; an estate tax is imposed on estates valued at more than $657,000 (progressive tax of 0.8% up to 16%)
South Carolina	"Pick-up" tax
South Dakota	"Pick-up" tax
Tennessee	Inheritance and "pick-up" tax; inheritance tax is imposed on amounts above $1 million (progressive tax of 5.5% up to 9.5%)
Texas	"Pick-up" tax
Utah	"Pick-up" tax
Vermont	State estate tax; an estate tax is imposed on estates valued at more than $2 million (progressive tax of up to 16%)
Virginia	"Pick-up" tax
Washington	State estate tax; an estate tax is imposed on estates valued at more than $2 million (progressive tax of 10% up to 19%)
West Virginia	"Pick-up" tax
Wisconsin	"Pick-up" tax
Wyoming	"Pick-up" tax

SOURCE: Government of the District of Columbia, Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison.

Issue

All provisions of the federal Economic Growth and Tax Relief Act of 2001 (Act) will sunset in 2011 unless reenacted (in whole or in modified form) by Congress. If Congress does not reenact or modify the Act, the federal credit for state estate taxes paid will revert to its amount prior to its gradual elimination, and Virginia's estate tax will be imposed as it was prior to the Act. On the other hand, Congress could modify the Act in any number of ways, including not restoring the federal credit. In such case, Virginia's estate tax would remain dormant.

Summary

As a result of the federal Economic Growth and Tax Relief Act of 2001, and the General Assembly's amendment to Virginia's estate tax conforming the rate to the amount of the federal credit for state estate taxes paid (currently zero), Virginia's estate tax is dormant. It will be revived only if Congress reinstates the federal credit.

Cigarette and Other Tobacco Product Taxes

Cigarette and Other Tobacco Product Taxes

History

Virginia first imposed a state cigarette tax effective October 1, 1960, at a rate of three cents per pack. A similar tax was also imposed on cigars. The tax rate on cigarettes remained at three cents per pack until 1966, when Virginia imposed a sales and use tax and simultaneously lowered the cigarette tax to 2.5 cents per pack.[1]

Several changes were made to Virginia's cigarette and other tobacco product taxes in 2004. The 2004 Special Session I of the General Assembly increased the state cigarette tax to 20 cents per pack in 2004 and to 30 cents per pack beginning in 2005. The Special Session also established a state tax on other tobacco products (cigars, smokeless tobacco, pipe tobacco, and roll-your-own tobacco) at a rate of 10 percent of the sales price charged by wholesale dealers.[2] All revenues from the state cigarette tax and the state tax on other tobacco products were dedicated to the Virginia Health Care Fund to be used for purposes such as Medicaid payments,

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[1] Va. Code § 58.1-1001.
[2] Chapter 3, 2004 Acts of Assembly, Special Session I.

disease diagnosis, prevention and control, and community health services.[3] In 2005, the General Assembly changed the rate of the other tobacco products tax effective January 1, 2006, from 10 percent of the sales price charged by wholesale dealers to 10 percent of the manufacturer's sales price for the tobacco product.[4] In 2006, the General Assembly fixed the rate of the state tax on roll-your-own tobacco at 10 percent of the manufacturer's sales price.[5]

As Table 1 shows, revenues from Virginia's tobacco taxes, the state cigarette tax and the state tax on other tobacco products increased dramatically beginning in fiscal year 2005, which was the first year that the other tobacco products tax was imposed and the year that the state cigarette tax increased to 20 cents per pack. Similarly, the growth in revenues in fiscal year 2006 can be explained in part by the state cigarette tax increasing to 30 cents per pack beginning July 1, 2005.

TABLE 1
Cigarette and Other Tobacco Product Tax Revenues
Fiscal Years 2000 - 2009

Fiscal Year Ending June 30	Collections	% Change From Previous Year
2000	$15,208,000	-1.1%
2001	$15,074,000	-.9%
2002	$15,023,000	-.3%
2003	$15,314,000	1.9%
2004	$16,118,000	5.3%
2005	$113,108,000	701.7%
2006	$187,084,000	65.4%
2007	$186,920,000	-.1%
2008	$183,946,000	-1.6%
2009	$183,750,000	-.1%

SOURCE: Virginia Department of Taxation.

Cigarettes are clearly one of the most heavily taxed commodities, if not the most heavily taxed, in the United States. Cigarettes are subject to a $1.01-cents-per-pack federal excise tax, an extremely high state cigarette tax in almost all states, state and local sales and use taxes, and (in six states) local cigarette taxes. To place the burden in perspective, in 21 states total federal and state cigarette taxes alone equaled at least 50 percent of the average price of cigarettes.

During the 10-year period between 1997 and 2006, annual cigarette sales in the United States declined by 28.2 percent.[6] During that same period, annual cigarette sales in Virginia declined by 10.6 percent, while per capita sales have declined significantly.[7] The Tobacco Master Settlement agreement and the associated cigarette price increase have accelerated the decline of cigarette sales. Revenues from the state cigarette tax over the course of the next few

[3] *Id*.
[4] Chapter 71, 2005 Acts of Assembly.
[5] Chapter 768, 2006 Acts of Assembly.
[6] *Federal Trade Commission Report for 2006*, Issued 2008, Federal Trade Commission.
[7] Department of Taxation report of cigarette tax revenues for fiscal years 1997 through 2006.

years will likely decline even faster as fewer and fewer consumers choose to use tobacco products.

Cigarette Taxes

Comparison with Other States

Virginia's state cigarette tax of 30 cents per pack ranks 49th out of the 50 states and the District of Columbia.[8] Only South Carolina at seven cents per pack and Missouri at 17 cents per pack have lower state cigarette taxes. Most of the states and the District of Columbia have cigarette taxes significantly higher than Virginia's (see Table 2). State cigarette taxes per pack in neighboring states are as follows: North Carolina (45 cents); West Virginia (55 cents); Kentucky (60 cents); Tennessee (62 cents); Maryland ($2); and the District of Columbia ($2.50). Twenty-eight states impose a cigarette tax of at least $1 per pack and 15 states impose a cigarette tax of at least $2 per pack, with Rhode Island having the highest state cigarette tax at $3.46 per pack.

TABLE 2
State Cigarette Tax Rates - 2009

State	Tax Per Pack	State	Tax Per Pack
Alabama	$0.425	Indiana	$0.995
Alaska	$2.00	Iowa	$1.36
Arizona	$2.00	Kansas	$0.79
Arkansas	$1.15	Kentucky	$0.60
California	$0.87	Louisiana	$0.36
Colorado	$0.84	Maine	$2.00
Connecticut	$2.00	Maryland	$2.00
Delaware	$1.60	Massachusetts	$2.51
District of Columbia	$2.50	Michigan	$2.00
Florida	$1.339	Minnesota	$1.56
Georgia	$0.37	Mississippi	$0.68
Hawaii	$2.60	Missouri	$0.17
Idaho	$0.57	Montana	$1.70
Illinois	$0.98	Nebraska	$0.64

[8] This ranking is for state cigarette tax rates and does not include local option cigarette taxes.

TABLE 2 (con't)
State Cigarette Tax Rates - 2009

State	Tax Per Pack	State	Tax Per Pack
Nevada	$0.80	South Carolina	$0.07
New Hampshire	$1.78	South Dakota	$1.53
New Jersey	$2.70	Tennessee	$0.62
New Mexico	$0.91	Texas	$1.41
New York	$2.75	Utah	$0.695
North Carolina	$0.45	Vermont	$2.24
North Dakota	$0.44	**Virginia**	**$0.30**
Ohio	$1.25	Washington	$2.025
Oklahoma	$1.03	West Virginia	$0.55
Oregon	$1.18	Wisconsin	$2.52
Pennsylvania	$1.35	Wyoming	$0.60
Rhode Island	$3.46		

SOURCE: *Campaign for Tobacco-Free Kids,* State Cigarette Excise Tax Rates & Rankings.

Local Cigarette Taxes

In addition to state cigarette taxes, Virginia is one of six states where selected localities are permitted to impose local cigarette taxes. In 2008, two counties, 30 cities, and 20 towns levied local cigarette taxes, which generated almost $66.2 million in revenue. The rates of local cigarette taxes in counties, cities, and towns ranged from four cents per pack in the City of Bristol and the Town of Clifton Forge to 80 cents per pack in the Town of Vienna. In 2008, Virginia Beach collected $11.6 million from its local cigarette tax, Fairfax County collected $9.5 million, Norfolk collected $7.6 million, Chesapeake collected $4.8 million, and Newport News collected $4.2 million. These five localities accounted for 57 percent of the total local cigarette tax revenues on a statewide basis (see Table 3).

TABLE 3
Local Cigarette Tax Rates and Revenues - 2008

Locality	Tax Per Pack	Collections
Counties		
Arlington	$.30	$ 2,621,265
Fairfax	$.30	9,498,075
Subtotal Counties		**$12,119,340**
Cities		
Alexandria	$.70	$ 2,681,573
Bedford	$.20	121,440
Bristol	$.04	153,216
Charlottesville	$.35	705,063
Chesapeake	$.50	4,756,421
Covington	$.20	86,754
Fairfax	$.50	778,192
Falls Church	$.75	468,720
Franklin	$.50	252,010

TABLE 3 (con't)

Local Cigarette Tax Rates and Revenues - 2008

Locality	Tax Per Pack	Collections
Fredericksburg	$.31	593,940
Hampton	$.65	3,759,713
Harrisonburg	$.30	868,029
Lynchburg	$.35	1,014,759
Manassas	$.50	832,606
Martinsville	$.20	99,023
Newport News	$.65	4,205,798
Norfolk	$.65	7,576,528
Norton	$.10	41,612
Petersburg	$.10	317,406
Poquoson	$.10	74,601
Portsmouth	$.50	2,644,994
Radford	$.15	107,878
Roanoke	$.27	2,882,612
Salem	$.15	424,771
Staunton	$.15	318,196
Suffolk	$.50	1,415,123
Virginia Beach	$.50	11,503,774
Waynesboro	$.20	432,587
Williamsburg	$.25	180,701
Winchester	$.10	234,925
Subtotal Cities		**$49,532,965**
Towns		
Abingdon	$.10	$ 127,579
Big Stone Gap	$.05	39,969
Blacksburg	$.30	323,879
Bluefield	$.06	182,588
Christiansburg	$.40	541,980
Clifton Forge	$.04	13,340
Culpeper	$.10	183,449
Dumfries	$.60	121,432
Herndon	$.50	322,660
Leesburg	$.50	871,299
Orange	$.12	120,895
Pulaski	$.20	158,949
Purcellville	$.50	238,446
Smithfield	$.25	142,195
Strasburg	$.25	83,202
Vienna	$.80	429,906
Warrenton	$.15	222,415
Wise	$.05	39,701
Woodstock	$.05	108,838

TABLE 3 (con't)
Local Cigarette Tax Rates and Revenues - 2008

Locality	Tax Per Pack	Collections
Wytheville	$.09	219,850
Subtotal Towns		**$ 4,492,572**
Total Counties, Cities, and Towns		**$66,144,877**

SOURCE: *Comparative Report of Local Government Revenues and Expenditures*, Fiscal year ended June 30, 2008, Auditor of Public Accounts. *Virginia Local Tax Rates 2008*, 27th Annual Edition, Weldon Cooper Center for Public Service, University of Virginia, Charlottesville, Virginia, 2008.

Fifteen cities and six towns have local cigarette taxes in excess of the 30 cents per pack state cigarette tax. Two counties, one city, and one town have local cigarette taxes that are equal to the 30 cents per pack state cigarette tax.

Other Tobacco Products Tax

Forty-nine states and the District of Columbia impose a tax on other tobacco products, with Pennsylvania the exception. Table 4 displays the state tax rates imposed on other tobacco products. Virginia imposes a 10 percent tax on the manufacturer's selling price for the tobacco product. As can be seen from Table 4, because there is a great deal of variability in the tax bases upon which states impose the other tobacco products tax, it is very difficult to compare the tax rates charged by the states.

TABLE 4
Other Tobacco Products Tax Rates - 2007

State	Rate**
Alaska	75.0% of wholesale price
Arkansas	32.0% of manufacturer's selling price
California	46.76% of wholesale value
Colorado	40.0% of manufacturer's list price
Delaware	15.0% of wholesale price
District of Columbia	12.0% of retail gross receipts
Florida	25.0% of wholesale price
Hawaii	40.0% of wholesale price
Idaho	40.0% of wholesale price
Illinois	18.0% of wholesale price
Indiana	18.0% of wholesale price
Kansas	10.0% of wholesale price
Maryland	15.0% of wholesale price
Michigan	32.0% of wholesale price
Minnesota	70.0% of wholesale price
Mississippi	15.0% of manufacturer's list price
Missouri	10.0% of manufacturer's price
Nebraska	20.0% of manufacturer's selling price
Nevada	30.0% of wholesale price
New Hampshire	19.0% of wholesale price

TABLE 4 (con't)
Other Tobacco Products Tax Rates - 2007

State	**Rate********
New Mexico	25.0% of wholesale product value
New York	37.0% of wholesale price
North Carolina	3.0% of initial wholesale cost
Ohio	17.0% of wholesale price
Oregon	65.0% of wholesale price
South Carolina	5.0% of manufacturer's price
South Dakota	10.0% of wholesale price
Tennessee	6.6% of wholesale price
Utah	35.0% of manufacturer's selling price
Virginia	**10.0% of manufacturer's selling price**
Washington	75.0% of taxable sales price
West Virginia	7.0% of wholesale price
Wisconsin	25.0% of manufacturer's selling price
Wyoming	20.0% of wholesale price

** Alabama, Arizona, Connecticut, Georgia, Iowa, Kentucky, Louisiana, Maine, Massachusetts, Montana, New Jersey, North Dakota, Oklahoma, Rhode Island, Texas, and Vermont impose different tax rates on other tobacco products depending on the type of tobacco product.
SOURCE: Wisconsin Legislative Fiscal Bureau, Madison, Wisconsin.

Tax Administration

The administration of the state cigarette tax is relatively straightforward, with most states utilizing a tax stamp to indicate payment of the tax. The stamp is affixed to the pack by the wholesaler or distributor. Virginia grants a two percent discount to wholesalers and distributors on the purchase of state cigarette tax stamps.[9] Virginia's localities are authorized, but not required, to provide compensation to wholesalers and distributors for the administration of the local cigarette tax.[10]

No tax stamp is utilized to collect Virginia's other tobacco products tax. The tax is paid by the distributor when submitting a monthly return to the Department of Taxation reporting the quantity and manufacturer's sales price of each tobacco product (other than cigarettes) distributed in the Commonwealth.[11] The return and tax is due by the twentieth of each month for tobacco products distributed in the preceding month.[12] Virginia grants a two percent discount to distributors of other tobacco products at the time of remitting the tax due, provided that the tax due was not delinquent at the time of remission.[13]

The Commonwealth has had other taxes in the past that utilized some type of method indicating that the appropriate amount of tax had been paid. One example is the beer and beverage excise tax, where a stamp, crown, or lid was affixed to the container to indicate the

[9] Va. Code § 58.1-1009.
[10] Va. Code § 58.1-3832.
[11] Va. Code § 58.1-1021.03.
[12] *Id*.
[13] *Id*.

state tax was paid. This method was eliminated on July 1, 1972.[14] It should be noted that no commission was provided as compensation for affixing the stamp, crown, or lid. However, the 1978 Session of the General Assembly enacted legislation effective July 1, 1980, which provided a one percent commission to the wholesale dealer for the administration of the beer and beverage excise tax, and it is still in effect.[15]

Issues

Tax Rate

The 2009 Session of the General Assembly saw multiple bills to increase Virginia's state cigarette tax. During this time frame, the Commonwealth, along with the rest of the country, was mired in a deep recession. Thus, given that Virginia's state cigarette tax ranked 49th out of the 50 states and the District of Columbia, it should not be surprising that any legislation to increase revenues would include an increase in the rate of the state cigarette tax. However, any increase in the state cigarette tax would have been on top of the increase to 20 cents per pack in 2004 and to 30 cents per pack beginning in 2005 (pursuant to legislation passed by the 2004 Special Session I of the General Assembly).

Table 5 provides an estimate of additional revenues that would be received under different increases in the rate of the state cigarette tax.

TABLE 5
Estimated Revenues from Increased Cigarette Tax Rates

Tax	Estimated Revenue	Change From Current Tax
$.30 (current)	$167.5 million (2009)	
$.40	$223.3 million	+ $55.8 million
$.50	$279.2 million	+ $111.7 million
$.60	$335 million	+ $167.5 million

SOURCE: Virginia Department of Taxation.

[14] Chapter 784, 1970 Acts of Assembly.
[15] Chapter 795, 1978 Acts of Assembly.

Summary

Virginia's state cigarette and other tobacco products taxes generated $183.8 million in fiscal year 2009. This revenue is dedicated to the Virginia Health Care Fund to be used for purposes such as Medicaid payments, disease diagnosis, prevention and control, and community health services. Thus, under current law, this revenue is not available for the payment of general obligations of the Commonwealth.

The 2004 Special Session I of the General Assembly increased the state cigarette tax to 20 cents per pack beginning in 2004 and to 30 cents per pack beginning in 2005. The Special Session also established a state tax on other tobacco products (cigars, smokeless tobacco, pipe tobacco, and roll-your-own tobacco), which are currently taxed at a rate of 10 percent of the manufacturer's sales price. The changes made by the Special Session help to explain the growth in revenue from cigarette and other tobacco product taxes from $16.1 million in fiscal year 2004 to $183.8 million in fiscal year 2009.

Virginia's state cigarette tax is 49th out of the 50 states and the District of Columbia and could be increased significantly and still be in line with other states. However, any such increase would be on top of the increases in 2004 and 2005 to the state cigarette tax, and on top of local cigarette taxes. It is also clear that Virginia's localities tax cigarettes at extremely high rates and place Virginia in a position of losing sales to other states, especially in the border areas.

Enforcement and Collection of State Taxes

Enforcement and Collection of State Taxes

History

State tax assessment and collection procedures directly affect the Commonwealth's general fund. The proper assessment of taxes by the Department of Taxation and timely payment by the taxpayer reduce the cost of administration and maximize the availability of general fund revenues for other purposes. Nevertheless, because erroneous tax assessments and delinquent tax payments occur, administrative and judicial remedies are available to augment the tax collection and refund procedures in the Commonwealth.

Prior to 1980, Virginia's administrative and judicial tax procedures were unstructured due to a lack of written tax regulations and legal precedent.[1] When taxpayers questioned the

[1] Phillips, *Virginia Tax Procedures: Unfinished Business*, 38 Washington & Lee L. Rev. 1115 (1981).

Department's interpretation of statutory provisions, the Tax Commissioner issued individual letters establishing the state's tax policy. Because no other written tax regulations existed (except for sales and use tax), the Commissioner's interpretations were given great deference by the courts. As a result, the Commonwealth's tax procedures confused both taxpayers and tax practitioners.

In 1978, a joint task force comprised of members of the taxation committees of the Virginia Bar Association, Virginia State Bar, and the Virginia Society of Certified Public Accountants conducted a study on Virginia's tax procedures.[2] The task force examined Virginia's practices relating to administrative and judicial correction procedures, refund procedures, levy and collection of taxes, and penalties. The task force identified specific problems in the tax procedures, which included inadequate refund procedures and an absence of written regulations.[3]

Changes

In 1980, following a General Assembly joint subcommittee study and based on its findings, substantial revisions to the tax procedures were enacted by the General Assembly. Such changes included:

1. The required publication of written regulations by the Department pursuant to the Administrative Process Act;
2. The revision and clarification of the period of limitations for the assessment of taxes by the Department; and
3. Additional definitions to clarify the standing and limitation provisions for persons assessed with state taxes.

The revised administrative and judicial tax procedures enacted by the 1980 General Assembly are substantially the same tax collection and refund procedures that exist in the Commonwealth today.

Virginia Taxpayer Bill of Rights

The Virginia Taxpayer Bill of Rights was passed by the 1996 General Assembly and went into effect July 1, 1997. The purpose of the bill of rights is to guarantee that (i) the rights, privacy, and property of Virginia taxpayers are adequately protected throughout all tax assessment, collection, and enforcement procedures under the Commonwealth's revenue laws; and (ii) the taxpayer is treated with respect.[4]

The Taxpayer Bill of Rights contains short but comprehensive statements that explain in simple terms the rights and obligations of the Department of Taxation and taxpayers. There are 13 "rights" outlined in § 58.1-1845 ranging from "the right to...prompt, courteous and accurate responses to questions and requests for tax assistance" to "the right to procedures which assure

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[2] *Id.*, at 1116.
[3] *Report of the Practices and Procedures in the Collection and Administration of State Taxes Study Committee*, House Document No. 30 (1980).
[4] Va. Code § 58.1-1845.

that the individual employees of the Department [of Taxation] are not paid, evaluated, or promoted on the basis of assessments or collections from taxpayers...."

Collection of Delinquent Taxes by the Department of Taxation

State tax administrators are authorized to employ a variety of legal procedures to collect delinquent tax assessments. Although most taxpayers submit timely payments, the Department estimates that the legal procedures are essential in collecting taxes from less than two percent of the Commonwealth's taxpayers.

An assessment is made by the Department when written notice of assessment is delivered to the taxpayer by an employee of the Department or the date when the assessment is mailed to the taxpayer's last known address.[5] An assessment shall also be deemed made when a notice of assessment is sent by the Department to the taxpayer by either facsimile transmission or electronic mail, as approved and designated by the taxpayer in writing.[6] Payment of a tax is delinquent if it is not paid within 30 days from the date the assessment is made.[7]

When a tax is delinquent, the Department attempts to collect the tax by sending at least two assessment notices to the taxpayer before its Delinquent Collections Unit uses legal process to collect the delinquent tax. Typically, the Department first attempts to use a third-party lien addressed to the taxpayer's employer or bank, which could occur as soon as 40 days from the assessment date. Other techniques may be employed before it files a memorandum of lien in the circuit court. In fiscal year 2009, the Department issued 119,107 third-party liens to banks and employers, and recorded 4,741 memorandums of liens with the clerks of Virginia's circuit courts.

The memorandum of lien is filed in any county or city where the taxpayer's business is located, where the taxpayer resides, or in every county or city in which the taxpayer owns real estate. If the taxpayer has no residence or business in the Commonwealth, the lien may be filed in the Circuit Court of the City of Richmond. The lien attaches to the taxpayer's real estate and personal property located in the respective jurisdiction and allows the Department, after following proper legal procedures, to have the property sold to satisfy payment of the delinquent taxes.[8]

During fiscal year 2009, the Department reported collecting $290,248,011 in taxes delinquent 30 days or more, of which about $161 million was delinquent 90 days or more. The Department's use of legal process and other collection tools play a significant role in collecting taxes that are delinquent more than 90 days.

The Department may also impose penalties and interest upon a taxpayer for failing to file a proper return or failing to pay the full amount of tax due. The penalty is six percent of the amount of tax due for each month of delinquency up to a maximum penalty of 30 percent of the

[5] Va. Code § 58.1-1820.
[6] *Id*.
[7] Va. Code § 58.1-1812.
[8] Va. Code § 58.1-1805.

amount of tax due.[9] No penalty or interest can be imposed on any tax assessment for the recovery of erroneous refunds that occur as a result of an error by the Department, as long as the tax due is remitted to the Department within 30 days of the tax bill.[10]

If the taxpayer's failure to pay the tax in full was fraudulent, a penalty of 100 percent of the tax due is assessed.[11] The Department estimates that it collected $33,813,670 in penalties from delinquent business taxpayers and $37,574,983 from delinquent individual taxpayers in fiscal year 2009.

Delinquent taxes may be administratively offset against any tax refunds that may be owed to the taxpayer, as well as many types of payments that other state agencies make to businesses and individuals.

The Department must assess taxes within three years from the date the return was filed, or if no return was filed, the assessment must be made within six years from the date the return was due.[12] However, the Department and the taxpayer may waive this statute of limitations on assessments by written agreement.[13] There is no period of limitation on assessments if a false or fraudulent return is filed with intent to evade payment of the tax.[14] Additionally, criminal liability and 100 percent liability are imposed upon officers of a corporation or partnership for willful failure to file a return, keep records, or supply information to the Department.[15]

Since July 1, 1989, the Tax Commissioner has had the authority to enhance tax collections from delinquent businesses. The Tax Commissioner may padlock the doors of any business delinquent in filing or paying taxes owed the Commonwealth after the Commissioner has filed a lien in the circuit court and if he determines that padlocking the premises is in the Commonwealth's best interest.[16] If the tax deficiency is not paid within three business days, the commissioner may sell the business property to satisfy the lien.[17] The taxpayer may appeal the Tax Commissioner's memorandum of lien if the taxpayer alleges an error in the lien filing. The Tax Commissioner then has 14 days to make a determination regarding the appeal.[18] The Tax Commissioner has promulgated regulations setting forth the circumstances when he may place padlocks on the doors of businesses.[19]

Four additional statutory procedures exist that allow taxpayers to challenge tax assessments:

1. The taxpayer may file an application for correction with the Tax Commissioner;[20]
2. The taxpayer may file an amended tax return;[21]

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[9] Va. Code §§ 58.1-347, 58.1-450, 58.1-455, 58.1-635, and 58.1-1812.
[10] Va. Code § 58.1-1812.
[11] *Id.*
[12] *Id.*
[13] Va. Code § 58.1-220.
[14] Va. Code § 58.1-1812.
[15] Va. Code § 58.1-1813.
[16] Va. Code § 58.1-1805.
[17] *Id.*
[18] *Id.*
[19] *Id.*
[20] Va. Code § 58.1-1821.
[21] Va. Code § 58.1-1823.

3. The taxpayer may apply directly to the circuit court for relief;[22] or
4. The taxpayer may file an application for correction, or amended return, pay the tax, and file a protective refund claim to preserve the right to proceed in the circuit court after the Tax Commissioner issues a final ruling.[23]

Administrative Remedies

Application to Tax Commissioner

Any taxpayer may file an application with the Tax Commissioner to correct an erroneous assessment within 90 days after the assessment date. Payment of the tax prior to filing the application is unnecessary, unless the Tax Commissioner determines that collection of the tax is in jeopardy.[24] The Tax Commissioner considers the evidence submitted relating to the assessment and determines whether the assessment is correct. If the Tax Commissioner determines the assessment exceeds the proper amount, the Commissioner can either order the taxpayer exempt from payment of the erroneous amount or refund any amount improperly collected from the taxpayer.[25] In fiscal year 2009, applications for correction with the Tax Commissioner were filed by 362 taxpayers. The Department resolved 174 appeals and 150 offers in compromise during fiscal year 2009, representing a total assessed amount of approximately $49.6 million.

Offers In Compromise

A taxpayer who is financially unable to pay a tax assessment may submit an offer in compromise along with financial statements. In fiscal year 2009, the Department resolved 2,250 offers in compromise, which resulted in collections of $8,408,927. If an offer in compromise involves disputed facts or interpretations of law, then it is resolved by the section within the Department that handles administrative appeals.

Filing an Amended Return

A taxpayer may also file an amended return within (i) three years from the last date for timely filing of the return; (ii) one year from a final determination of any federal income tax liability that is the basis for the Virginia individual income tax; (iii) two years from the filing of an amended Virginia return resulting in the payment of additional tax; or (iv) two years from payment of an assessment.[26] The Department of Taxation may either refund any amount that the taxpayer overpaid or reassess the taxpayer. If the Department denies the refund or fails to respond within three months, the taxpayer may subsequently pursue judicial remedies if he has paid the tax.[27]

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[22] Va. Code § 58.1-1825.
[23] Va. Code § 58.1-1824.
[24] Va. Code § 58.1-1821.
[25] Va. Code § 58.1-1822.
[26] Va. Code § 58.1-1823.
[27] *Id.*

In addition, according to § 58.1-1824, any taxpayer who has paid the assessed state taxes may preserve his judicial remedies by filing a refund claim with the Tax Commissioner within three years of the assessment date. Within one year after the Tax Commissioner's decision, the taxpayer may apply to the circuit court for relief.

Judicial Remedies

Application to Circuit Court

A taxpayer may apply directly to the circuit court for relief of an erroneous tax assessment or the improper collection of tax. The application must be filed within three years from the assessment date.[28] Instead of filing for correction directly with the circuit court, any taxpayer who has paid the tax and applied for administrative relief from the Tax Commissioner may also file for relief in the circuit court within one year from the Tax Commissioner's final ruling on the correction of an erroneous assessment or amended return, provided the taxpayer filed a protective refund claim, which extends the statute of limitations and preserves the right to proceed judicially.[29] In every judicial proceeding, the taxpayer bears the burden of establishing that the correction or assessment is erroneous.

Generally, assessments are presumed correct and courts will not disturb them unless the applicant clearly establishes that the assessment is erroneous.[30] A court can order a correction of the assessment, exoneration from payment on a refund, or payment of the tax if there is an underpayment.[31] Any taxpayer or the Tax Department can appeal any circuit court decision to the Supreme Court of Virginia.[32]

In fiscal year 2009, only two taxpayers in the Commonwealth filed an application for correction of erroneous assessment with the circuit court. Furthermore, no taxpayers appealed circuit court decisions to the Supreme Court in fiscal year 2009, according to the Department of Taxation.

[28] Va. Code § 58.1-1825.
[29] Va. Code § 58.1-1824.
[30] Va. Code § 58.1-1825.
[31] Va. Code § 58.1-1826.
[32] Va. Code § 58.1-1828.

Summary

The Commonwealth's procedures relating to the collection, enforcement, and remedies available for state tax assessments provide taxpayers and tax administrators with a variety of options to resolve disputes about tax assessments.

Taxpayers can challenge erroneous assessments by (i) applying to the Tax Commissioner for correction, (ii) filing an amended return, or (iii) paying the tax and applying directly to the circuit court for relief. Taxpayers have substantial flexibility in deciding whether to pursue remedies administratively, judicially, or both.

Similarly, tax administrators are authorized to employ a variety of procedures to collect delinquent tax assessments, such as sending third-party liens to employers or banks, filing a memorandum of lien, imposing penalties and interest, or seizing the property of certain delinquent taxpayers.

Collection and refund tax procedures are significant components in the Virginia tax scheme, because definite yet flexible standards reduce the cost and complexity of taxpayer compliance and tax administration in the Commonwealth.

Public Service Corporation Taxes/ Energy Consumption Taxes

Public Service Corporation Taxes/Energy Consumption Taxes

Gross Receipts Tax on Public Service Corporations

History

The state gross receipts tax on public service corporations in Virginia was first imposed in 1898 when the General Assembly adopted a franchise tax based on gross receipts for telegraph companies at a rate of two percent. When the Constitution of 1902 was adopted and the State Corporation Commission was established, the General Assembly extended this tax to railroads at a rate of one percent of gross receipts and to telephone companies at a rate of two percent of their intrastate gross receipts.

In 1916, the General Assembly expanded the state gross receipts tax to include water, heat, light, and power companies at the rate of 0.75 percent of their gross receipts. Table 1 lists the dates the original gross receipts tax rates were adopted and the rate for each public service industry. These tax rates have been changed by the General Assembly from time to time over the years.

TABLE 1
ORIGINAL YEAR OF ADOPTION AND TAX RATE OF VIRGINIA'S GROSS RECEIPTS TAXES ON PUBLIC SERVICE CORPORATIONS

YEAR	PUBLIC SERVICE CORPORATION	TAX RATE
1898	Telegraph	2%
1902	Railroads	1%
1902	Telephone	2%
1916	Water, heat, light, and power	0.75%

Current System of Taxing

The gross receipts tax on public service corporations is administered by the State Corporation Commission. The tax is imposed on all revenue derived in the Commonwealth by the public service corporation. The tax rate currently is set at two percent.[1]

This method of taxation differs from the predominant way in which other corporations are taxed in the Commonwealth pursuant to the corporate income tax. The Virginia corporate income tax is basically a tax on profits rather than gross receipts. The gross receipts tax, also called a "license tax" or "franchise tax," historically has been justified as a tax on the privilege granted to public service corporations to operate exclusive public service franchises in the Commonwealth.

Table 2 shows the revenue generated by the gross receipts tax for fiscal years 2000 through 2009. Revenues from the gross receipts tax amounted to $104,197,000 in fiscal year 2000 and $93,427,000 in fiscal year 2001.[2] This 10.3 percent decrease in revenue from the gross receipts tax on public service corporations can be partly explained by the imposition of corporate income taxes and energy consumption taxes on electric power companies and gas power companies effective January 1, 2001, in lieu of the gross receipts tax on such companies. In fiscal year 2000, the gross receipts tax on public service corporations accounted for about one percent of the total general fund revenues. Likewise, in fiscal year 2009, with $91,340,000 in revenues generated, the gross receipts tax on public service corporations accounted for approximately one percent of total general fund revenues.

[1] Va. Code § 58.1-2626.
[2] Department of Accounts *Summary Report on General Fund and Lottery Revenue Collections* for Fiscal Years 2000 and 2001.

TABLE 2
GROSS RECEIPTS TAX REVENUE
FROM PUBLIC SERVICE CORPORATIONS

FISCAL YEAR	REVENUE	% Change From Previous Year
2000	$104,197,000	-6.9%
2001	$93,427,000	-10.3%
2002	$77,152,000	-17.4%
2003	$91,247,000	18.3%
2004	$86,870,000	-4.8%
2005	$88,309,000	1.7%
2006	$89,992,000	1.9%
2007	$87,961,000	-2.3%
2008	$96,390,000	9.6%
2009	$91,340,000	-5.2%

SOURCE: Department of Accounts *Summary Report on General Fund and Lottery Revenue Collections (2000-2009).*

Reduction in Scope of Industries Covered

As market competition gradually has replaced exclusive "franchises" among public service corporations, the corporate income tax gradually has replaced the gross receipts tax. Railroads and telecommunications companies ceased being subject to the gross receipts tax in 1978 and 1988, respectively, and, instead, became subject to the corporate income tax.

As part of the process of moving the energy industry to market competition, in 1999 and 2000 the General Assembly enacted legislation that ended the gross receipts tax on electric power companies and gas power companies, respectively, on January 1, 2002, and replaced it with corporate income taxes and energy consumption taxes effective January 1, 2001 (see chapter on Corporate Income Tax herein for discussion of corporate income taxes, and see immediately below for discussion of energy consumption taxes). Accordingly, the only entities remaining liable under the state gross receipts tax for gross receipts received after January 1, 2002, are water companies.

Electric Utility Consumption Tax

A new electric utility consumption tax became effective January 1, 2001. This tax was intended to replace (i) the state gross receipts tax on electric utility companies, (ii) the special regulatory tax on such companies for the cost of regulation by the State Corporation Commission, and (iii) the local license tax on these companies (local option to impose license tax up to 0.5 percent of gross receipts).[3]

The consumption tax is imposed on all consumers of electricity in the Commonwealth (except, under certain conditions, consumers who purchase electricity from municipality-owned

[3] Chapter 29 (§ 58.1-2900 et seq.) of Title 58.1 of the Code of Virginia.

electric companies, or from a utilities consumer services cooperative) based on kilowatt hours (KWh) used per month, according to the following schedule:

KWh Used Per Month	Rate
First 2,500 KWh	$0.00155/KWh
KWh between 2,501 KWh and 50,000 KWh	$0.00099/KWh
Any KWh over 50,000 KWh	$0.00075/KWh[4]

The revenue generated by this tax is divided according to a set formula among (i) the Commonwealth's general fund, (ii) the State Corporation Commission's special regulatory fund, and (iii) localities according to point of consumption.[5] The formula for the amount to be distributed to each of these entities is calculated with the intent to replace the amount of revenues each would have generated by the aforementioned taxes and fees replaced by the consumption tax.

In this regard, the portion earmarked for localities is based on the estimated revenues that would have been generated by the local license tax on electric utilities on a statewide basis. However, it is a local option to decide whether to impose such a tax and, if so imposed, at what rate (up to 0.5 percent).[6] Accordingly, if a locality imposed less than the maximum local license tax rate as of December 31, 2000 (the last day before the electricity consumption tax became effective), the amount by which the portion of the consumption tax earmarked for that locality exceeds the revenues that would have been generated by the local license tax for that locality goes to the Commonwealth.[7] Effective January 1, 2003, for purposes of receiving that portion of the electric utility consumption tax revenue that is paid by the citizens of the locality, a locality that did not impose a local license tax as of December 31, 2000, on electric utility companies is assumed to have imposed the local license tax at the maximum rate of 0.5 percent.[8]

Natural Gas Consumption Tax

A new natural gas consumption tax became effective January 1, 2001, that parallels the structure of the electric utility consumption tax.[9] Under the tax, all consumers of natural gas (except consumers served by a gas utility owned or operated by a municipality) pay taxes based on the number of cubic feet of gas used per month.[10] The tax replaces and is in lieu of the state gross receipts tax on gas companies, the special regulatory fee charged by the State Corporation Commission to gas companies, and the local license tax on gas companies.[11]

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[4] Va. Code § 58.1-2900.
[5] *Id.*
[6] Va. Code § 58.1-3731.
[7] Va. Code § 58.1-2901.
[8] *Id.*
[9] Chapter 29.1 (§ 58.1-2900 et seq.) of Title 58.1 of the Code of Virginia.
[10] Va. Code § 58.1-2904.
[11] *Id.*

The gas consumption tax is imposed only on the first 500 CCF of gas used per month.[12] The rate of the tax is $0.0195 per CCF of gas used per month. The revenues generated by this tax are divided according to a set formula among (i) the Commonwealth's general fund, (ii) the State Corporation Commission's special regulatory fund, and (iii) localities according to point of consumption. The formula for the amount to be distributed to each of these entities is calculated with the intent to replace the amount of revenues each would have generated by the aforementioned taxes and fees replaced by the natural gas consumption tax.[13]

If a locality imposed less than the maximum local license tax rate on gas companies as of December 31, 2000 (the last day before the natural gas consumption tax became effective), the amount by which the portion of the consumption tax earmarked for that locality exceeds the revenues that would have been generated by the local license tax for that locality goes to the Commonwealth.[14] Effective January 1, 2001, for purposes of receiving that portion of the gas consumption tax revenue that is paid by the citizens of the locality, a locality in which natural gas service is first made available after July 1, 2000, is assumed to have imposed the local license tax on gas companies at the maximum rate of 0.5 percent.[15]

Issues

The major issues regarding the foregoing taxes relate to the transition from the state gross receipts tax on electric and gas power companies to the corporate income tax on such companies, combined with electric and gas consumption taxes to be paid by residential and commercial users. These transitions were intended to be revenue neutral.

For purposes of achieving revenue neutrality, in 2004 the General Assembly established an alternative minimum tax to be paid by certain electric suppliers and cooperatives in lieu of the corporate income tax.[16] The alternative minimum tax is imposed in any year in which the alternative minimum tax exceeds the tax imposed under the corporate income tax. The alternative minimum tax equals 1.45 percent of the electric supplier's or cooperative's gross receipts for the year in question.[17]

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[12] Id.
[13] Va. Code §§ 58.1-2904 and 58.1-2905.
[14] Va. Code § 58.1-2905.
[15] *Id.*
[16] Va. Code § 58.1-400.3.
[17] *Id*.

Summary

As market competition gradually has replaced exclusive "franchises" among public service corporations, the corporate income tax gradually has replaced the gross receipts tax. Beginning with removal of the railroads and telecommunications industries, and then more recently with the electric and natural gas industries, the number of industries subject to the state gross receipts tax has dwindled such that the only public service corporations subject to the tax are water companies.

In addition to the corporate income tax on electric and gas companies, consumption taxes on the use of electricity and natural gas have been established to replace revenues given up by the repeal of (i) the gross receipts tax on electric and gas companies, (ii) the State Corporation Commission's special regulatory fee on electric and gas companies, and (iii) the local license tax on these companies.

Insurance Premiums Tax

Insurance Premiums Tax

History

In 1842, Virginia levied an annual tax of $100 on each insurance office in the Commonwealth. Insurance premiums were first taxed by Virginia in 1856 when it levied a tax of 0.5 percent on the gross premiums of insurance companies doing business in Virginia but chartered outside of the Commonwealth. In 1873, the gross premiums tax was increased to 1.5 percent, and its reach was expanded to include the gross premiums of both foreign and domestic insurers. The tax on insurance premiums was reduced to one percent in 1874. That same year Virginia also adopted a retaliatory tax.

Based on findings of the 1914 Report of the Joint Commission on Tax Revision, the 1915 General Assembly established separate gross premiums tax rates according to company type: sick benefit companies (one percent), life insurance companies (2.25 percent), and fire and marine, surety, health and accident, and other companies (2.75 percent). In addition, insurers were made exempt from most state and local taxes; however, insurers were still subject to assessment fees; charter, franchise, and registration charges; and local property taxes. In 1987, the gross premiums tax on fire and marine, surety, health and accident, and other companies was reduced from 2.75 percent to 2.25 percent.

The 1990s saw the General Assembly pass legislation providing for assessments on specific types of insurance policies. The General Assembly provided for a one percent tax on the gross premiums from flood insurance policies to fund flood prevention programs (1990) and a 0.25 percent tax on the gross premiums of certain automobile physical damage insurance policies to fund programs to reduce losses from motor vehicle thefts (1991). In addition, a 0.8 percent fire programs tax enacted in 1985 was increased to one percent in 1995 to fund fire prevention and public safety programs.[1]

In 1998, Virginia domiciled insurers were allowed a retaliatory tax credit up to the amount of retaliatory taxes and fees they were charged by other states. Other states commonly assess taxes and fees on foreign domiciled insurers (including Virginia insurers) in order to enable their own insurance companies to better compete.

Finally, in 2007, the General Assembly passed legislation dedicating one-third of the revenues from the insurance premiums tax to the Priority Transportation Fund to be used for transportation purposes.[2] Prior to this change, all insurance premiums tax revenues were dedicated to the Commonwealth's general fund to be used for general obligations of the Commonwealth.

Insurance Premiums Tax Structure and Tax Rates

As can be seen in Table 1, the insurance premiums tax generated $251.1 million in fiscal year 2000 and $387.3 million in fiscal year 2009, an increase of 54.2 percent over the decade. However, insurance premiums tax revenues decreased by 2.4 percent between fiscal year 2008 and fiscal year 2009. The 2.4 percent decline in fiscal year 2009 was reflective of the deep recession across Virginia and the United States. Historically, insurance premiums tax revenues have been one of the more stable sources of general fund revenues; however, the growth in insurance premiums tax revenues began to flatten out in fiscal years 2006, 2007, and 2008, foreshadowing the revenue decline in 2009.

Generally speaking, insurance premiums tax revenues have not experienced the volatility that has been characteristic of individual income tax revenues and other general fund revenue sources. This is due in part to the fact that there is a strong need for insurance in both good and bad economic times. As a result, consumer-buying habits for insurance may be expected to remain relatively constant even as the economy changes. In addition, the structure of the insurance premiums tax has remained relatively unchanged during the decade. In comparison, Virginia's individual income tax structure has undergone many changes during the decade.

In fiscal year 2000, insurance premiums tax revenues accounted for 2.3 percent of all general fund revenues, making this the fourth largest source of general fund revenues. By the end of fiscal year 2009, insurance premiums tax revenues dipped to 1.8 percent of all general fund revenues primarily because one-third of the total insurance premiums tax revenues were deposited into the Priority Transportation Fund (a nongeneral fund) beginning July 1, 2008, to be used for transportation purposes (as described above). Even after accounting for this change in the use of a portion of insurance premiums tax revenues, the remaining insurance premiums tax revenues that are deposited into the general fund make up the fifth largest source of general fund revenues.

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[1] This information is paraphrased from House Document No. 78, 1997, *Virginia's Gross Receipts Tax* Imposed on Insurance Companies.

[2] Chapter 896, 2007 Acts of Assembly.

TABLE 1
Insurance Premiums Tax Revenues
Fiscal Years 2000 - 2009

Fiscal Year Ending June 30	Collections	% Change From Previous Year
2000	$251,074,000	2.5%
2001	$268,060,000	6.8%
2002	$292,702,000	9.2%
2003	$333,004,000	13.8%
2004	$351,278,000	5.5%
2005	$373,571,000	6.3%
2006	$373,781,000	0.1%
2007	$384,894,000	3.0%
2008	$396,858,000	3.1%
2009	$387,319,000	-2.4%

SOURCE: Department of Accounts *Summary Report on General Fund and Lottery Revenue Collections (2000-2009).*

The insurance premiums tax is a privilege tax that is administered by the State Corporation Commission. For the privilege of doing business in the Commonwealth, insurance companies are assessed an annual tax measured by their gross income from premium and subscription sales. An insurer's "license" to do business in Virginia runs from July 1 through June 30 of the succeeding year.[3] The due date for payment of the tax to the Commission is March 1.[4]

The cost of obtaining this license or the tax charged for the license is equal to a percentage of the insurer's gross income from premium and subscription sales in Virginia during the previous calendar year. That percentage or the applicable tax rate varies depending on the type of insurance as follows:

- 2.25 percent of the gross income from accident and sickness, fire damage, water damage, burglary and theft, personal injury liability, property damage, credit, title, and motor vehicle damage and liability insurance policies;
- 2.25 percent of the gross income from life insurance and accidental death and dismemberment insurance policies;
- One percent of the gross income from industrial sick benefit insurance policies; and
- 0.75 percent of the gross income from subscription contracts to individuals for certain health services and 2.25 percent of the gross income from all other subscription contracts for health services.[5]

Fraternal benefit societies are exempt from the insurance premiums tax. In addition, the tax may not be imposed on workers' compensation insurance premiums and on the consideration paid for contracts for annuities.[6]

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[3] Va. Code §§ 58.1-2500 and 58.1-2501.
[4] Va. Code § 58.1-2503.
[5] Va. Code § 58.1-2501.
[6] Va. Code § 58.1-2502.

Comparison with Other States

With the exception of Oregon, all states levy taxes on insurance companies with most states levying a gross receipts tax on insurance premiums.[7] In 2007, Virginia ranked in a tie for 11th with four other states for the highest tax rates imposed on life insurance premiums (See Table 2). Of the states imposing the tax, Illinois imposed the lowest tax rate, 0.5 percent, while Nevada imposed the highest tax rate, 3.5 percent. Since 1985, 25 states, including Virginia, have reduced their taxes on insurance products.

TABLE 2
Gross Premium Tax Rates on Foreign Life Insurers in the United States
Fiscal Year 2007

State	2007 Rate	Action Since 1985
Alabama	2.3%	Decreased
Alaska	2.7%	Decreased
Arizona	2.0%	-
Arkansas	2.5%	-
California	2.35%	-
Colorado	2.0%	Decreased
Connecticut	1.75%	Decreased
Delaware	2.0%	-
Florida	1.75%	Decreased
Georgia	2.25%	-
Hawaii	2.75%	Decreased
Idaho	1.99%	Decreased
Illinois	.5%	Decreased
Indiana	1.75%	Decreased
Iowa	1.75%	Decreased
Kansas	2.0%	-
Kentucky	2.0%	-
Louisiana	2.25%	-
Maine	2.0%	-
Maryland	2.0%	-
Massachusetts	2.0%	-
Michigan	1.25%	Decreased
Minnesota	1.625%	Decreased
Mississippi	3.0%	-
Missouri	2.0%	-
Montana	2.75%	-
Nebraska	1.0%	Decreased
Nevada	3.5%	Increased

[7] *Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison, 2007*, Issued August 2008, Government of the District of Columbia, Office of the Chief Financial Officer, Office of Revenue Analysis.

TABLE 2 (con't)
Gross Premium Tax Rates on Foreign Life Insurers in the United States
Fiscal Year 2007

State	2007 Rate	Action Since 1985
New Hampshire	2.0%	-
New Jersey	2.1%	Increased
New Mexico	3.0%	-
New York	0.7%	Decreased
North Carolina	1.9%	Decreased
North Dakota	2.0%	-
Ohio	1.4%	Decreased
Oklahoma	2.25%	Decreased
Oregon	No Tax	Decreased
Pennsylvania	2.0%	-
Rhode Island	2.0%	-
South Carolina	0.75%	Decreased
South Dakota	2.5%	-
Tennessee	1.75%	Decreased
Texas	1.75%	Decreased
Utah	2.25%	-
Vermont	2.0%	-
Virginia	**2.25%**	**Decreased**
Washington	2.0%	Decreased
West Virginia	2.0%	Decreased
Wisconsin	2.0%	-
Wyoming	0.75%	Decreased

SOURCE: *Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison, 2007*, Issued August 2008, Government of the District of Columbia, Office of the Chief Financial Officer, Office of Revenue Analysis.

In comparison with neighboring states, Virginia has the highest gross receipts tax on life insurance premiums at 2.25 percent (See Table 3). West Virginia, Kentucky, and Maryland impose a two percent gross receipts tax on life insurance premiums, North Carolina imposes a 1.9 percent tax, and finally Tennessee imposes a 1.75 percent gross receipts tax on life insurance premiums.

TABLE 3
Gross Premium Tax Rates on Foreign Life Insurers; Neighboring States
Fiscal Year 2007

State	2007 Rate
Virginia	**2.25%**
West Virginia	2.0%
Kentucky	2.0%
Maryland	2.0%
North Carolina	1.9%
Tennessee	1.75%

SOURCE: *Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison, 2007*, Issued August 2008, Government of the District of Columbia, Office of the Chief Financial Officer, Office of Revenue Analysis.

Issues

Retaliatory Tax Credit

Most states impose retaliatory taxes on foreign insurance companies (companies incorporated in another state). Retaliatory taxes are imposed to protect a state's domiciled insurance companies when they do business in another state.[8] As an example, Virginia domiciled insurance companies pay a 2.3 percent insurance premiums tax on policies sold in Alabama, but Alabama domiciled insurance companies pay only a 2.25 percent insurance premiums tax on policies sold in Virginia. To eliminate this difference in taxes, Virginia will impose a retaliatory tax of 0.05 percent on the policies sold in Virginia by Alabama insurance companies. The end result is that both Virginia and Alabama domiciled insurance companies pay an aggregate tax of 2.3 percent on their insurance sales in the other state.

Retaliatory taxes are used to deter other states from increasing their taxes on foreign insurance companies.[9] If a state increases its insurance premiums tax on foreign insurance companies doing business in that state, it can expect that its own insurance companies will be made subject to higher retaliatory taxes on sales made in other states. Similarly, if a state reduces its insurance premiums tax on foreign insurance companies, there should be a reduction in the amount of retaliatory taxes paid by its own insurance companies.

In 1998, Virginia enacted a retaliatory tax credit that reimburses Virginia domiciled insurance companies for the retaliatory taxes paid on insurance sales in other states.[10] This enables Virginia to impose a somewhat high insurance premiums tax when compared with other states, while reducing the impact of retaliatory taxes on Virginia domiciled companies.

Revenues Dedicated to Transportation Initiatives

Beginning July 1, 2008, one-third of all insurance premiums taxes have been deposited into the Priority Transportation Fund to help finance priority transportation projects. As a result, under current law, these revenues cannot be used for purposes other than funding priority transportation projects.

[8] Virginia's Gross Receipts Tax Imposed on Insurance Companies, House Document No. 78, 1997.
[9] *Id*.
[10] Va. Code § 58.1-2510.

Summary

The insurance premiums tax generated $387.3 million in fiscal year 2009, and the portion of the insurance premiums tax revenue that is deposited into the general fund is the fifth largest source of general fund revenues. Historically, insurance premiums tax revenues have been one of the more stable sources of general fund revenues; however, the growth in insurance premiums tax revenues began to flatten out in fiscal years 2006, 2007, and 2008, foreshadowing a 2.4 percent decline in fiscal year 2009. A possible reason for the historical stability in insurance premiums tax revenues is that there is a strong demand for insurance products in both good and bad economic times.

Beginning July 1, 2008, one-third of insurance premiums tax revenues have been dedicated to the Priority Transportation Fund (a nongeneral fund) to fund priority transportation projects. Insurance premiums tax revenues deposited into the Priority Transportation Fund cannot be used for purposes other than funding priority transportation projects. The amount of insurance premiums taxes dedicated toward meeting Virginia's transportation needs may continue to be an issue for the General Assembly.

Motor Fuels Tax

History

Structure, Rates, and Revenue

Comparison with Other States

Issues

Flat Rate versus Percentage Rate
Motor Vehicles Using Less Fossil Fuels

Summary

Motor Fuels Tax

History

Virginia's motor fuels tax dates to 1923,[1] when the General Assembly first provided matching funds to obtain federal grants for highway construction, and imposed a two cents per gallon tax on motor vehicle gasoline to pay the matching funds. A "fuels use tax" on fuels other than gasoline was added in 1940.

In 1995, Virginia became one of the first states to prohibit the use of dyed diesel fuel for motor vehicles on the highway except for a few limited exemptions. All diesel fuel except that which is lawfully used for motor vehicles are colored by dye. Fuel that is lawfully used in motor vehicles remains undyed and is taxed. Requiring highway motor vehicle fuel to be singularly undyed makes it much easier to enforce the fuels tax, because officials can catch those that unlawfully dodge the tax merely by looking at the color of the fuel. In the six years immediately prior to the prohibition of dyed fuel, annual motor fuels tax collections increased approximately 1.8 percent per year; compared with 3.3 percent in the six years immediately following prohibition.

Prior to 2001, the ultimate consumer paid the tax at the gas station when he bought the fuel (referred to as tax "at the pump"). Under this system, there were over 1,300 entities remitting fuels tax, and fuel could be purchased and sold numerous times among wholesalers before the fuels tax was finally collected. These factors made tracking the fuel for tax purposes very difficult and led to uncollected revenues according to the Department of Motor Vehicles.

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[1] Chapter 107, 1923 Acts of Assembly.

In 2001, Virginia began collecting the tax at the terminal rack (commonly referred to as tax "at the rack") from suppliers, before the fuel leaves the terminal and circulates to distributors. At the inception of tax "at the rack," the number of entities submitting fuels taxes fell from 1,300 to about 200.

Structure, Rates, and Revenue

The terminal rack is the point at which fuels leave a terminal and are deposited into a tank truck, rail car, or other means of transportation to begin the distribution process. There are two exceptions to the "tax at the rack" rule: (i) when fuels are imported into Virginia by means other than through terminals, and (ii) when fuels are blended in Virginia outside the terminal system. In these cases, the tax is assessed when imported or blended.

Suppliers are generally major oil companies that pay the tax to the Department of Motor Vehicles on the 20th day of the second month after the transaction.

The motor fuel tax rates are as follows:[2]

1. Seventeen and one-half cents per gallon on gasoline, diesel fuel, gasohol, blended fuel containing gasoline, and alternative fuels;

2. Five cents per gallon on aviation gasoline (seventeen and one-half cents if used in a highway vehicle);

3. Five cents per gallon on aviation jet fuel purchased or acquired for use by a user of aviation fuel other than an aviation consumer; and

4. Five cents per gallon on the first 100,000 gallons of aviation jet fuel, excluding bonded aviation jet fuel, purchased or acquired for use by any aviation consumer in a fiscal year and one-half cent per gallon on such aviation jet fuel in excess of 100,000 gallons in a fiscal year (seventeen and one-half cents on all gallons if used in a highway vehicle.

Federal, state and local governments, and certain nonprofit charitable organizations are exempt from the fuels tax.[3]

Table 1 shows the motor fuels tax collections for the past 10 years.

TABLE 1
Motor Fuels Tax
Fiscal Years 2000-2009

Fiscal Year Ending June 30	Tax Collections	% Increase/ Decrease from Previous Year
2000	$784,434,000	+1.7
2001	778,191,000	-0.8

[2] Va. Code § 58.1-2217.
[3] Va. Code § 58.1-2226.

TABLE 1 (con't)
Motor Fuels Tax
Fiscal Years 2000-2009

Fiscal Year Ending June 30	Tax Collections	% Increase/ Decrease from Previous Year
2002	794,266,000	+2.1
2003	808,527,000	+1.8
2004	846,080,000	+4.6
2005	849,489,000	+0.4
2006	870,414,000	+2.5
2007	859,482,000	-1.3
2008	863,024,000	+0.4
2009	839,513,000	-2.7

SOURCE: Virginia Department of Taxation.

Comparison with Other States

Every state has some type of fuel excise tax, whether collected at the rack or in some other manner. In addition, the federal government imposes a motor fuels tax rate of 18.4 cents per gallon. Table 2 provides a comparison of each state's excise tax on motor fuels.

TABLE 2
Motor Fuels Tax Rates

STATE	Motor Fuels Tax Rates (Cents per Gallon)
Alabama	20.9
Alaska	8
Arizona	19
Arkansas	21.8
California	39.9
Colorado	22
Connecticut	36.4
Delaware	23
District of Columbia	20
Florida	34.5
Georgia	12.4
Hawaii	33.6
Idaho	25
Illinois	33.8
Indiana	29.7
Iowa	22
Kansas	25
Kentucky	22.5
Louisiana	20

TABLE 2 (con't)
Motor Fuels Tax Rates

STATE	Motor Fuels Tax Rates (Cents per Gallon)
Maine	29.9
Maryland	23.5
Massachusetts	23.5
Michigan	30.9
Minnesota	25.6
Mississippi	18.8
Missouri	17.3
Montana	27.8
Nebraska	27.3
Nevada	33.1
New Hampshire	19.6
New Jersey	14.5
New Mexico	18.8
New York	42.5
North Carolina	30.2
North Dakota	23
Ohio	28
Oklahoma	17
Oregon	25
Pennsylvania	32.3
Rhode Island	31
South Carolina	16.8
South Dakota	24
Tennessee	21.4
Texas	20
Utah	24.5
Vermont	20
Virginia	**17.5 (19.1)**[4]
Washington	37.5
West Virginia	32.2
Wisconsin	32.9
Wyoming	14

SOURCE: Tax Foundation, State Sales, Gasoline, Cigarette And Alcohol Taxes, (2009). Tax rates do not include any local option taxes.

[4] In an attempt to make the rates of states that use different methods of taxation comparable, the entity that compiled the table, the Tax Foundation, adopted the methodology of the American Petroleum Institute for determining the average tax rate on a gallon of fuel. This methodology considers, among other things, storage tank fees, environmental fees, and other types of fees. As a result, Virginia's rate is listed as 19.1 as opposed to 17.5.

Issues

Flat Rate versus Percentage Rate

Unlike the retail sales and use tax, the fuels tax is imposed at a flat cents per gallon rate, rather than as a percentage of the sales price. Because of the general upward trend of prices of goods over time due to inflation, revenue from a flat excise tax does not keep pace with that of a percentage-based one. For example, for the period 2000 through 2009, the average annual growth rate in retail sales and use tax revenue, 3.67 percent, was more than four times greater than the growth in fuels tax revenue, 0.87 percent. In recent sessions of the General Assembly, there have been bills introduced that would convert the fuels tax rate to a percentage. Some of these bills include a computation of the percentage amount so that it would be revenue-neutral when it takes effect. Other bills would impose the percentage rate only if and when the price of gasoline falls to a certain price per gallon.

Motor Vehicles Using Less Fossil Fuels

Whether it is regular motor vehicles designed to be more fuel-efficient, hybrid motor vehicles, or motor vehicles like electric ones that are driven entirely by nonfossil fuels, motor vehicles are on a clear path to use less and less fossil fuels. As this happens, Virginia can expect to see depletions of the current fuels tax revenue, at least per motor vehicle. An increase in the number of motor vehicles cannot offset the impact of this depletion on transportation funding, because each motor vehicle needs the same road space and causes the same amount of wear and tear on the roads, regardless of fuel-efficiency. In fact, more motor vehicles would only exacerbate the need for new roads. The General Assembly may wish to examine this issue well before the time when these motor vehicles of the future reach a critical mass.

Summary

The Commonwealth first imposed a fuels tax in 1923 at a rate of two cents per gallon to provide funding for transportation needs. In 2001, the Commonwealth stopped collecting the tax at the gas pump, and started collecting it at the terminal rack. The current tax, at the rate of seventeen and one-half cents per gallon, generates about $850 million annually. The revenue is dedicated to help fund transportation. The motor vehicles of the future will be less and less dependent on fossil fuels, which may render the current fuels tax structure antiquated, if not obsolete.

Virginia's Motor Vehicle Titling Tax

History

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Summary

Virginia's Motor Vehicle Titling Tax

History

Virginia adopted its Motor Vehicle Sales and Use Tax in 1966 at the same rate, two percent, and the same time, September 1, 1966, as the Virginia Retail Sales and Use Tax.[1] The two percent tax rate remained unchanged until it was increased to three percent during the 1986 Special Session on Transportation.[2]

The Commonwealth relies on the tax as an important component of financing transportation infrastructure. Table 1 shows Virginia's tax collections during the past 10 years. The volatility in these collections from year to year, including the 22.8 percent drop in 2009 due to the severe recession, shows how sensitive the sale of motor vehicles is to overall economic conditions.

TABLE 1
Motor Vehicle Sales and Use Tax Collections
Fiscal Years 2000-2009

Fiscal Year Ending June 30	Collections	% Change from Previous Year
2000	$498,098,000	+12.8
2001	502,403,000	+0.9
2002	532,107,000	+5.9
2003	542,743,000	+2.0
2004	604,078,000	+11.3
2005	615,261,000	+1.9
2006	628,689,000	+2.2
2007	628,458,000	0.0
2008	573,000,000	-8.8
2009	442,309,000	-22.8

SOURCE: Virginia Department of Taxation.

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[1] Chapter 587, 1966 Acts of Assembly.
[2] Chapter 11, 1986 Acts of Assembly, Special Session.

Administration

The tax is administered by the Department of Motor Vehicles (DMV), and is paid by the purchaser of the motor vehicle at the time the purchaser applies to the DMV for a certificate of title (which is the reason the tax often is referred to as the "titling tax"). The tax is based on the "sales price" of the vehicle as determined by DMV. Unlike most other states, Virginia does not reduce the sales price by the value of any trade-in. A credit is given for sales and use taxes paid to another state. There are a number of exemptions for such things as a motor vehicle: (i) registered in the name of a volunteer fire department or rescue squad not operated for profit; (ii) a gift to a spouse, son, or daughter; or (iii) to be titled in a motor vehicle dealer's name for resale.

Comparison with Other States

Table 2 provides a listing of state titling tax rates in the other states. Virginia's titling tax rate of three percent compares favorably with the other states. Only two of the states imposing the tax have a lower rate than does Virginia. In addition, unlike Virginia, a number of states allow localities to impose a local titling tax. There are 17 states with a titling tax rate of six percent or higher. The highest tax rate is imposed by the state of California, which has a rate of 8.25 percent.

Virginia's titling tax is below those of neighboring states with the exception of North Carolina. North Carolina imposes the same three percent tax rate but allows a deduction for the value of the trade-in.

TABLE 2
MOTOR VEHICLES SALES AND USE TAX TABLE

STATE	MOTOR VEHICLE SALES AND USE TAX
Alabama	2.0%
Alaska	None
Arizona	5.6%
Arkansas	6.0%
California	8.25%
Colorado	2.1%
Connecticut	6.0%
Delaware	3.25%
District of Columbia	6.0%
Florida	6.0%
Georgia	4.0%
Hawaii	4.0%
Idaho	5.0%
Illinois	6.25%
Indiana	5.0%
Iowa	5.0%
Kansas	5.3%
Kentucky	6.0%
Louisiana	4.0%
Maine	5.0%
Maryland	5.0%
Massachusetts	5.0%
Michigan	6.0%
Minnesota	6.5%

TABLE 2 (con’t)
MOTOR VEHICLES SALES AND USE TAX TABLE

STATE	MOTOR VEHICLE SALES AND USE TAX
Mississippi	3.0%
Missouri	4.225%
Montana	None
Nebraska	5.5%
Nevada	6.5%
New Hampshire	None
New Jersey	7.0%
New Mexico	3.0%
New York	4.0%
North Carolina	3.0%
North Dakota	5.0%
Ohio	5.5%
Oklahoma	3.25%
Oregon	None
Pennsylvania	6.0%
Rhode Island	7.0%
South Carolina	5.0%
South Dakota	3.0%
Tennessee	7.0%
Texas	6.25%
Utah	4.75%
Vermont	6.0%
Virginia	**3.0%**
Washington	6.8%
West Virginia	5.0%
Wisconsin	5.0%
Wyoming	3.0%

SOURCE: Government of the District of Columbia, Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison (2008).

Summary

Virginia's titling tax on average generates almost $500 million annually to help Virginia fund its transportation program. The tax is imposed on the sale of motor vehicles in Virginia and is levied at a three percent rate on the selling price of the motor vehicle. Collections are largely dependent on the level of economic activity because the state of the economy is a prime factor in determining motor vehicle sales.

Virginia's titling tax rate is relatively low compared to other states, however, the Commonwealth is one of only eight states that does not reduce the tax by the value of a trade-in.