REPORT OF THE

REVENUE RESOURCES AND ECONOMIC COMMISSION

TO

THE GOVERNOR

AND

THE GENERAL ASSEMBLY OF VIRGINIA

Senate Document No. 20

COMMONWEALTH OF VIRGINIA
Department of Purchases and Supply
Richmond
1976

MEMBERS OF COMMISSION

LEROY S. BENDHEIM, Chairman

CARRINGTON WILLIAMS, Vice-Chairman

GEORGE S. ALDHIZER, II

SAM T. BARFIELD

GEORGE W. JONES

JOHN L. KNAPP

JOSEPH A. LEAFE

J. HARRY MICHAEL, JR.

RAYMOND M. MUNSCH

STANLEY A. OWENS

OWEN B. PICKETT

LESTER E. SCHLITZ

STAFF

ECONOMIC STAFF

Barry E. Lipman

Robert T. Benton

John A. Garka

Nancy D. Beistel

Elizabeth P. Martin

William P. Dickinson

COUNSEL

Sally T. Warthen

E. M. Miller, Jr.

RESEARCH ASSOCIATE

Jill M. Pope

INTRODUCTION

The Revenue Resources and Economic Commission, first created in 1968 to study and report on various proposals affecting the fiscal status of the Commonwealth, became a permanent Commission in 1974. The Commission's charge is to study the tax structure and sources of revenue of the Commonwealth and its local governments, especially the division of sources of revenue between the State and the localities, and to recommend reforms.

During 1975, the Commission's staff prepared and published its biennial report, Fiscal Prospects and Alternatives, 1976, which examines the State and local fiscal outlook and various alternative methods of raising additional revenue, and contains specific study of many areas in need of reform. In addition, the Commission has received two in-depth studies from consultants: A Comparative Analysis of Public Utility Taxation in Virginia, prepared by William F. Hellmuth, Larry G. Beall and George W. Jennings, and Transportation Taxation in Virginia: an Interstate and Intermodal Analysis, prepared by Charles J. Gallagher and George E. Hoffer. The Commission also heard testimony from groups interested in the two consultants' reports. Many of the issues raised and discussed in this wealth of material supplied by the staff and interested parties are too complicated to permit the Commission to make recommendations in this report, and many subjects have been reserved for further study. Moreover, because of the hazy economic picture, the Commission has been reluctant to recommend reforms which would necessarily cost the State or local governments large amounts of revenue.

The Commission's recommendations appear in the beginning of the report. The following sections are: I. Analysis of the fiscal outlook for the biennium; II. Explanation of recommendations for changes in local taxation; III. Explanation of proposed State tax changes; and IV. Alternative tax proposals if increased revenue is needed.

RECOMMENDATIONS:

Local Issues

(a). Appraisals for assessment of real property in localities not employing an annual assessment procedure, now required every four years in cities and every six years in counties, should be required at least every two years in cities and every four years in counties, as a step toward annual assessments.

(b). In order to permit accurate study of the tax on tangible personal property, machinery and tools, and merchants' capital, a uniform reporting system should be developed for all localities.

(c). Localities should be required to extend personal property taxes on motor vehicles and travel trailers thoughout the entire year, rather than to assess and tax them only as of January first.

(d). The temporary ceiling placed on local business, professional and occupational license taxes (local gross receipts taxes) in 1975 should be extended until January 1, 1977, to permit further study of the problems caused by such taxation.

State Issues

(a). The legislation limiting Virginia's standard deduction for taxable years beginning during 1975 to the amount permitted in 1974 should be extended to apply to taxable years beginning during 1976, freezing the Virginia standard deduction at 15 percent with a maximum of $2,000 and a minimum of $1,300.

(b). The income tax exclusion for all dividends received from banks and dividends from corporations a majority of whose income is taxed in Virginia should be repealed.

(c). Individuals, like corporations, should be required to include the full amount of net long term capital gain in Virginia taxable income.

I. Fiscal Outlook

Although the economy has been subject to unforeseen changes and much uncertainty since July, 1975, when Fiscal Prospects and Alternatives: 1976 was formally presented to the Commission, the long-term fiscal outlook as contained in that report has not been altered significantly. For the State's general fund, the projections show that revenues are expected to incease substantially over the next six years but, even after the tax increases of 1972, they are not anticipated to display the percentage gains as those experienced in the last two biennia of the 1960's. As for expenditures, general fund outlays are projected to grow by various amounts under alternative sets of assumptions. Using the broadest and probably the most accurate projection of expenditures (scope and quality plus capital outlay), the difference between general fund revenues and outlays results in a $254.7 million deficit for the 1976-78 biennium, a $231.2 million deficit for the 1978-80 biennium, and a $59.3 million deficit for the 1980-82 biennium. On the other hand, a more conservative projection of general fund outlay (allowing for changes in inflation, population workloads, and capital outlays but no increases for scope and quality of expenditure functions) yields a $94.1 million surplus for 1976-78, a $635.4 million surplus for 1978-80, and a $1,557.9 million surplus for 1980-82.

The large discrepancy between projected surpluses and deficits shown above reflects to some extent the precarious fiscal situation which now faces State government finances. In attempting to evaluate these projections, it must be pointed out that the gaps are residual measures particularly sensitive to estimating errors, since a small charge in projected revenues or expenditures would have a magnified impact on them. In addition, the short-run forecasts are generally more accurate than the long-range projections. Another note of caution is that the methodology for the expenditure projections has an upward bias. It assumes that all current expenditure programs will continue at baseline levels or will be expanded for improvements in scope and quality. In doing so, there is no allowance for new priorities that would lower or eliminate expenditures on some programs and there is no provision for new, lower cost methods of fulfilling program requirements.

A final aspect to be considered is that the projections assume federal general revenue sharing will expire in December 1976. Yet, there is a strong likelihood that revenue sharing will be extended. If so, projected revenue would be about $55 million greater in the 1976-78 biennium and $92 million greater in each of the two subsequent bienniums.

The above factors notwithstanding, there may be some need to raise taxes or to borrow for capital outlays should the projected scope and quality gaps prove reasonably accurate. This indeed may be the case should the Governor and General Assembly desire to undertake large, new programs which will probably require additional revenue from a major, new or existing revenue source. Because of these possibilities, this report presents a group of revenue alternatives to which the General Assembly could turn, if necessary, to fund additional expenditures. A discussion of these alternatives begins on page 22.

Since it is important not to analyze state government finances in a vacuum, the staff report also contained a forecast for all local governments in Virginia. These projections encompass all local governments and to a certain extent show only average trends that do not apply equally to the diverse localities of the Commonwealth—central cities, small cities, urban counties and rural counties. Because indvidual localities have different revenue sources and expenditure requirements, any single jurisdiction may fare better or worse than the overall fiscal outlook presented below.

To forecast the gaps for local governments, the staff again used various assumptions as to the growth and scope of expenditures categories. Combining the forecast of revenues with the broadest projection of ependitures (scope and quality plus capital outlay), the gaps indicate a $223.0 million deficit for 1975-76, a $163.3 million deficit for 1976-77 and a $309.1 million deficit for 1977-78. These negative gaps continue through the projection period that ends 1981-82 but steadily diminish in magnitude.

If scope and quality adjustments are not considered in the projections, the outlook for local governments is much improved. The difference between projected revenues and baseline expenditures plus capital outlay without allowance for scope and quality increases shows a $67.6 million deficit for 1975-76, a $73.1 million surplus for 1976-77, and a $51.8 million surplus for 1977-78. Thereafter, the surplus increases substantially over the remainder of the projection period. By 1981-82, the surplus is expected to stand at $803.7 million.

These projections are subject to two major limitations. First, the projected gaps assume no borrowing—a rather unrealistic premise if one considers the past behavior of Virginia local govenments which have regularly borrowed for capital outlays. If local governments increase their debt at a rate consistent with past growth, then about $150 million will be available from borrowing each year. Second, the projected gaps assume federal revenue sharing will expire in December 1976. If, as likely, the program continues, it would provide about $92 million per year to the localities. Thus, if borrowing and revenue sharing are allowed for, the fiscal outlook for local governments in the aggregate is fairly good.

II. Local Tax Issues

During 1974, the Commission's major topic of study was the real estate tax. Working with the product of a 1973 study conducted through the Governor's Office, Reforming the Virginia Property Tax, ("The Governor's Study"), the Commission made many recommendations which were enacted into law by the General Assembly in the 1975 Session.

Other recommendations of the Governor's Study were held for further study. Two of these were: (a) shortening the assessment cycle, which is now six years in counties and four years in cities, and (b) refinement of the present review and appeals procedure.

(a) Assessment cycle.—Except for the 26 localities which use the annual assessment method, the cities and counties of the commonwealth depend upon periodic general reassessments to keep their valuations of real property up to date. During the reassessment year, every parcel is separately evaluated and its assessed value adjusted if necessary. During the period between reassessments, no changes are made except where new construction, subdivision, or disaster loss makes action necessary. Under current Virginia law, general reassessments need only be made every six years in counties and every four years in cities.

The annual assessment method, properly employed, is a continuous maintenance system; with a combination of geographic sweep and hotspotting (assessment of those neighborhoods or types of property which market data indicates have changed the most in value), the assessing officers attempt to bring all assessments up to date annually. The Governor's Study recommended that all localities convert to the annual assessment method as soon as possible, as it constitutes the best method devised so far for maintaining uniformity. While the Commission endorses this recommendation as an ideal, we are cognizant of the difficulty and expense of making such a conversion, and are unwilling at this time to endorse legislation requiring it. In order to use this system, all localities would have to employ one or more professional appraisers, unless some method of sharing personnel is devised, and many would have to update and refine considerably their mapping and record keeping systems. To require conversion to such a system without proper preparation would be to encourage sloppy and inadequate appraisal.

The six and four year cycles now permitted by Virginia law are entirely too long, however, and should be shortened without further delay. In today's market, real property can change in value dramatically in a year's time. Particularly in urbanizing, suburban or resort areas, some properties may double or triple in value while others in the same locality stay the same or even decrease. Under such conditions, those with static or declining properties bear more each year of the burden properly belonging to others. The property tax, as a tax on value, can only be equitable if its base is updated competently and frequently. The constitutional requirement of uniformity must be obeyed.

For this reason, the Commission recommends as a first step that the maximum assessment cycle for cities be shortened to two years, and that for counties to four years. As local governments adjust to the changes made in compliance with this and other recent legislation, it is hoped that many more will be able to convert to an annual assessment system, and that further shortening of the assessment cycle may be effected for those who do not.

The legislation recommended by the Commission (see appendix) to shorten the assessment cycle repeals several sections and largely reorganizes Article 3 of Chapter 15 of Title 58. That article contains much unnecessary and outdated detail as to the timing of general reassessments. As reorganized, the article will provide the following:

1. Counties and cities are on four and two year cycle schedules. The schedules are planned so that an equal number of assessors will be required in the State each year;

2. The governing body of any county or city may order a general reassessment in any year between normal reassessments. If such an interim reassessment is conducted, the locality will not be required to reassess until two (if a city) or four (if a county) years after the interim reassessment;

3. Any county or city may extend the time of completion of a general reassessment until three months after the end of the year with the permission of the circuit court;

4. The procedure for general reassessments are left unchanged;

5. Any locality with a permanent assessor may reassess every two years taking the full two years for the reassessment, but using the same standards of value throughout; and

6. Section 58-795.1, which provides for special additional reassessments conducted by the Department of Taxation "within the limits of such appropriation as may be made therefor" is repealed, as no appropriation has ever been made for the purpose since the section was enacted in 1950.

(b) Review and appeal procedures.—Except in urban and suburban areas with unusually refined assessor's departments, the avenues for review of real estate assessments are limited. In the year of a general reassessment, the property owner is notified of any change in value and permitted a hearing before the board of assessors. If sufficient outcry is raised thereafter, the governing body of the locality *may* ask the circuit court to appoint an equalization board, which hears complaints and may make further adjustments. Once these bodies have completed their work and disbanded, taxpayers must go to the courts to obtain relief. This avenue is expensive and difficult, and therefore not often taken except where large amounts or money are involved.

The Commission has been interested in the proposal made by the Governor's Study that a permanent board of equalization be required in each locality. By this means, the most serious deficiencies of the present system can be corrected; the board can be available at all times, not just in reassesment years, and can develop and maintain the expertise necessary to perform its function efficiently ad equitably. We are reluctant, however, to require such and addition to local government expense before the need is manifest. Review by the board of assessors, which constitutes a significant improvement in assessment review, has been required only since 1973. Most localities with annual assessment systems already have permanent equalization boards, and the Commission has not been aware of significant interest in them from other areas in the State. Moreover, a permanent equalization board should become more effective as the assessment cycle is shortened; its services are required more regularly, thus permitting its members to develop necessary expertise.

It is our feeling that the 1975 legislation requiring assessment at 100 percent of fair market value beginning in 1977, and the shortening of the assessment cycle as recommended herein, will increase public awareness of the administration of the real estate tax, and will therefore highlight any deficiencies which exist in the review and appeal system. For this reason, we will await further developments before making concrete recommendations.

(c) Personal property taxation.—Because of the Governor's Study, and further consideration by this Commission, many difficult areas in real estate taxation have been uncovered and analyzed, and remedial steps have been taken. Tangible personal property, machinery and tools, and merchants' capital taxation in Virginia also has its troublesome aspects. Classification, valuation, equity and uniformity are equally important in all property taxation. The taxes are very difficult to administer because there is no one standard for valuation, and expertise is extremely scarce.

Because non-real estate property collections are significantly lower than real estate tax collections, comprising only about 9 percent of the local revenues from own sources as contrasted to 43 percent for the real property tax, the tax is of less vital importance to the taxpayer and the locality, and therefore unlikely to generate as much interest in reform. However, it is likely that an in-depth study of the field would be extremely fruitful.

Such study is made difficult by the lack of uniformity, and in some cases, completeness, in local reporting. The Commission has therefore requested its staff to consult the other State agencies interested in such reporting and recommend a standard for use throughout the State.

(d) Situs of tangible personal property.—One known trouble area in personal property taxation is the basic tax treatment of tangible personal property. In all localities except one, tangible personalty, like real property, is taxed as of January 1. The ownership and normal situs of the property on that day is controlling. A purchaser of a new automobile who takes possession on January 2 does not pay personal property tax until the following year; a person moving his property from the locality on January 2 pays taxes for the entire year.

Mild forms of tax evasion occur because of this rule. Taxpayers purchasing automobiles in the late fall often wait until January 2 to take possession; in a few cases; they may take possession earlier but delay registering the automobile through collusion with the dealer.

To correct the situation and pick up revenues lost by late registrations, Alexandria obtained a charter change in 1971 permitting it to prorate the tax on automobiles, travel trailers, boats and airplanes over the whole year. Each taxpayer is taxed for the portion of the year he owns the property; as records are kept monthly, a person buying a car in March pays personal property tax on it for nine-twelfths of the year. If he sells a car, he receives a rebate or a credit for a portion of the year. Apparently, the system has worked well in that city. The city keeps abreast of car sales through reports of dealers, who are apparently happy not to have the confusion at the end of the year caused by the old system. There is one major difficulty, however; since none of the surrounding localities use the system, a few taxpayers are taxed twice for the same property. For example, a person moving from Fairfax county into Alexandria in June is required to pay tax to Fairfax on his motor vehicle for the entire year, with no rebate, and tax to Alexandria for the portion of the year he lives in Alexandria. This treatment has brought forth quite legitimate complaints, out of which came Senate Joint Resolution No. 145 requesting that this Commission study the problem.

Several other counties and cities have been interested in using the proration method of taxing personal property. Others have resisted it, as it necessitates additional recordkeeping and administrative costs.

The Commission feels that the present situation, with one locality on a completely different system from everyone else, is most undesirable. While we are sympathetic with these localities who wish to stay with the system to which they are accustomed, we feel that proration is more equitable in this age of mobility, and that the administrative costs will be more than offset by additional revenues. For this reason the Commission recommends that the proration method be used in every locality, beginning January 1, 1977. A year's lead time is given to allow local officials to adjust to the new system.

(e) Local license taxation.—For the last several years, representatives of the business community have maintained before the finance committees of the House and Senate that the local business, professional and occupational license tax, or gross receipts tax, is inequitable and unduly burdensome. After preliminary study of the problem in 1974, this Commission recommended to the 1975 Session, and the General Assembly enacted, a bill freezing for one year the rates of local license taxes at the December 31, 1974 level, while study of the subject was completed.

A considerable amount of staff time has been spent in researching the problems of and alternatives to local gross receipts taxes. Like the consumer utility tax, the tax is an extremely important source of revenue, comprising 6 percent of locally raised revenues, or (in 1973) nearly $54 million. The tax is particularly important to those localities who are already using their other sources of revenue at a level close to capacity. The city of Richmond, for example, received over $11 million from it in 1973. This fact complicates any effort to deal with the problems arising out of its use, as a large increase in some other area would be needed to replace the revenue. The somewhat cloudy fiscal outlook of the State and local governments complicates the problem.

Because the Commission has not been able to devote sufficient time to the gross receipts tax to devise a workable and acceptable solution, we recommend that the moratorium on rates be extended for one more year of study.

Also in the area of local license taxes is Senate Joint Resolution No. 150, requesting that the Commission determine the feasibility of requiring the deduction of petroleum import and excess taxes from the base of gross receipt taxes. The resolution was an outgrowth of President Ford's energy package of 1975, which recommended sustantial increases in taxes to encourage home production of oil.

Because these proposals never became law, the great increase in the gross receipts tax base anticipated by Senate Joint Resolution No. 150 has not occurred. However, the Commission will keep the potential problem addressed by the resolution in mind while continuing its study of the gross receipts tax.

III. State tax changes

(a) The standard deduction.—Effective for taxable years beginning in 1975, Congress changed the standard deduction from the 1974 level of 15 percent of adjusted gross income with a maximum of $2,000, to 16 percent with a maximum of $2,600. The minimum standard deduction was raised from $1,300 to $1,900. It is likely that the 1975 levels will be extended for 1976. If Virginia had continued to conform to the federal standard deduction, the 1975 change would have lowered State individual income tax revenues by nearly 3 percent; the estimated potential loss for the 1976-1978 biennium was $61.6 million.

In order to prevent so large a revenue loss, the 1975 Session of the General Assembly froze the standard deduction at the 1974 level. As this legislation affects only 1975, a decision must be made whether to extend it or to conform to the federal deductions.

Because Virginia law requires taxpayers electing the federal standard deduction to use the State standard deduction, we felt that the two should be as nearly equivalent as possible, and were therefore hesitant to recommend the continuance of different levels. Moreover, the increases in the maximum and minimum standard deductions make a crude allowance for the high rate of inflation since 1972. On the other hand, we find that Virginia's use of the 1974 deductions may actually make its standard deduction more nearly equivalent to the federal than it was before. This results from the requirement that state income taxes be subtracted from itemized deductions for Virginia tax purposes; in effect, those itemizing deductions are required to add their state income tax payments back to taxable income for their Virginia returns, while those electing the standard deduction are not. If the 1974 level is continued, we anticipate that fewer taxpayers will have to pay higher Virginia taxes because of the requirement that the same deduction option be taken for both taxes.[1]

This report explains several possible rate increases— options which can be used if additional revenue is needed. We believe, however, that in view of the uncertainty about federal tax provisions, and the large rate adjustments required it would be preferable at this time to prevent the potential revenue loss caused by the change in the standard deduction by continuing the 1974 deductions rather than by increasing rates.

(b) Virginia dividend exclusion.—Under the preconformity income tax law, all dividends were excluded from taxable income to the extent the corporation paying them was taxed in Virginia. for example, dividends of a corporation doing business in Virginia and in other states which paid Virginia taxes on 45 percent of its income, were excluded to the extent of 45 percent. For the convenience of taxpayers, the Tax Department prepared a list of corporations and the extent to which their dividends were excludable.

In order to simplify tax administration, the conformity bill made all dividends of corporations more than 50 percent of whose income was taxed by Virginia exempt, and all others entirely taxable.

The original exemption represented a relatively logical approach; the corporation's income had already been taxed at the corporate level, and the dividend exclusion prevented a second tax on the same profits. Theoretically, stockholders would have received larger dividends if the corporate income had not been taxed. In fact, it is difficult to say whether this is true, as corporations treat taxes as a cost of operation, and to the extent possible, raise prices, pay lower wages, or cut other costs accordingly. Each corporation may handle the tax burden differently. In addition, the logic of the exclusion is affected by the failure to grant reciprocity to other states. Only Virginia shareholders of Virginia corporations get favored treatment. Hence, the dividend exclusion has always been best explained as an effort to show a favorable climate for corporate investment in Virginia, and to encourage Virginians to invest in Virginia corporations.

The present all-or-nothing treatment contains less logic, but may be more effective in favoring Virginia corporations; those firms who do enough business in Virginia to be substantially affected by Virginia tax law, and who are most likely to have Virginia investors, have a 100 percent exclusion. It appears, however, that this type of relief, which costs the State $3 to $5 million annually, is so limited that it provides very little incentive to invest in Virginia corporations, and virtually no benefits which would encourage new corporate activities in Virginia.[2] The effects of double taxation would in any event be minimized by the federal 85 percent exclusion of dividends paid to parent corporations and the $100 exclusion for individuals. In addition, it is a complicating factor in that it does not conform to federal law.

Dividends of State and federal banks and trust companies have also traditionally been excluded from income. For these the reason was somewhat different; federal law prohibited states which enacted a bank stock tax from taxing dividends of national banks, and it was inexpedient to tax the dividends of State banks if their federal competitors went tax free. When federal law was changed to permit the tax, the treatment was continued because of an effort to avoid discrimnation; while they paid no corporate income tax, most of the banks involved were Virginia based and did pay the bank stock tax in its place.

After having considered the advantages and disadvantages of the dividend exclusion, the Commission is of the opinion that it should be removed, as the logic and advantages of such a tax benefit do not justify the loss of revenue. The Commssion does recommend one exception. Domestic International Sales Corporations, (DISCs), creatures of federal tax law designed to encourage United States companies in foreign trade to expand within the United States rather than abroad, would be unduly prejudiced by the removal of the dividend exclusion. Under federal law, these corporations are excluded from income tax, but certain of their income is taxed as "deemed dividends" to the shareholders even through not paid to them. If actual dividends are paid later, they may be tax free to the extent taxed when "deemed". Virginia taxes the DISC at the corporate level, and would tax the "deemed dividends" and the actual dividends as well but for the Virginia dividend exclusion. It is therefore the Commission's recommendation that the stockholders of DISCs be permitted to continue to exclude their dividends, both "deemed" and real.

(c) Capital gains treatment.—Under the preconformity income tax all capital gain, or gain from the sale of assets not held in the ordinary conduct of business, was taxed as ordinary income. When the conforming statue was instituted in 1972, the federal treatment was adopted, and individuals were permitted to deduct 50 percent of the excess of net long term capital gain over net short term capital loss. In other words, any individual taxpayer who had net long term capital gain (on assets held longer than six months) after subtracting his long term capital loss and the excess of short term capital loss over short term capital gain, was permitted to subtract 50 percent before including the gain in taxable income. As an alternative, federal law provides a rate ceiling of 25 percent, applicable to capital gain both of individuals and of corporations, to which Virginia does not conform. As corporations are not eligible for the 50 percent deduction, Virginia law gives them no special provision for capital gain and so in effect continues them in the preconformity treatment.

The theoretical basis for the 50 percent deduction of long term capital gain is that capital is an entirely different thing from income and therefore to be taxed differently if at all in an income tax. Property which has been held a long time has risen in value in part because of inflation; the property has remained the same, but money has decreased in value. The 50 percent deduction is a kind of compromise adjustment for this factor. Moreover, to the extent that capital gain is realized from assets not intended to be sold, it is discontinuous and volatile.

The federal tax policy purpose for the deduction and the special tax rate is to encourage investment. Those who can best afford to risk their capital are encouraged to do so by the large deduction they receive when they succeed. The 25 percent maximum rate provides even greater incentive to those whose ordinary income is taxed at a rate above 50 percent.

Although these policy considerations have some validity for federal purposes, the Commission has not found them sufficiently cogent to justify continuation of the deduction from Virginia tax. In the first place, the fact that corporations are allowed no favorable treatment changes what might otherwise be a strong policy stand into a benefit-by-chance justified only by conformity. The encouragement afforded the investor by a 50 percent deduction from income taxed at 5.75 percent, when up to 71 percent of the impact of the tax is cushioned by deducting State income taxes from federal income, is minimal at best. Likewise, the impact of Virginia's tax on the gain as ordinary income is small. Moreover, the theoretical basis for the deduction is shaky. Income realized from the sale of an asset is still income; the strict dividing line between capital and income, observed as a religion in the days of 2 percent consols and The Forsyte Saga, is no longer quite so clear. Even endowment funds are now often permitted to spend their capital gains. Income from many assets other than true capital is taxed as capital gain for some federal tax policy reason or another. Some of the impact of taxing a windfall or one-time sale as ordinary income is mitigated by provisions such as those permitting income averaging, untaxed carryover of basis on sale and purchase of a residence, and exclusion of a portion of the gain from the sale of a residence by a elderly person. Despite its reluctance to complicate the return by adding another adjustment, it is the Commission's opinion that Virginia should revert to its previous treatment of capital gain and tax it as ordinary income. This change will increase State revenue by $10 to $15 million per year.[3]

(d) Retirement Income.—One of the most difficult problems to confront the Commission during the last few years has been the retirement income exclusion. Virginia law now permits the following exclusions:

1. $3,000 for federal civil service retirees and $1,500 for their surviving spouses;

2. $2,000 for military retirees age 60 and above, and $1,500 for their surviving spouses;

3. $2,000 for retirees from private industry and $1,000 for their surviving spouses.

4. All amounts received from the The Virginia Supplemental Retirement System and other retirment systems of this State and its local governments.

The exclusions described in paragraphs 1, 2 and 3 are reduced by the amount of the retiree's adjusted gross income above $12,000.

The present retirement income exclusions are the result of a bill recommended by this Commission to the 1974 Session and enacted with several significant changes. During 1974 the Commission studied the credit alternative and recommended adoption of an approach similar to the federal retirement income credit. The bill incorporating these principles was not enacted.

The history of the retirement income exclusions shows a gradual change in its purpose and effect. At first, only retirement income and pensions from this State were excluded. The tax exclusion was an indirect retirement benefit, built into the retirement systems' benefit formulae. Instead of paying out more and taxing its own payments, the State granted an exclusion. In 1966, however, the civilian federal employees, citing the fact that their retirement income did not include the tax-free social security benefit, obtained a $2,000 exclusion. If no further changes had been made, the State would be somewhat in conformity with the basic theory of the federal retirement income credit, which this Commission has found compelling: Those who did not receive tax-free Social Security would be put on the same tax footing as those who did. However, the military retirees obtained a $2,000 exclusion in 1968. A then second-term member of the House, speaking to the 1968 William and Mary Tax Conference, described the situation in these terms:

> Next is the question of exclusion of military retirement income. A $2,000 income exclusion for civilian retirees of federal government was given in the 1966 Session. Should we do the same thing for the military? If I may digress for a moment, this is an example of what you might say was successful taxpayer strategy, because the approach for time immemorial had been, I am told, that both the military retirees and the civilian retirees would come before the General Assembly and say "give us some retired income exclusions; give us at least $2,000 or $3,000 or whatever." They didn't get anywhere so they changed the strategy, and decided to let the

civilians go first and see if they could get it and then if they got it, the military people could come back and say, "Well, look, you gave it to them. You can't discriminate against us....As Judge Morrissett said, "I just don't understand where I was or what I was thinking about when I let that bill get through".[4]

Private sector retirees were added, the civilian federal exclusion raised to $3,000, surviving spouses included, and the $12,000 income limitation added in 1974.

The present exclusion structure presents a dilemma which the Commission has been unable to solve. It is patently obvious that the classes of retirees are treated non-uniformly. However, Virginia State and local government retirees have some equity in their argument that the State should make up in retirement benefits what it takes away in taxes. The civilian federal retirees do not have the tax free cushion of social security enjoyed by private and military employees; nor, as others will point out, did they pay social security taxes. Nor do they have the medical care and commissary benefits enjoyed by military employees. Although the military retirement plan is non-contributory, while civil service employees must contribute to their retirement, military retirees will point out that the government's retirement program is built into the salary-setting process and serves to reduce salaries. Although it is true that there are may more military retirees under age 60 than civilian retirees, early retirement has been introduced in civilian government employment and in the private sector. While one group complains about discrimination, another may point out that it is customary to discriminate between apples and oranges.

The retirement income exclusion is no small matter from the fiscal point of view. The staff estimates the annual cost of the present scheme to be between 9 and 11 million dollars per year. Virginia's treatment is far more generous than the federal credit or the programs of most other states. For instance, conformity to a percentage of the federal credit appropriate to the relative level of taxation (13.2 percent), which would equalize treatment of those not receiving tax-free social security or railroad retirement act benefits, would cost only $.5 million per year; if Virginia governmental employees were permitted to continue their present exclusion instead of the credit, the total program would cost only $2.5 million per year. Use of the <u>full</u> amount of the federal credit for all retirees including State governmental employees would cost only $4 million, or less than half the cost of the present treatment. Some 135,000 retirees now receiving benefits would not receive the credit.

Because it has been unable to agree on any feasible proposal which is consistent with the purpose of the exclusion, the Commission recommends no change to the present law.

(e) State license taxation.—The State license tax had its genesis before the turn of the century, and many of its present provisions were transferred intact from the 1919 Code. Others were added piecemeal therafter. The original purpose of license taxation was regulatory; the license afforded a method of keeping track of local businesses, and taxes on itinerants and peddlars afforded protection for resident merchants. Until the state tax on merchants' capital was removed in 1966, the license tax produced significant revenue; in 1965-1966 it produced around $16 million. In 1973-1974, the collections were $3,269,476, or only about 0.3 percent of total general fund revenue; contractors accounted for over 40 percent of that amount. Other categories taxed include circuses, amusement parks, itinerant merchants, peddlars, common criers, horses and mules sold in carload lots, junk dealers, laundries, engineers, lawyers, doctors, cotton factors, hotels and undertakers. Many businesses are not taxed at all, and there is no internal consistency whatever in the rates of tax. Licenses are sold by commissioners of the revenue, who receive a fee for the service, and the proceeds are remitted to the State.

At the very least, the license tax law should be updated, its rates given some consistency, its categories modernized. The Commission has not performed the very extensive and difficult work needed for revision, however, because it has heard strong recommendations that the tax be repealed altogether. Many feel that the Department of Taxation is not the appropriate agency to regulate businesses, particularly since the Department of Professional and Occupational Regulation exists for that purpose. Local governments can and do provide adequate license taxation, with whatever regulation is necessary, administered by the same officials who now sell the State licenses. As the tax no longer brings in sufficient revenue to justify the effort of bringing it up to date, administering it properly, and keeping it current, and the burden that additional complexity in tax law places on the public, there is significant feeling that it should be taken off the books entirely.

If repeal is the answer, however, 1976 is not the time to repeal. State revenues are too limited to justify cutting off even a small source of funds.

The Commission therefore recommends that the State license tax not be changed at this time, but will hold the matter for future study.

(f) Public Service Corporation Taxation.—The taxation of public service corporations, and particularly of power companies, has become an issue of great importance with the enormous rise in utility rates. For its study of the subject, the Commission obtained this year an analysis of public utility taxation by Drs. Hellmuth, Jennings and Beall of Virginia Commonwealth University. It also has had the benefit of a position paper for the Electricity Cost Commission prepared by Samuel H. Baker and Martin A. Garrett of William and Mary College, entitled "The Consumers' Utility Tax Imposed by Localities in Virginia", and of other materials supplied by interested parties.

The issue of State and local taxation of public service corporations has also been analyzed closely by a special committee appointed by the Governor for that specific purpose, under the authority of House Joint Resolution 285. That committee has had access to the same materials, and has just made its report, suggesting substantial changes to the tax structure of the

Commonwealth and the localities. The Commission is impressed with the report of the Governor's committee, which shows thorough analysis and a serious effort to solve the very real problem of public service corporation taxation. It therefore proposes to use the Committee's report as a starting point for continuing its study of the issue.

(g) Transportation taxation.—During 1975 the Commission has received much information on the relative tax burdens of different forms of transportation. After releasing the study by Drs. Gallagher and Hoffer mentioned in the beginning of this report, the Commission heard comment and received much information from the railroad industry and the Highway Users Association, and obtained further analysis by its staff. Although we have made considerable progress in understanding the complex issues presented in this wealth of information, the Commission has been as yet unable to determine what course to recommend, and will therefore continue the study.

(h) Veteran's benefits.—Senate Joint Resolution No. 26 of the 1975 Session directed the Commission to study the feasibility of two programs designed to benefit veterans of the armed forces:

(1) credit in state and local retirement systems for service in the armed forces, and

(2) real property tax relief for veterans.

The Commission does not consider these programs to be feasible or desirable.

The Virginia Supplemental Retirement System and other state and local retirement systems were created to provide some security for State and local employees, both for equity reasons and to attract public servants of high caliber. They are not intended to be, nor could they operate effectively as, public welfare systems, nor are they adequate as a means of rewarding all types of public service. They are similar in scope and purpose to the retirement systems of many private employers. Service in the armed forces, although true public service, is not service to the State government or its subdivisions.

During World War II, special exceptions were made to permit State employees who were drafted and then returned to State service to receive credit for the period spent in the armed forces. The interruption of many otherwise stable careers, at a time when retirement benefits would be substantially reduced by interruption in service, made the exceptions necessary. Various changes in the retirement systems have minimized the hardship on those few who are required to interrupt their careers to serve in the armed forces. While we do not in any way belittle the importance or the generosity of such service, we feel that State and local retirement systems are not proper vehicles to reward it.

The proposal to grant to veterans a homestead exemption from property tax does not merit serious consideration. Because the property tax is by far the most important source of revenue for the localities, exemptions from it should not be taken lightly. Because an exemption from such a general tax constitutes an indirect subsidy from the locality, it should be granted only to those who are performing services which would otherwise fall to government or to those who demonstrate extreme need.

The Constitution of Virginia follows this policy; all property must be taxed with the limited exceptions named in Article X secton 6. As veterans are not mentioned, it would be necessary to amend the Constitution to exempt them. The General Assembly and the people found compelling reasons to permit exemption of elderly, needy persons from tax on their residences. While good arguments have been made to extend such benefits to the totally disabled, and various proposals for changing the Constitution have been made, no such need has been demonstrated on the part of veterans as a class. The Commission, therefore, recommends no action on this proposal.

IV. Alternative Revenue Sources

Table 1 examines various alternative revenue sources that could be utilized to provide additional revenue that might be needed. The revenue measures are not considered in any order of priority, but are simply listed as possible alternatives to be considered by the General Asembly. Major items from this list are discussed below.

Table 1 - Projected Revenues From Alternative Changes In Revenue Structure And/Or Rates, 1976-78 Biennium

(Millions of Dollars)

Revenue Source	1976-77 Projected Revenue	1976-77 Change from present Tax	1977-78 Projected Revenue	1977-78 Change from present Tax
CORPORATIONS—				
INCOME TAX				
Present structure; present 6% rate	$ 133.9	$	$ 155.0	$
Present structure 7 % rate	162.6	+28.7	180.8	+25.8
INDIVIDUALS AND FIDUCIARIES-INCOME TAX				
Present structure:				
Present rates	810.2		977.6	
Rate schedule 1	886.6	+76.4	1,047.0	+69.4
Rate schedule 2	901.7	+91.5	1,060.7	+83.1
Rate schedule 3	928.6	+118.4	1,085.1	+107.5
Rate schedule 4	1,013.6	+203.4	1,162.4	+184.8
Structure based on Tax Reduction Act of 1975:				
Present rates	785.9	-32.3	948.3	-29.3
Rate schedules 5, 6, 7, and 8	810.2		977.6	
Rate schedule 9	866.2	+56.0	1,028.4	+50.8
Rate schedule 10	944.7	+134.5	1,099.8	+122.2
Rate schedule 11	955.5	+145.3	1,109.6	+132.0
Rate schedule 12	989.5	+179.7	1,140.9	+163.3
Taxation of 100 % of all capital gains	An additional $10 to $15 million in each fiscal year			
Elimination of the Virginia dividend exclusion	An additional $3 to $5 million in each fiscal year			
STATE SALES AND USE TAX (EXCLUDING LOCAL OPTION				
Present structure; present rate	486.4		552.7	
Present structure; 4 % rate	637.0	+150.6	736.9	+184.2
Adding selected services; present rate	529.8	+43.4	605.8	+53.1

Adding selected services; 4 % rate	694.8	+208.4	807.7	+255.0
TOBACCO PRODUCTS TAX				
Present structure; present rates	19.1		20.5	
Present structure; 5 cent rate; no change in sales	38.2	+19.1	41.0	+20.5
Present structure; 5 cent rate; 5 % drop in sales	36.3	+17.2	38.9	+18.4
Present structure; 5 cent rate; 10 % drop in sales	34.4	+15.3	36.9	+16.4
Present structure; 5 cent rate; 20 % drop in sales	30.6	+11.5	32.8	12.3
ALCOHOLIC BEVERAGES STATE TAX				
Present structure; present 14 % rate	31.2		33.0	
Present structure 15 % rate	33.2	+2.0	35.1	+2.1
BEER AND BEVERAGE EXCISE TAX				
Present structure; present rates	24.2		26.6	
Present structure; 25 % increase in rates	29.2	+5.0	32.8	+6.2

Individual Income Tax

The 1971 extra session of the General Assembly adopted an individual income tax structure that conforms in large part with the federal income tax structure. Virginia is one of 31 states that conform their tax in some degree to federal provisions.

The present or conformity structure became effective January 1, 1972. Its basic elements are:

1. Exemptions: $600 for personal, dependent, and blind with $1,000 for persons sixty-five and over. (The federal exemption is $750 for all classes with an additional $30 credit in 1975 for all personal and dependent exemptions.)

2. Maximum Standard Deduction: The Virginia maximum standard deduction is 15 percent of adjusted gross income (AGI) up to $2,000 for all taxpayers. (At the federal level the Tax Reduction Act of 1975 increased this to 16 percent up to a maximum of $2,600 for married taxpayers and $2,300 for single taxpayers.)

3. Minimum Standard Deduction: The minimum standard deduction or low income allowance is $1,300 in Virginia. (The federal Tax Reduction Act of 1975 increased this at the federal level to $1,900 for married and $1,600 for single filers.)

4. Treatment of 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. This treatment was permitted before conformity and was retained in the conformity legislation. In effect this is a tax reduction for married pesons who both have income, since they are allowed to be taxed at a lower effective rate than those who are single or those married persons filing a joint return. (At the federal level the split income option allows married persons a tax advantage versus a single person with the same gross income.)

The present rate schedule also became effective Jaunary 1, 1972, and is only slightly different from the previous one:

Previous Rate Schedule		Present Rate Schedule	
Taxable Income	Rate	Taxable Income	Rate
First $3,000	2%	First $3,000	2%
$ 3,001-$5,000	3%	$ 3,001-$5,000	3%
$ 5,001 and over	5%	$ 5,001-$12,000	5%
		$12,001 and over	5.75%

It should be noted that the rate schedules apply to net taxable income—income which has been adjusted for exemptions, deductions, and exclusions. Under the present Virginia structure, a married couple with two dependents filing a joint return, would show the following taxable income for various levels of adjusted gross income:

Adjusted Gross Income	Net Taxable Income	Net Taxable Income as a % of AGI
$ 5,000	$ 1,300	26
10,000	6,100	61
15,000	10,600	71
20,000	15,600	78

With the present rate schedule, Virginia's revenues from the individual income tax are expected to be $810.2 million in fiscal year 1976-77 and $977.6 million in fiscal year 1977-78. If the Commonwealth needed additional revenues, one possible source could be a change in the Virginia individual income tax rate schedule. Twelve alternative rate schedules, as set forth in Fiscal Prospects and Alternatives: 1976, are given in Table 2. Of the twelve, the first four show rate changes under the current law that would raise additional general fund revenues, the second four show rate schedules that would offset the revenue loss resulting from a permanent increase in the minimum and maximum standard deductions as set out in the Tax Reduction Act of 1975, and the last four present rate schedules which would raise additional revenue under the provisions of the Tax Reduction Act of 1975. This complex presentation is necessary because, as previously noted, the Tax Reduction Act of 1975 increased the minimum and maximum standard deductions while Virginia maintained its standard deductions at their 1974 levels for 1975. The impact of the proposed rate schedules on revenue in the 1976-78 biennium is shown in Table 1.

Table 2 - Alternative Income Tax Rate Schedules

Alternative Rate Schedules To Produce Additional Revenues

Using the Present Virginia Income Tax Structure

Schedule 1

Net Taxable Income	Rate
$ 0-$ 3,000	2%
$ 3,001-$ 5,000	3%
$ 5,001-$12,000	5%
$12,001-$25,000	7%
$25,001-$50,000	8%
over -$50,000	9%

Schedule 2

Net Taxable Income	Rate
$ 0-$ 3,000	2%
$ 3,001-$ 5,000	3%
over -$ 5,000	6%

Schedule 3

Net Taxable Income	Rate
$ 0-$ 3,000	2%
$ 3,001-$ 5,000	3%
$ 5,001-$10,000	5%
$10,001-$20,000	7%
$20,001-$30,000	8%
$30,001-$50,000	9%
over -$50,000	10%

Schedule 4

Net Taxable Income	Rate
$ 0-$ 3,000	2%
$ 3,001-$ 5,000	3%
$ 5,001-$10,000	6%
$10,001-$15,000	7%
$15,001-$20,000	8%
over -$20,000	9%

Alternative Rate Schedules to Offset Revenue Loss

Under the Tax Reduction Act of 1975

Schedule 5

Net Taxable Income	Rate
$ 0-$ 2,000	2%
$ 2,001-$ 5,000	3%
$ 5,001-$12,000	5%
over -$12,000	5.75%

Schedule 6

Net Taxable Income	Rate
$ 0-$ 3,000	2%
$ 3,001-$ 5,000	3%
$ 5,001-$12,000	5%
over -$12,000	6.75%

Schedule 7

Net Taxable Income	Rate
$ 0-$ 3,000	2%
$ 3,001-$ 5,000	3%
$ 5,001-$12,000	5%
$12,001-$20,000	6%
$20,001-$30,000	7%
over -$30,000	8%

Schedule 8

Net Taxable Income	Rate
$ 0-$ 3,000	2%
$ 3,001-$ 5,000	3%
$ 5,001-$10,000	5%
$10,001-$25,000	6%
$25,001-$50,000	7%
over -$50,000	8%

Alternative Rate Schedules to Raise

Additional Revenue Under the Tax Reduction Act of 1975

Schedule 9

Net Taxable Income	Rate
$ 0-$ 3,000	2%
$ 3,001-$ 5,000	3%
$ 5,001-$12,000	5%
$12,001-$20,000	7%
$20,001-$30,000	8%
over -$30,000	9%

Schedule 10

Net Taxable Income	Rate
$ 0-$ 3,000	2%
$ 3,001-$ 5,000	3%
$ 5,001-$10,000	6%
$10,001-$25,000	7%
$25,001-$50,000	8%
over -$50,000	9%

Schedule 11

Net Taxable Income	Rate
$ 0-$ 3,000	2%
$ 3,001-$ 5,000	3%
$ 5,001-$12,000	6%
over -$12,000	8%

Schedule 12

Net Taxable Income	Rate
$ 0-$ 2,000	2%
$ 2,001-$ 5,000	3%
$ 5,001-$12,000	6%
over -$12,000	8%

Dividends Paid by Virginia Corporations and Taxation of Long-Term Capital Gains

Elsewhere in this report, the Commission has recommended that the preferential tax treatment for dividends paid by Virginia corporations and for long-term capital gains be eliminated. Although the primary objective of these recommendations is to improve horizontal and vertical equity of the tax structure, these measures would raise small amounts of additional revenue. The repeal of the dividend exclusion would provide an additional $3 to $5 million during each year of the 1976-78 biennium. Taxation of 100 percent of all capital gains would add another $15 to $20 million annually.

Sales Tax

Another alternative for raising revenues would be to modify the Virginia sales and use tax law. Adjustments to the present system could be made either to raise the state tax rate, to expand the current tax base, or to do both. As shown in Table 1, an increase in the state sales tax rate from 3 to 4 percent would produce an additional $150.6 million in 1976-77 and $184.2 million in 1977-78. Making the sales tax applicable to selected services not presently taxed would expand the base by nearly 8 percent and lead to increased revenues of $43.4 million in 1976-77 and $53.1 million in 1977-78. Finally, application of the 4 percent rate to the expanded tax base would provide an extra $463.4 million over the next biennium to finance general fund outlays.

Tobacco Products

Another revenue source is the tax on tobacco products. At present, Virginia has a state cigarette tax of 2.5 cents per pack, which is the second lowest tax in the nation. Virginia is, however, one of eight states in which localities impose additional cigarette taxes. In fiscal year 1973-74, 19 cities and 2 counties in Virginia imposed rates ranging rom 2 to 10 cents per pack. In fiscal year 1973-74, these localities received $12.7 million in revenue from the locally imposed cigarette taxes while the state tobacco products tax produced $17.0 million in revenue. One possible rate change would be a doubling of the state tobacco products tax to 5 cents per pack. If the state tobacco products tax were doubled (assuming a 5 percent drop in sales), revenues in fiscal yer 1976-77 would increase from $19.1 million to $36.3 million, a $17.2 million increase, and in fiscal year 1977-78 revenues would increase from $20.5 million to $38.9 million, an $18.4 million increase.

Alcoholic Beverages

Liquor sold in the A.B.C. stores of Virginia is subject to a percentage markup and also a 14 percent alcoholic beverages state tax. Both of these rates were raised by 4 percentage points effective January 1, 1970, and July 1, 1970, respectively. Additional taxes are levied on bottle sales for resale by the drink.[5] Wine sales are subject to a tax of 35 cents per gallon on unfortified wine and 70 cents per gallon on fortified wine (raised from 35 cents per gallon effective July 1, 1970). In addition, there is a beer and beverages excise tax of 2 cents per 12-ounce bottle and $6 per barrel.[6]

Net profits from liquor sales and all alcholic beverages taxes, except the additional tax on beverages that are bought for resale by the drink, are allocated to the general fund; however, two-thirds of the wine and spirits sales tax and two-thirds, but not less than $14,805,677 of A.B.C. profits, are distributed to localities on the basis of population for general purposes. In fiscal year 1973-74 revenues from the alcoholic beverage state tax were $74,841,886. The wine and spirits sales tax contributed $2,410,658 and the revenues from the beer and beverages excise tax were $18,685,771. The tax on alcoholic beverages bought for resale by the drink amounted to $757,251 (allocated to a special fund), and A.B.C. profits were $26,103,101.

Increasing the tax on alcoholic beverages is another alternative method to meet demands for additional revenues. Any discussion of raising additional revenues via an increase in alcoholic beveraae taxation, however, should bear in mind that a further increase in such taxation in Virginia will increase the price differential and worsen the already poor competitive price position of Virginia vis-a-vis the District of Columbia. Thus, any increased rate of taxation will produce greater revenues, but this increase in revenues will be tempered by the resulting decline in sales.

Mineral Production

Under § 58-266.1:1 of the Code of Virginia, a local option tax may be levied not to exceed .5 percent of the gross receipts from the sale of coal or natural gas severed within a county. Four of the seven coal producing counties (Buchanan, Dickenson, Tazewell, and Wise) have this local option tax. To provide additional revenues for the State, another alternative would be for Virginia to adopt a similar tax on the gross receipts of selected minerals and mined products. Although the amount of revenue raised by such a tax would depend on the rate structure and tax base adopted (see Table 3), a rate of 3.5 percent of gross receipts from the sale of coal or natural gas, making the combined State and local rate of taxation equal to 4 percent, would be comparable to the severance tax on coal in Kentucky and the coal turnover tax in West Virginia which are imposed at 4 percent and 3.85 percent, respectively. Under this alternative, revenues accruing to the State would have totaled $29.6 million in 1974 based on the value of production of coal and natural gas in Virginia as reported by the U.S. Department of the Interior. Expanding the tax base to include other types of mined products such as sand, gravel, lime, zinc, etc. would have provided an additional $6.4 million during the same year.

The imposition of a tax on the production of minerals would have both positive and negative features. Perhaps the most attractive aspect of the tax is that it is imposed on immobile factors of production (i.e., natural resources). To the extent that mineral rights represent an immobile investment, capital investment in equipment and structures is relatively immobile, and demand is fairly inelastic, the tax represents an opportunity for the taxing authority to impose a major tax without a large impart on production and output. In the long run, as demand became more elastic due to competition from other fuels, the tax would be borne mainly by producers. As a result, some reduction in the rate of profits could be expected for most mining companies and a few firms which are marginal in operation could be hastened into bankruptcy. On this basis, it could be argued that the tax is both inequitable and discriminatory in the sense that it singles out one type of commerce for undue taxation. The possibility of this consequence, however, would be lessened if the tax were adopted and the rate of taxation increased gradually.

Even if the tax partially is shifted forward to final consumers, an undersirable effect may accompany the shift in that wide differences can arise in the total amount of tax included in the price of various products. For example, a severence tax on coal would increase the cost of producing electricity for certain utilities. The inclusion of these additional costs in utility sales figures in effect inflate the base for other taxes (i.e., those taxes based on sales volume, such as gross receipt taxes and consumer utility taxes). As a result, the original increase in costs attributable to the severance tax would be compounded by taxes applied at later stages of production or distribution. The exact effect of the tax, therefore, will vary substantially among commodities requiring coal as an input.

A final criticism of the tax concerns the volatility of tax collections. Revenues from the tax, like those from many narrow-based taxes, may fluctuate widely from year to year. This characteristic arises from the fact that the tax would be collected on the basis of an industry's gross receipts and gross receipts are, in turn, dependent on output and product price. While in the case of coal, for example, output (nationwide) has fluctuated only slightly in recent years, price has varied considerably. Steam coal, which was priced below $10 per ton in 1973, rose in price in 1974 to nearly $40 per ton. This price fluctuation, and the consequent fluctuation in the coal industry's gross receipts has caused considerable change in collections in those states having such taxes.

Table 3 - Alternative Tax Structure

And Rates On Mineral Production

	Estimated Annual Revenue (Millions)(a)	
State Tax Rate	Taxation of coal and natural gas	Taxation of coal, natural gas, and other selected minerals (b)
.5%	$ 4.2	$ 5.1
1.0%	8.5	10.3
1.5%	12.7	15.4
2.0%	16.9	20.6
2.5%	21.1	25.7
3.0%	25.4	30.9
3.5%	29.6	36.0
4.0%	33.8	41.2

(a) Based on 1974 values for production as measured by mine shipments, sales, or marketable production (including consumption by producers).

(b) Other selected minerals include clays, gem stones, lead, lime, sand and gravel, soapstone, stone, zinc, aplite, cement, gypsum, and kyanite.

Source: U.S. Department of the Interior, "Mineral Industry Surveys," (Washington, D.C.: Bureau of Mines, Division of Fossil Fuels).

Borrowing

It is not necessary to finance all outlays from general fund revenues; general obligation borrowing could be another source. Under the present Constitution, limitations for general obligation borrowing have been liberalized to allow more borrowing. Under a conservative interpretation of the constitutional formula, the following maximum amounts of borrowing could be authorized. These estimates assume that the bonds are approved in a referendum the fiscal year following authorization by the General Asembly (i.e., borrowing authorized at the 1976 Session of the General Assembly and approved in fiscal year 1976-77 would be available for spending in the 1976-78 biennium).

Year General Assembly Meets	Biennium	Maximum Debt Which Could Be Authorized (Millions of Dollars)
1975-76	1976-78	$ 268.0
1977-78	1978-80	87.7
1979-80	1980-82	126.3

As shown above, the new debt provisions will permit large new borrowings in the next three biennia if the General Assembly and the voters wish to use the maximum authority. Of course, any new authorized debt would have to be serviced out of general fund revenues. The staff report projects the following amounts for debt service in the next three biennia if the maximum amount of general obligation borrowing were utilized. These estimates are based on a 5.5 percent annual rate of interest with payments beginning in the fiscal year following approval and sale of the bonds and a 5 percent annual amortization rate for sinking fund payments beginning in the fiscal year following the sale of the bonds.

Biennium	Millions of Dollars
1976-78	$ 27.4
1978-80	62.1
1980-82	80.7

Respectfully submitted,

Leroy S. Bendheim, Chairman

Carrington Williams, Vice-Chairman

George S. Aldhizer, II

Sam T. Barfield

George W. Jones

John L. Knapp

Joseph A. Leafe

J. Harry Michael, Jr.

Raymond M. Munsch

Stanley A. Owens

Owen B. Pickett

Lester E. Schlitz

FOOTNOTES

1. The impact of the state tax addback is different on every level of taxpayer, but for those in the mid-to-upper-middle income range, where a hard choice between standard deduction and itemized deductions is most likely to occur, the lower 1974 Virginia Standard deduction is more comparable to the federal Standard deduction.

Example:	Assume AGI.	.$16,000
	Federal standard deduction. . . .	.2,560
	Virginia standard deducton	.2,000
	Virginia tax paid (on net taxable income of $14,000).	.585

2. See letter from J. Frank Alspaugh, Director of the Division of Industrial Development, in the report of this Commission to the 1975 Session.

3. Mssrs. Bendheim, Owens, Pickett, and Jones voted against this recommendation.

4. Williams, Carrington, "Reason For, and Effect of, the 1968 Virginia Assembly Tax Changes", Fourteenth Annual Tax Conference. Marshall-Wythe School of Law (1968).

5. See the Code of Virginia, Section 4-15.3.

6. bid., Section 4-40.

APPENDIX I

Grouping of Counties and Cities for General Reassessments

COUNTIES
GROUP I - 1977
POPULATION GROUP - less than 14,000

1970 population	county	latest reassessment
2,529	Highland	1974
3,524	Craig	1974
5,192	Bath	1973
5,199	Rappahannock	1974
5,248	Greene	1974
5,300	New Kent	1973
5,423	Bland	1971
5,491	King and Queen	1973
5,841	Richmond	1972
5,882	Surry	1973
6,158	Charles City	1973
6,179	Cumberland	1976
6,295	Middlesex	1971
7,099	Essex	1974
7,168	Mathews	1973
7,497	King William	1974
7,592	Amelia	1975
7,621	Fluvanna	1972
7,696	Powhatan	1975
8,039	King George	1973
8,102	Clarke	1973
8,638	Madison	1973
9,126	Lancaster	1973
9,239	Northumberland	1974
9,604	Greensville	1973
9,775	Floyd	1973
9,784	Appomattox	1976
10,069	Goochland	1972
10,597	Buckingham	1971
11,464	Sussex	1973
11,551	Charlotte	1973
11,687	Lunenburg	1974
11,702	Nelson	1976
12,142	Westmoreland	1973
12,461	Alleghany	1973
13,792	Orange	1971
13,925	Caroline	1975

GROUP II - 1978
POPULATION GROUP - 14,000 to 23,999

1970 population	county	latest reassessment
14,004	Louisa	1976
14,059	Gloucester	1972
14,260	Nottoway	1976
14,379	Prince Edward	1972
14,442	Northampton	1976
15,282	Patrick	1973
15,301	Warren	1973
15,439	Grayson	1973
16,077	Dickenson	1973
16,172	Brunswick	1975
16,424	Spotsylvania	1971
16,581	Page	1973
16,637	Rockbridge	1974
16,741	Giles	1971
18,193	Botetourt	1973
18,218	Culpeper	1973
18,285	Isle of Wight	1973
18,582	Southampton	1976
20,321	Lee	1975
22,139	Wythe	1976
22,852	Shenandoah	1972
23,092	Carroll	1972

GROUP III - 1979

Population Group - 24,000 to 39,000

1970 population	county	latest reassessment
24,063	Frederick	1974
24,376	Scott	1973
24,533	Russell	1971
24,587	Stafford	1973
25,046	Dinwiddie	1972
26,072	Amherst	1976
26,375	Fauquier	1972
26,728	Bedford	1971
26,797	York	1971
26,858	Franklin	1976
29,004	Accomack	1975
29,426	Mecklenburg	1975
29,564	Pulaski	1972
30,076	Halifax	1973
31,349	Smyth	1973
32,071	Buchanan	1972
35,947	Wise	1971
37,479	Hanover	1973

GROUP IV - 1980
POPULATION GROUP - over 39,000

1970 population	county	latest reassessment
39,816	Tazewell	1971
40,835	Washington	1973
43,319	Campbell	1971
44,220	Augusta	1976
47,157	Montgomery	1972
47,890	Rockingham	1971
50,901	Henry	191
58,789	Pittsylvania	1976
67,339	Roanoke	1974
91,389	Prince William	1974

CITIES
GROUP V - 1977
POPULATION GROUP - less than 14,000

1970 population	city	latest reassessment
4,001	Norton	1974
5,300	~~Emporia~~	1974
5,501	Clifton Forge	1974
6,011	Bedford	1974
6,278	Galax	1974
6,425	Buena Vista	1974
6,450	Poquoson	
6,880	Franklin	1974
6,889	South Boston	1974
7,597	Lexington	1974
8,605	Manassas Park	
9,069	Williamsburg	1974
10,772	Falls Church	1974
11,108	Manassas City	
11,596	Radford	1973

GROUP VI - 1978
POPULATION GROUP - 14,000 or more

1970 population	city	latest reassessment
14,450	Fredericksburg	1974
14,605	Harrisonburg	1974
14,857	Bristol	1974
15,097	Colonial Heights	1974
19,473	Winchester	1974
19,653	Martinsville	1974
23,471	Hopewell	1974

APPENDIX II

A Bill to amend and reenact §§ 58-764, 58-776, 58-776.1, 58-778, 58-784.3, 58-784.5, 58-792 and 58-795, as severally amended, of the Code of Virginia; to amend the Code of Virginia by adding a section numbered 58-778.1, and to repeal §§ 58-776.5, 58-776.6, 58-776.7, 58-780, 58-780.1, 58-782, 58-783, 58-784, 58-784.2, 58-784.4, 58-792.1, 58-792.2, 58-792.3, 58-792.4, 58-792.5 and 58-795.1, as severally amended, of the Code of Virginia, relating to general reassessments of real estate.

Be it enacted by the General Assembly of Virginia:

1. That §§ 58-764, 58-776, 58-776.1, 58-778, 58-784.3, 58-784.5, 58-792 and 58-795, as severally amended, of the Code of Virginia are amended and reenacted, and that the Code of Virginia is amended by adding a section numbered 58-778.1 as follows:

§ 58-764. Change when easement acquired.— ~~**In any county in which a general reassessment of real estate has not been made for a period of four years, any owner of real estate therein who is of opinion that the assessed value of the real estate is greater than its fair market value may apply for relief to the circuit court of the county.**~~ In the case of any real estate upon which any easement has been acquired for the installation of public service, highway or street facilities, and which has not been reassessed by the commissioner of the revenue on request of the landowner as provided in the preceding section (§ 58-763), the owner thereof may apply for relief to the circuit court of such county or any city court of record wherein such property is located. If the governing body of any county is of the opinion that any real estate therein is assessed at less than its fair market value, it shall direct the Commonwealth's attorney to apply to the circuit court of such county to have the assessment corrected. Proceedings upon any such application shall be as provided in §§ 58-1145 to 58-1151 and the court shall enter such order with respect to the assessment as is just and proper.

§ 58-776. In cities.— ~~***There shall be a general reassessment of real estate in the year nineteen hundred and fifty and every fourth year thereafter in each of the cities of this Commonwealth.***~~ *In each of the cities of this Commonwealth having a population according to the census of nineteen hundred seventy of not more than twelve thousand, there shall be a general reassessment of real estate in nineteen hundred seventy-seven and every second year thereafter. In each of the cities having such population of more than twelve thousand, there shall be a general reassessment in ninteen hundred seventy-eight and every second year thereafter. Provided, however, if any city has had a general reassessment the year prior to the year designated herein, it may delay such reassessment until the next year designated for such city herein.* Sections 58-785, 58-786, 58-788, 58-789, and 58-794, and other relevant provisions of law shall be applicable to general reassessments of real estate in cities.

The provisions of this section shall not affect the power of any city to use the annual assessment method in lieu of general assessments.

§ 58-776.1. Annual assessment and reassessment in cities having not more than 30,000 population; board.—The governing body of any city having a population not in excess of thirty thousand may, in lieu of the ~~quadrennial~~ reassessment provided by general law, by ordinance provide for the annual assessment and reassessment and equalization of assessments of real estate therein, and to that end may appoint a board of assessors to assess and from time to time reassess for taxation in such city, and shall prescribe the duties and terms of office of the assessors.

§ 58-778. In counties.—There shall be ~~such~~ *a* general reassessment *of real estate* in the year nineteen hundred ~~fifty~~ *seventy-seven* and ~~at least~~ every fourth year thereafter in each county having a population of *not* more than ~~two thousand inhabitants per square mile~~ *fourteen thousand according to the census of nineteen hundred seventy . There shall be such a general reassessment in the year nineteen hundred seventy-eight and every fourth year thereafter in each county of the Commonwealth having such population of more than fourteen thousand but not more than twenty-four thousand. There shall be such a general reassessment in the year nineteen hundred seventy-nine and every fourth year thereafter in each county having such population of more than twenty-four thousand but not more than thirty-nine thousand. There shall be such a general reassessment in the year nineteen hundred eighty and every fourth year thereafter in each county having such population of over thirty-nine thousand. Provided, however, that if any county has had a general reassessment within three years of the date designated herein for its next general reassessment, it may delay such reassessment until the next year designated for such county herein.*

Nothing in this section shall affect the power of any county to use the annual assessment method.

§ 58-778.1. Biennial general reassessments.—Notwithstanding any other provision of law, general or special, the governing body of any county or city having at least one full time real estate appraiser or assessor certified by the Tax Commissioner may provide by ordinance for the biennial assessment and equalization of real estate in lieu of the reassessments required by §§ 58-776 and 58-778. Any county or city employing such method shall conduct a new reassessment of all real property biennially, but may complete such reassessment during an entire two-year period, employing the same standards of value for all appraisals made during such period.

§ 58-784.3. Reassessment by direction of governing body.—Notwithstanding any other provision of this article to the contrary, there may be a general reassessment of real estate in any county *or city* in any year if the governing body so directs by a majority of all the members thereof, by a recorded yea and nay vote. *If such general reassessment is conducted, further general reassessments shall be required only every fourth year thereafter, if a county, or every second year thereafter, if a city, notwithstanding the provisions of §§ 58-776 and 58-778 to the contrary.*

§ 58-784.5. General reassessment every four years not required in certain counties.—The governing body of any county which established a department of real estate assessments and provided for annual assessment and reassessment and equalization of assessments of real estate as provided in § 15.1-686 shall not be required to undertake general reassessments of real estate every ~~six~~ *four* years as otherwise provided in this article.

§ 58-792. Completion of work; extension.—In every city and county the person or persons, or officer or officers, making such reassessment shall complete the same and comply with the preceding section (§ 58-791) not later than December thirty-first of the year of such reassessment. But the judge of any court in the clerk's office of which the original of such reassessment is required to be filed may, for good cause, extend the time for completing such reassessment and complying with such section for a period not exceeding ~~one hundred twenty days~~ *three months* from the thirty-first day of December of the year of such reassessment.

§ 58-795. Reassessment in towns.—In any incorporated town there may be for town taxation and debt limitation, a general reassessment of the real estate in any such town in the year designated, and every ~~fourth~~ *second* year thereafter, that the council of such town shall dec~~lare by~~ ordinance or resolution the necessity therefor. Every such general reassessment of real estate in any such town shall be made by a board of assessors consisting of three resident freeholders, who hold no official office or position with the town government, appointed by the council of such town for each general reassessment and the compensation of the person so designated shall be prescribed by the council and paid out of the town treasury. The assessors so designated shall assess the property in accordance with the general law and Constitution of Virginia. If for any cause the board is unable to complete an assessment within the year for which it is appointed, the council shall extend the time therefor for ~~such duration as may be necessary to complete the assessment~~ *three months.* Any vacancy in the membership of the ~~board shall~~ be filled by the council within thirty days after the occurrence thereof, but such vacancy shall not invalidate any assessment. The assessments so made shall be open for public inspection after notice of such inspection shall have been advertised in a newspaper of general circulation within the town at least five days prior to such date or dates of inspection. Within thirty days after the final date of inspection the assessors shall file the completed reassessments in the office of the town clerk and at the same time forward to the Department of Taxation a copy of the recapitulation sheets of such assessments. Any person, firm, or corporation claiming to be aggrieved by any assessment may within thirty days after the filing of reassessments in the office of the town clerk, apply to the town council for a correction of such assessment by filing with the town clerk a written statement setting forth wherein he claims to be aggrieved. The council of every such town shall, within thirty days of the filing of such complaint, fix a date for a hearing on such application and after giving the applicant at least ten days' notice of the time fixed, shall hear such evidence as may be introduced by interested parties and correct the assessment by increasing or reducing the same. Town taxes for each year on real estate subject to reassessment shall be extended on the basis of the last general reassessment made prior to such year subject to such changes as may have been lawfully made. *The town tax assessor shall make changes required by new construction, subdivision and disaster loss.* ~~Notwithstanding any foregoing provision of this section to the contrary, a town located in a county having a population of more than thirty eight thousand but less than forty thousand may~~ *The council of any town may provide by ordinance that it will* have a general reassessment of real estate in the town in the year designated by the town council and every year thereafter; the town council may declare the necessity for such general reassessment by *such* ordinance ~~or resolution~~ ; in all other respects this section shall be controlling. No county or district levies shall be extended on any assessments made under the provisions of this section. *Any town which has failed to conduct a general reassessment within three years shall use only those assessed values assigned by the county.*

2. That §§ 58-776.5, 58-776.6, 58-776.7, 58-780, 58-780.1, 58-782, 58-783, 58-784, 58-784.2, 58-784.4, 58-792.1, 58-792.2, 58-792.3, 58-792.4, 58-792.5, and 58-795.1, as severally amended, of the Code of Virginia are repealed.

3. That this act shall be effective on and after January one, nineteen hundred seventy-seven.

#

A Bill to amend and reenact § 58-834, as amended, of the Code of Virginia, relating to situs for assessment of personal property.

Be it enacted by the General Assembly of Virginia:

1. That § 58-834, as amended, of the Code of Virginia is amended and reenacted as follows:

§ 58-834. Situs for assessment of personal property subject to local taxation; nonresident exception; refund of tax paid to city or county.— *A.* The situs for the assessment and taxation of tangible personal property, merchants' capital and machinery and tools shall in all cases be the county, ~~district, town or city~~ *city or town* in which such property may be physically located on the first day of the tax year, except the situs for purposes of assessment of motor vehicles, travel trailers, boats and airplanes as personal property shall be the county, ~~district, town or~~ city *or town* where the vehicle is normally garaged, docked or parked; provided, however, that any person domiciled in another state, whose motor vehicle is principally garaged or parked in this State during the tax year, shall not be subject to a personal property tax on such vehicle upon a showing of sufficient evidence that such person has paid a personal property tax on such vehicle *for the entire year* in the state in which he is domiciled. Any person who, after January one, nineteen hundred seventy-three, paid a personal property tax on a motor vehicle to a county or city in this State and a similar tax on the same vehicle in the state of his domicile may apply to such county or city for a refund of such tax payment. Upon a showing of sufficient evidence that such person has paid the tax for the same year in the state in which he is domiciled, the county or city may refund the amount of such payment.

B. Any person first registering a motor vehicle or travel trailer within a county, city or town after January one of any year shall be liable for tax for that portion of the year during which such vehicle was owned by him and garaged or parked therein. The commissioner of the revenue shall make assessments on such vehicles as of the first day of each month following the month such property was registered within the county, city or town.

Any person selling a motor vehicle or travel trailer or moving such vehicle from a county, city or town shall, upon filing a claim therefor, receive a credit or refund of the tax paid by him on such vehicle for the portion of the year it will no longer be owned by him or will be normally garaged or parked elsewhere, or an exoneration from such portion of the tax if not yet paid. If the person making such claim is removing such vehicle, such claim shall state the complete address to which such vehicle will be removed. If such address is within the Commonwealth, the commissioner of the revenue shall mail a copy of such claim to the commissioner of the revenue of the county or city in which such address is located. The commissioner of the revenue shall furnish the assessing officer of every town within the county the assessment sheets.

The Division of Motor Vehicles shall transmit to the commissioner of revenue of every county and city on a monthly basis the transfers of title applicable to such county or city.

Every seller of motor vehicles or travel trailers located within the Commonwealth *shall, upon sale of any such vehicle, notify the commissioner of revenue of the county or city of the buyer's residence of the sale of such vehicle, and shall include in such notification the sales price and any amount allowed for trade-in.*

2. That this act shall be effective on and after January one, nineteen hundred seventy-seven.

#

A Bill to amend and reenact § 58-266.1, as amended, of the Code of Virginia, relating to local license taxes.

Be it enacted by the General Assembly of Virginia:

1. That § 58-266.1, as amended, of the Code of Virginia is amended and reenacted as follows:

§ 58-266.1. Cities, towns and counties may impose local license taxes; limitation of authority.—A. The council of any city or town, and the governing body of any county, may levy and provide for the assessment and collection of city, town or county license taxes on businesses, trades, professions, occupations and callings and upon the persons, firms and corporations engaged therein within the city, town or county, whether any license tax be imposed thereon by the State or not, subject to the following limitations:

(1) No city, town or county shall levy any license tax in any case in which the levying of a local license tax is prohibited by any general law of this State, or on any public service corporation except as permitted by other provisions of law, nor shall this section be construed as repealing or affecting in any way any general law limiting the amount or rate of any local license tax.

(2) No city, town or county shall impose upon or collect from any person any tax, fine or other penalty for selling farm or domestic products or nursery products, ornamental or otherwise, or for the planting of nursery products, as an incident to the sale thereof, within the limits of any such town, county or city outside of the regular market houses and sheds of such city, county or town; provided, such products are grown or produced by such person.

(3) No city, town or county shall require a license to be obtained for the privilege or right of printing or publishing any newspaper, or for the privilege or right of operating or conducting any radio or television broadcasting station or service, any municipal charter provisions to the contrary notwithstanding.

(4) No city, town or county shall levy any license tax on a manufacturer for the privilege of manufacturing and selling goods, wares and merchandise at wholesale at the place of manufacture, whether the same be measured by gross receipts or otherwise, any city or town charter provisions to the contrary notwithstanding; provided, that any city, town or county which imposed such a tax prior to January first, nineteen hundred sixty-four may continue it until January first, nineteen hundred sixty-nine at the same or reduced rates.

(5) Whenever any county imposes a county license tax on merchants, the same shall be in lieu of a county property tax on the capital of merchants, as defined by § 58-833.

(6) No city, town or county shall levy a tax upon a wholesaler for the privilege of selling goods, wares and merchandise to other persons for resale unless said wholesaler has a definite place of

business or store in said city, town or county, but the foregoing shall not be construed as prohibiting any city, town or county from imposing a local license tax on a peddler at wholesale who is subject to a State license tax under article 10 (§ 58-346 et seq.) of this chapter.

(6a) Notwithstanding any provision of law, general or special, no city, town or county shall levy any license tax upon any person, firm or corporation for engaging in the business of renting, as the owner of such property, real property other than hotels, motels, motor lodges, auto courts, tourist courts, trailer parks, lodging houses, rooming houses and boardinghouses; provided, however, that any county, city or town having such a license tax on January one, nineteen hundred seventy-four, shall not be precluded from the levy of such tax by the provisions of this subsection.

(7) Any county license tax imposed hereunder shall not apply within the limits of any town located in such county, where such town now, or hereafter, imposes a town license tax on the same privilege; provided, however, that if the governing body of any town within a county, which county has a population of at least fourteen thousand six hundred fifty but not in excess of fourteen thousand seven hundred, shall provide that a county license tax shall apply within the limits of such town, then such license tax may be imposed within such town.

(8) Before issuing any license to do business as a tour guide or tourist guide, the city council or the board of supervisors may require that an applicant take and pass an examination to determine the fitness of such person as to his knowledge of the history of the city or the county and of the historical and tourist attractions located therein.

(9) Gross receipts for license tax purposes shall not include any amount paid to the State or any county, city or town for the Virginia retail sales or use tax, for any local sales tax or any local excise tax on cigarettes.

(10) No city, town or county shall levy any license tax upon a wholesaler or retailer for the privilege of selling bicentennial medals on a nonprofit basis for the benefit of the Virginia Independence Bicentennial Commission or any local bicentennial commission.

B. No local license tax, imposed pursuant to the provisions of this section, *or any other provision of law or charter,* shall be greater than such rate as levied by such city, town or county on December thirty-one, nineteen hundred seventy-four. Any city, town or county, increasing such tax after December thirty-one, nineteen hundred seventy-four, ~~but prior to June one, nineteen hundred seventy five~~, to a rate greater than the levy applicable on such date, shall roll back such taxes to the December thirty-one, nineteen hundred seventy-four rate and refund any amount in excess thereof.

The provisions of this subsection shall cease to be of any force or effect on December thirty-one, nineteen hundred seventy- ~~five~~ *six,* unless extended by the General Assembly of Virginia.

The provisions of this subsection shall not apply to rates adopted by ordinance prior to December thirty-one, nineteen hundred seventy-four but not effective until after that date.

2. That an emergency exists and this act is in force from its passage.

#

A Bill to amend and reenact § 58-151.013, as amended, of the Code of Virginia, relating to Virginia taxable income.

Be it enacted by the General Assembly of Virginia:

1. That § 58-151.013, as amended, of the Code of Virginia be amended and reenacted as follows:

§ 58-151.013. Virginia taxable income.—(a) General.—The Virginia taxable income of a resident individual means his federal adjusted gross income for the taxable year, with the modifications specified in this section.

(b) Additions.—To the extent excluded from federal adjusted gross income, there shall be added:

(1) Interest, less related expenses to the extent not deducted in determining federal taxable income, on obligations of any state other than this State, or of a political subdivision of any such other state unless created by compact or agreement to which this State is a party; and

(2) Interest or dividends, less related expenses to the extent not deducted in determining federal taxable income, on obligations or securities of any authority, commission or instrumentality of the United States, which the laws of the United States exempt from federal income tax but not from state income taxes.

(c) Subtractions.—To the extent included in federal adjusted gross income, there shall be subtracted:

(1) Interest or dividends on obligations of the United States (other than on refunds of federal taxes) and on obligations or securities of any authority, commission or instrumentality of the United States to the extent exempt from state income taxes under the laws of the United States; and

(2) Interest on obligations of this State or of any political subdivision or instrumentality of this State.

(3) The following items of pension or retirement income and benefits:

(A) Pensions or retirement income to officers and employees of this State, its subdivisions and agencies, or surviving spouses of such officers or employees exempt from State income taxation under the laws of this State, and pensions or retirement income to officers and employees who are retired under the provisions of chapter 2 (§ 51-3 et seq.) of Title 51, or to spouses of such officers and employees;

(B) Pensions received from the United States or this State on account of military or naval service in armed forces, whether such service was rendered by the recipient of the pension, or by a relative by blood or marriage; and

(C) to (E) [Repealed.]

(F) The first three thousand dollars of retirement benefits derived in each taxable year by a retiree and the first one thousand five hundred dollars received by the surviving spouse of such retiree from civilian service for the federal government or any agency thereof; the first two thousand dollars of retirement benefits derived in each taxable year by a retiree who has reached the age of sixty and the first one thousand five hundred dollars received by the surviving spouse of such retiree, from the armed forces of the United States; the first two thousand dollars of retirement benefits derived in each taxable year by a retiree and the first one thousand dollars received by the surviving spouse of such retiree from any employer having a retirement plan meeting the qualification requirements of § 401 of the Internal Revenue Code of 1954 or from a state or local government other than those covered by subsection 3 (A) hereof; provided, however, that such two or three thousand dollar subtraction for the retiree or one thousand or one thousand five hundred dollar subtraction for the surviving spouse shall be reduced by any adjusted gross income exceeding twelve thousand dollars, exclusive of any Social Security retirement benefits, received by such retiree or spouse during the taxable year.

(4) Dividends to the extent includible in gross income for federal income tax purposes and in excess of any dividend exclusion provided in the laws of the United States relating to federal income taxes, upon stock in:

(A) National banks and banks and trust companies organized under the laws of this State;

(B) Any corporation, fifty percent or more of the income of which was assessable for the preceding year under the provisions of the income tax laws of this State.

(5) The amount of any refund or credit for overpayment of income taxes imposed by this State or any other taxing jurisdiction.

(d) Deductions.—There shall be deducted:

(1) The amount allowable for itemized deductions for federal income tax purposes where the taxpayer has elected for the taxable year to itemize deductions on his federal return, but reduced by the amount of income taxes imposed by this State or any other taxing jurisdiction and deducted on such federal return; or

(2) The amount allowable as the standard deduction or low income allowance for federal income tax purposes ~~where the taxpayer has elected for the taxable year to take such standard deduction or low income allowance on his federal return; provided that for the taxable year nineteen hundred seventy five, such deductible amount shall be the amount~~ allowed pursuant to § 141 of the Internal Revenue Code of 1954, as it existed on December thirty-one, nineteen hundred seventy-four *, provided that the taxpayer has elected for the taxable year to take the applicable standard deduction or low income allowance on his federal return*; and

(3) A deduction in the amount of six hundred dollars for each personal exemption allowable to the taxpayer for federal income tax purposes, and an additional deduction of four hundred dollars for each exemption allowable to the taxpayer under paragraph (c) of § 151 of the Internal Revenue Code.

(e) Other modifications and adjustments.—(1) There shall be added to or subtracted from federal adjusted gross income (as the case may be) the individual's share, as beneficiary of an estate or trust, of the Virginia fiduciary adjustment determined under § 58-151.023.

(2) Where husband and wife have not separately reported and claimed items of income, exemptions and deductions for federal income tax purposes, and have not elected to file a joint Virginia income tax return, such items allowable for Virginia income tax purposes shall be allocated and adjusted as follows:

(A) Income shall be allocated to the spouse who earned the income or with respect to whose property the income is attributable.

(B) Allowable deductions with respect to trade, business, production of income, or employment shall be allocated to the spouse to whom attributable.

(C) Nonbusiness deductions, where properly taken for federal income tax purposes, shall be allowable for Virginia income tax purposes, but shall be allocable between husband and wife as they may mutually agree. For this purpose, "nonbusiness deductions" consist of allowable deductions not described in subparagraph (B) above.

(D) Where the standard deduction or low income allowance is properly taken pursuant to subsection (d) (2) of this section such deduction or allowance shall be allocable between husband and wife as they may mutually agree.

(E) Personal exemptions properly allowable for federal income tax purposes shall be allocated for Virginia income tax purposes as husband and wife may mutually agree; provided, however, that exemptions for taxpayer and spouse together with exemptions for old age and blindness must be allocated respectively to the spouse to which they relate.

(3) Where allocations are permitted to be made under subparagraph (2) above pursuant to agreement between husband and wife, and husband and wife have failed to agree as to such allocations, such allocations shall be made between husband and wife in a manner corresponding to the treatment for federal income tax purposes of the items involved, under regulations prescribed by the Department of Taxation.

(f) Nonresidents.—(1) Nonresident individuals, partners and beneficiaries.—The Virginia taxable income of a nonresident individual, partner or beneficiary shall be an amount bearing the same proportion to his Virginia taxable income, computed as though he were a resident, as the net amount of his income, gain, loss and deductions from Virginia sources bears to the net amount of his income, gain, loss and deductions from all sources.

(2) Certain nonresident shareholders.—For a nonresident individual who is a shareholder in an electing small business corporation, there shall be included in his Virginia taxable income his share of the taxable income of such corporation, and his share of any net operating loss of such corporation shall be deductible from his Virginia taxable income.

(g) Transitional modifications.—There shall be added or subtracted, as the case may be, the amounts provided in § 58-151.0111 as transitional modification.

(h) Partner's modifications.—Virginia taxable income shall, as to partners, be adjusted to reflect the modifications provided in § 58-151.014.

2. This act shall be effective for taxable years beginning on and after January one, nineteen hundred seventy-six.

#

A Bill to amend and reenact § 58-151.013, as amended, of the Code of Virginia, relating to Virginia taxable income.

Be it enacted by the General Assembly of Virginia:

1. That § 58-151.013, as amended, of the Code of Virginia be amended and reenacted and follows:

§ 58-151.013. Virginia taxable income.—(a) General.—The Virginia taxable income of a resident individual means his federal adjusted gross income for the taxable year, with the modifications specified in this section.

(b) Additions.—To the extent excluded from federal adjusted gross income, there shall be added:

(1) Interest, less related expenses to the extent not deducted in determining federal taxable income, on obligations of any state other than this State, or of a political subdivision of any such other state unless created by compact or agreement to which this State is a party; and

(2) Interest or dividends, less related expenses to the extent not deducted in determining federal taxable income, on obligations or securities of any authority, commission or instrumentality of the United States, which the laws of the United States exempt from federal income tax but not from state income taxes *; and*

(3) Any federal long term capital gain deduction.

(c) Subtractions.—To the extent included in federal adjusted gross income, there shall be subtracted:

(1) Interest or dividends on obligations of the United States (other than on refunds of federal taxes) and on obligations or securities of any authority, commission or instrumentality of the United States to the extent exempt from state income taxes under the laws of the United States; and

(2) Interest on obligations of this State or of any political subdivision or instrumentality of this State.

(3) The following items of pension or retirement income and benefits:

(A) Pensions or retirement income to officers and employees of this State, its subdivisions and agencies, or surviving spouses of such officers or employees exempt from State income taxation under the laws of this State, and pensions or retirement income to officers and employees who are retired under the provisions of chapter 2 (§ 51-3 et seq.) of Title 51, or to spouses of such officers and employees;

(B) Pensions received from the United States or this State on account of military or naval service in armed forces, whether such service was rendered by the recipient of the pension, or by a relative by blood or marriage; and

(C) to (E) [Repealed.]

(F) The first three thousand dollars of retirement benefits derived in each taxable year by a retiree and the first one thousand five hundred dollars received by the surviving spouse of such retiree from civilian service for the federal government or any agency thereof; the first two thousand dollars of retirement benefits derived in each taxable year by a retiree who has reached the age of sixty and the first one thousand five hundred dollars received by the surviving spouse of such retiree, from the armed forces of the United States; the first two thousand dollars of retirement benefits derived in each taxable year by a retiree and the first one thousand dollars received by the surviving spouse of such retiree from any employer having a retirement plan meeting the qualification requirements of § 401 of the Internal Revenue Code of 1954 or from a state or local government other than those covered by subsection 3 (A) hereof; provided, however, that such two or three thousand dollar subtraction for the retiree or one thousand or one thousand five hundred dollar subtraction for the surviving spouse shall be reduced by any adjusted gross income exceeding twelve thousand dollars, exclusive of any Social Security retirement benefits, received by such retiree or spouse during the taxable year.

(4) Dividends to the extent includible in gross income for federal income tax purposes and in excess of any dividend exclusion provided in the laws of the United States relating to federal income taxes, upon stock in:

(A) ~~National banks and banks and trust companies organized under the laws of this State;~~

(B) Any ~~corporation~~ *Domestic International Sales Corporation, as defined in § 992 of the Internal Revenue Code, as amended,* fifty percent or more of the income of which was assessable for the preceding year under the provisions of the income tax laws of this State.

(5) The amount of any refund or credit for overpayment of income taxes imposed by this State or any other taxing jurisdiction.

(d) Deductions.—There shall be deducted:

(1) The amount allowable for itemized deductions for federal income tax purposes where the taxpayer has elected for the taxable year to itemize deductions on his federal return, but reduced by the amount of income taxes imposed by this State or any other taxing jurisdiction and deducted on such federal return; or

(2) The amount allowable as the standard deduction or low income allowance for federal income tax purposes where the taxpayer has elected for the taxable year to take such standard deduction or low income allowance on his federal return; provided that for the taxable year nineteen hundred seventy-five, or fiscal year beginning in nineteen hundred seventy-five, such deductible

amount shall be the amount allowed pursuant to § 141 of the Internal Revenue Code of 1954, as it existed on December thirty-one, nineteen hundred seventy-four; and

(3) A deduction in the amount of six hundred dollars for each personal exemption allowable to the taxpayer for federal income tax purposes, and an additional deduction of four hundred dollars for each exemption allowable to the taxpayer under paragraph (c) of § 151 of the Internal Revenue Code.

(e) Other modifications and adjustments.—(1) There shall be added to or subtracted from federal adjusted gross income (as the case may be) the individual's share, as beneficiary of an estate or trust, of the Virginia fiduciary adjustment determined under § 58-151.023.

(2) Where husband and wife have not separately reported and claimed items of income, exemptions and deductions for federal income tax purposes, and have not elected to file a joint Virginia income tax return, such items allowable for Virginia income tax purposes shall be allocated and adjusted as follows:

(A) Income shall be allocated to the spouse who earned the income or with respect to whose property the income is attributable.

(B) Allowable deductions with respect to trade, business, production of income, or employment shall be allocated to the spouse to whom attributable.

(C) Nonbusiness deductions, where properly taken for federal income tax purposes, shall be allowable for Virginia income tax purposes, but shall be allocable between husband and wife as they may mutually agree. For this purpose, "nonbusiness deductions" consist of allowable deductions not described in subparagraph (B) above.

(D) Where the standard deduction or low income allowance is properly taken pursuant to subsection (d) (2) of this section such deduction or allowance shall be allocable between husband and wife as they may mutually agree.

(E) Personal exemptions properly allowable for federal income tax purposes shall be allocated for Virginia income tax purposes as husband and wife may mutually agree; provided, however, that exemptions for taxpayer and spouse together with exemptions for old age and blindness must be allocated respectively to the spouse to which they relate.

(3) Where allocations are permitted to be made under subparagraph (2) above pursuant to agreement between husband and wife, and husband and wife have failed to agree as to such allocations, such allocations shall be made between husband and wife in a manner corresponding to the treatment for federal income tax purposes of the items involved, under regulations prescribed by the Department of Taxation.

(f) Nonresidents.—(1) Nonresident individuals, partners and beneficiaries.—The Virginia taxable income of a nonresident individual, partner or beneficiary shall be an amount bearing the same proportion to his Virginia taxable income, computed as though he were a resident, as the net amount of his income, gain, loss and deductions from Virginia sources bears to the net amount of his income, gain, loss and deductions from all sources.

(2) Certain nonresident shareholders.—For a nonresident individual who is a shareholder in an electing small business corporation, there shall be included in his Virginia taxable income his share of the taxable income of such corporation, and his share of any net operating loss of such corporation shall be deductible from his Virginia taxable income.

(g) Transitional modifications.—There shall be added or subtracted, as the case may be, the amounts provided in § 58-151.0111 as transitional modifications.

(h) Partner's modifications.—Virginia taxable income shall, as to partners, be adjusted to reflect the modifications provided in § 58-151.014.

2. This act shall be effective for taxable years beginning on and after January one, nineteen hundred seventy-six.