

W E S T V I R G I N I A



DEPARTMENT OF REVENUE

Joint Select Committee on Tax Reform Current Tax Structure

DEPUTY REVENUE SECRETARY MARK B. MUCHOW

West Virginia State Capitol
May 4, 2015

Some Notes Concerning Taxation

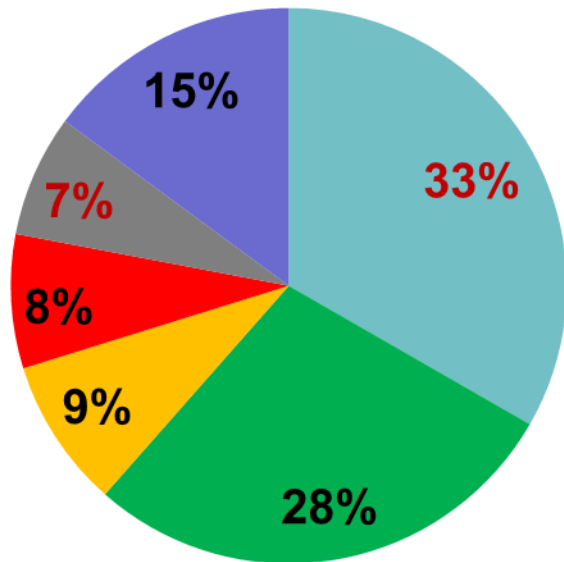
- Tax = price paid for government goods and services
 - Higher price = less demand (budget surplus)
 - Lower price = more demand
 - Federal deficit spending
 - Exporting of tax (e.g., Destination gaming, tourism, certain taxes)
- All taxes are paid by individuals – economic incidence
- Two principles of taxation
 - Ability to Pay (Federal Government)
 - Benefits (State and Local Governments)
- Three broad categories of taxation
 - Property (Real estate taxes, ad valorem tax, franchise tax)
 - Consumption (General sales, gross receipt, excise)
 - Income (personal income, profits, wages, dividends)

State and Local Government Expenditures 2011: WV Ranks

14th in Per Pupil K-12 Education Funding; 16th in Per Capita Higher Education Funding; 11th in Per Capita Highways Funding; 48th in Per Capita Police Protection

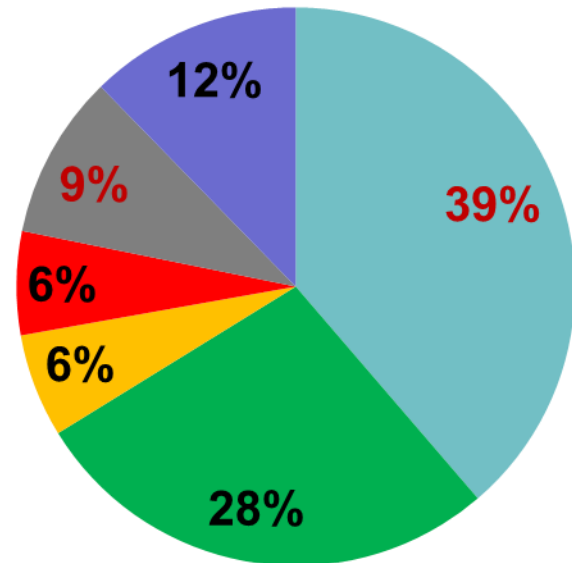
Sources: U.S. Census Bureau & State Higher Education Executive Officers Association

All State Total: \$2.6 Trillion



Education
Public Safety
Transportation
Social Services/Welfare
Environment/Housing
Other

West Virginia: \$14.5 Billion



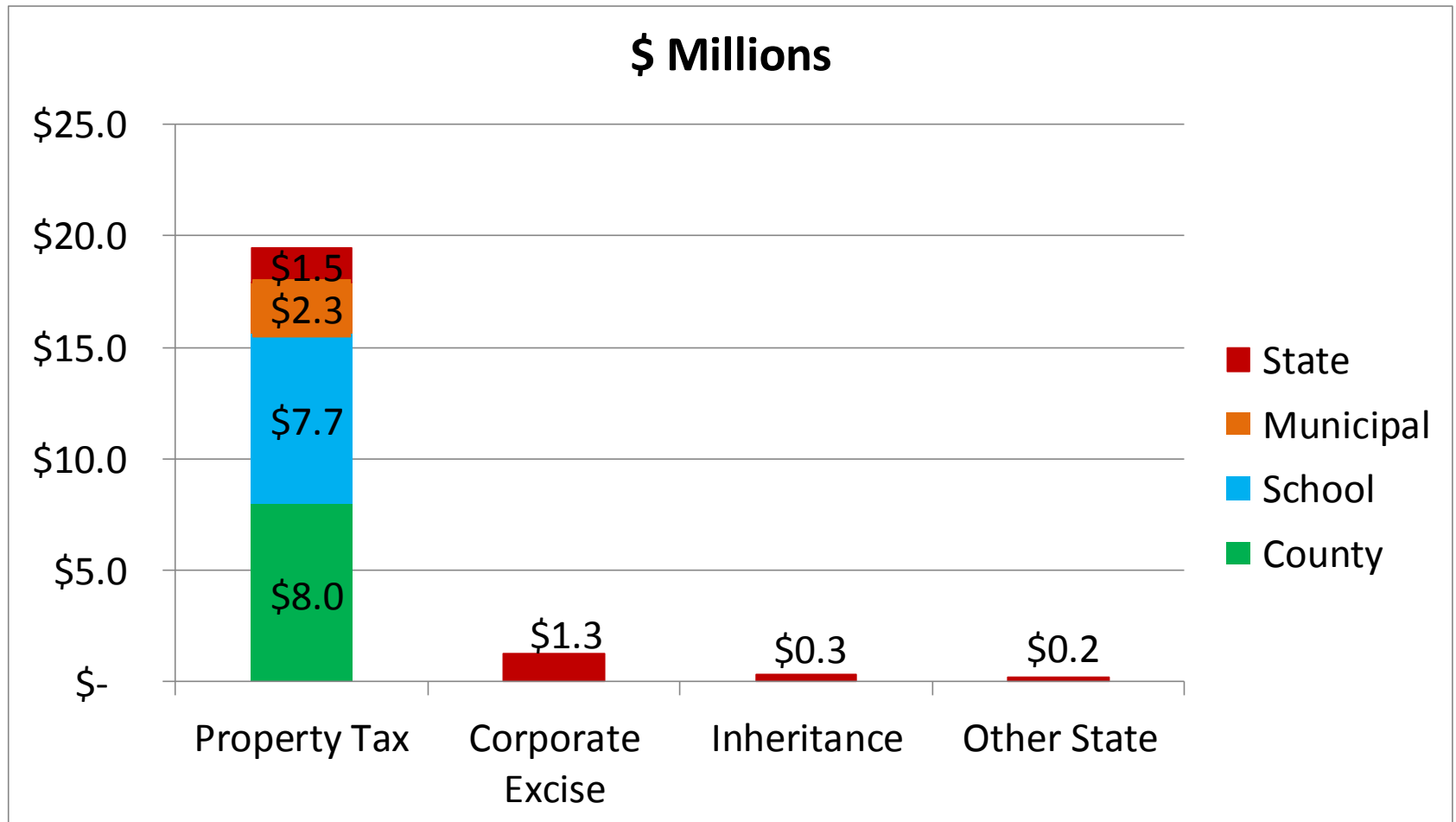
Education
Public Safety
Transportation
Social Services/Welfare
Environment/Housing
Other

Historical Events Shape Tax System

- Prohibition: (WV goes Dry in 1914: New Tax System)
 - Move to State consumption taxes (B&O and gasoline)
- Great Depression of the 1930s
 - Property Tax Revolt (Move toward government centralization)
 - Move to more State consumption taxation (Sales Tax and more)
 - Roads transferred from counties to State
- Educating Baby Boomers in 1960s:
 - Higher sales tax rates
 - Introduction of personal income tax and corporate income tax
- 1970s Energy Boom Followed by Bust in 1980s
 - Significant growth in B&O taxes due to energy and inflation
 - Removal of sales tax on groceries and increase in tax rate
 - Shift from consumption tax (B&O) to income taxes
 - Reinstatement of grocery tax and higher sales tax rate
- 2000s Energy Boom Followed by Recent Downturn
 - Removal of sales tax on groceries
 - Repeal of a number of taxes and other tax relief
 - Record levels of severance tax collection

FY1918: Distribution of Tax Collections

Property Tax Largest Source & 80% of Revenue is Local



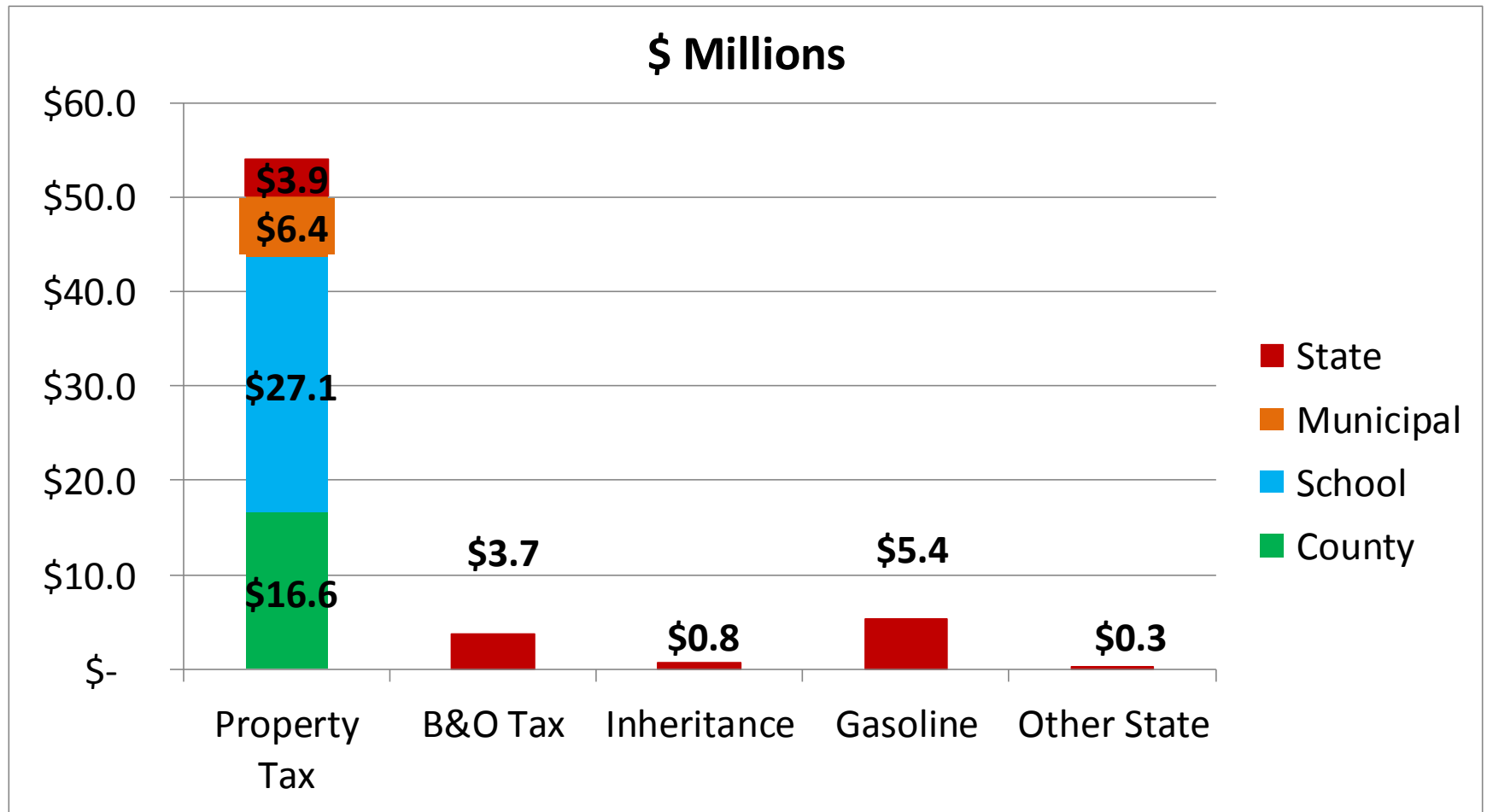
Origin of the State B&O Tax

State Went Dry in 1914 - Gross Sales Tax Law - 1921

- The “fairest tax” replaced a tax on corporate profits & an unconstitutional gas pipeline tax as of July 1, 1921
- Base of tax was business gross receipts > \$10,000
- Mining: 0.40% of gross receipts
- Manufacturing: 0.20% of gross receipts
- Retail: 0.20% of gross receipts
- Wholesale: 0.33% of gross receipts
- Banks & Utilities: 0.20% of gross receipts
- All Other Business: 0.20% of gross receipts

FY1930: Distribution of Tax Collections

Property Tax Largest Source & 80% of Revenue is Local

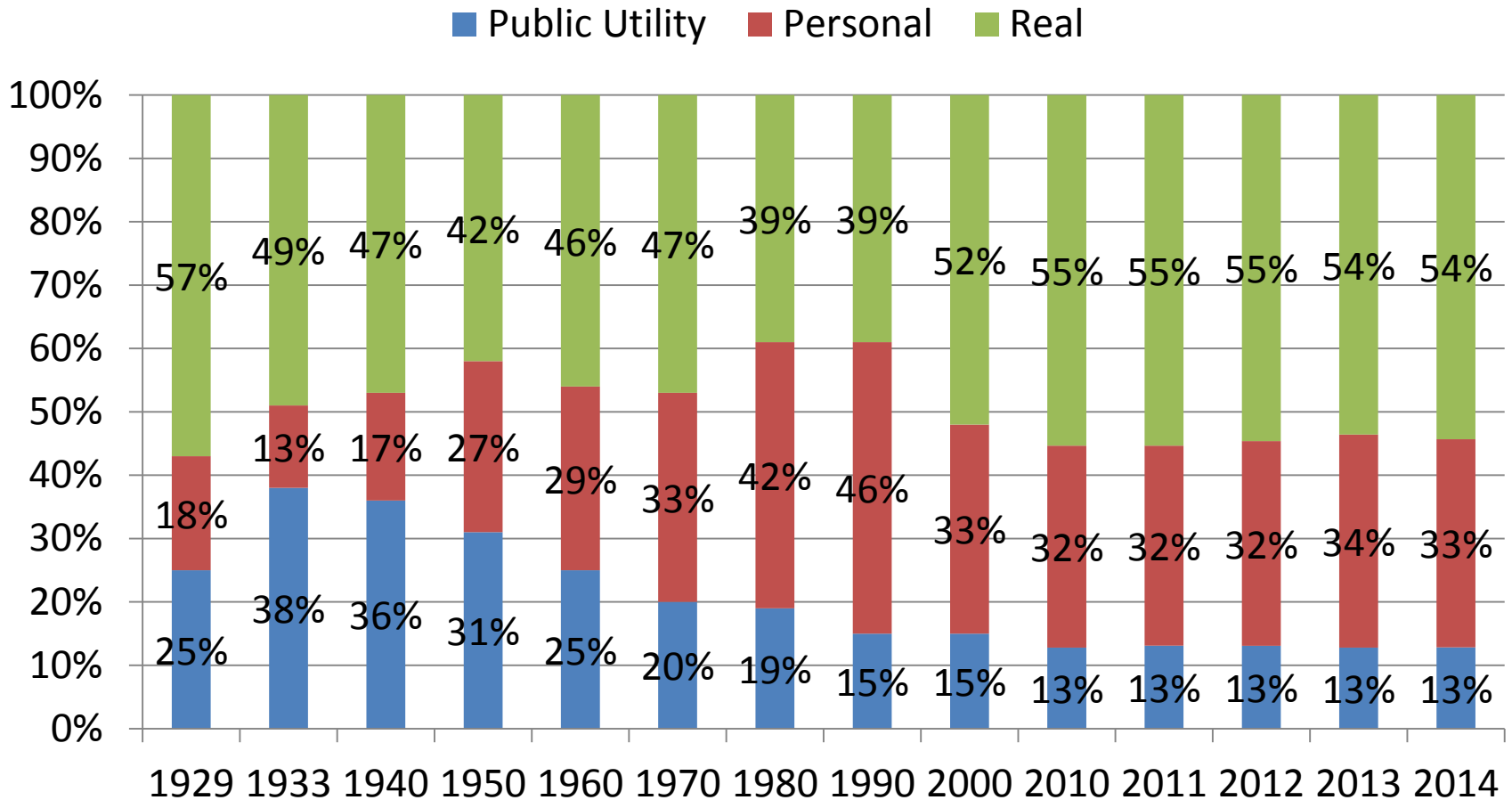


Property Tax Limitation Amendment: 1932

- Reduced average tax rates by roughly 50%
 - Revenue falls from \$54 million in FY1930 to \$27 million in FY1934
- Single tax rate structure replaced by three-tier rate system outlined in four classes
 - Tier 1- Intangibles and Farm Personal Property: 0.5% max rate
 - Tier II – Farm Real Property and Residential Homes: 1.0% max rate
 - Tier III – All Other Property: 2.0% max rate
- Individual Government level rate restrictions at maximum
 - Schools receive 45.9% (urban) and 61.2% (rural) share
 - Counties receive 28.6% (urban) and 38.1% (rural) share
 - Cities receive 25% share and just 46.6% on non-education local share
- Tax rates capped with option for voter approved excess levies

Sources of WV Property Taxes

Sources: *Biennial Report Tax Commissioner of West Virginia and Classified Assessed Valuations*





Voters Account for Nearly 40% of WV Property Taxes

| | <u>Rural WV</u> | <u>All WV</u> |
|---------------------------------------------|------------------------|----------------------|
| Share of Tax Imposed by Voters: | 40% | 39% |
| Share of Tax Imposed by Legislature: | 35% | 34% |
| Share of Tax Imposed by County Commissions: | 24% | 23% |

Origin of Consumer Sales Tax

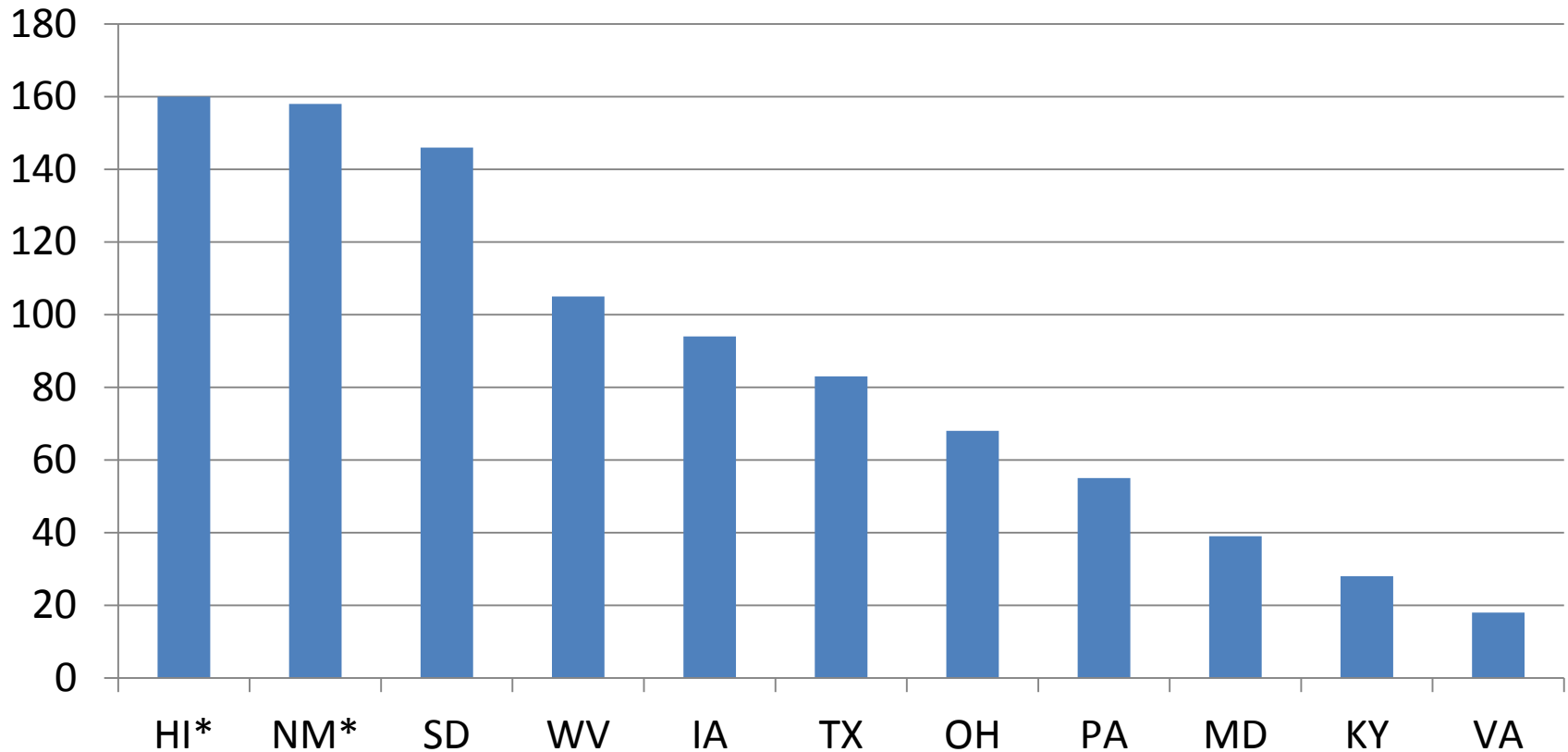
- April 1, 1934 at a rate of 2% on goods & services
- Major exemptions (sales for resale, sales to government, isolated transactions)
 - Public utility services [Electric, gas, water, telephone, transportation] (B&O Tax & Excise Tax)
 - Professional & personal services (Health Care Provider Tax in 1993)
 - Real property contracting services (contractor purchases subject to tax)
 - Gasoline (until wholesale sales tax in 1983)
 - 1937-Motor Vehicles (Motor Vehicle Sales Tax)
 - 1955-Business inputs & charitable organizations
 - 1963-Newspaper Carriers
 - 1969-Prescription Drugs with expanded definitions in 1979 and 2007
 - 1974-Day Care, advertising space
 - 1981-1989 Groceries and 2013-
 - 1987-Electronic Data Processing Services
 - 1992-Personalized Health Fitness Services
 - Digital goods not defined in tax base
- Tax rate increases
 - 3% as of July 1, 1961
 - May 31, 1981 to 5% following grocery tax exemption
 - June 1, 1988 to 6%
 - Local 1% sales tax begins October 1, 2011 (Williamstown)

Number of Services Taxed Out of 168

* Sales Tax Liability on Vendor, Not Consumer

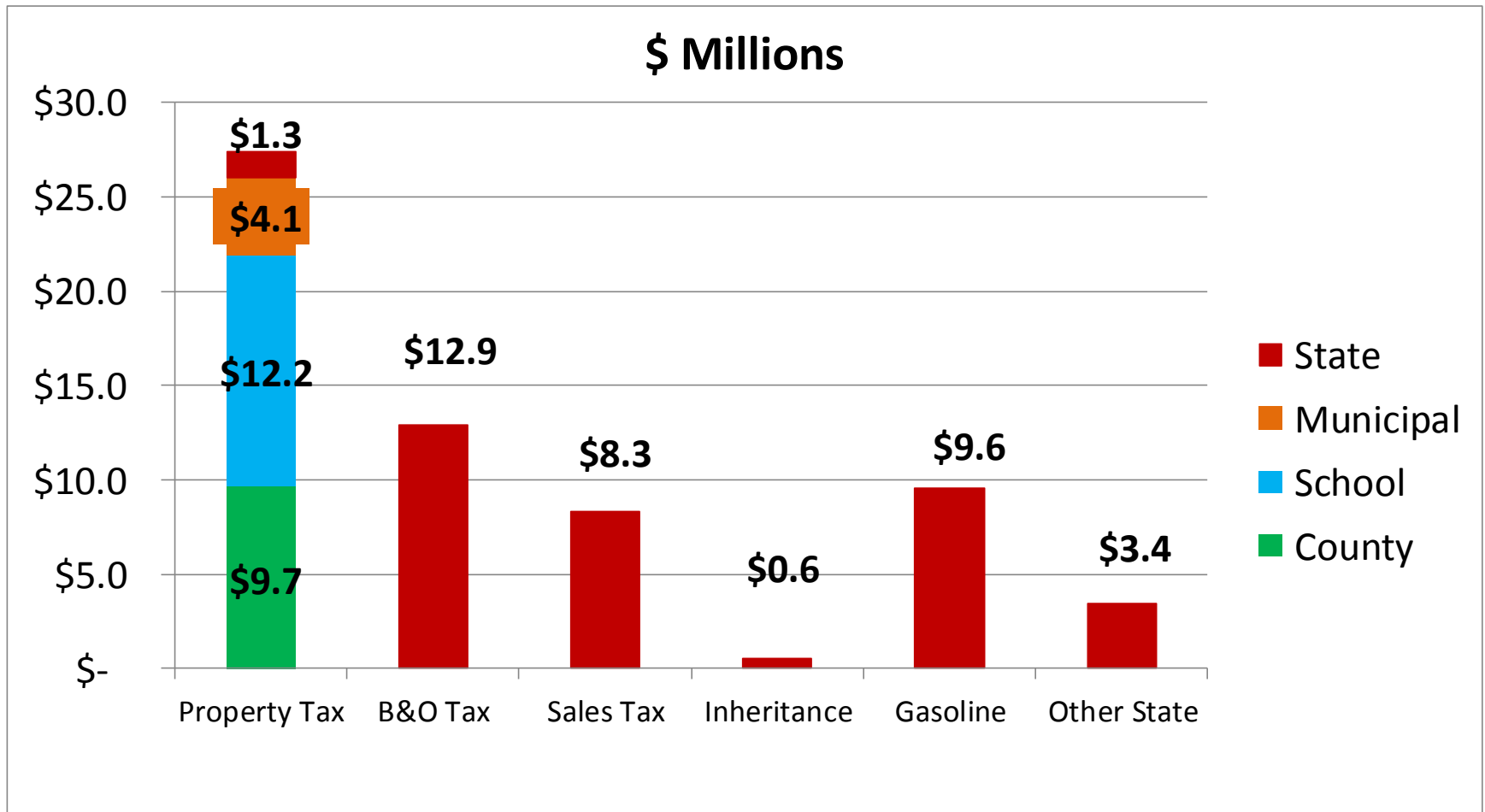
Source: Federation of Tax Administrators Survey : July 2007 Update

Taxable Services Under General Sales Tax



FY1938: Distribution of Tax Collections

Property Tax Largest Source & 40% of Revenue is Local

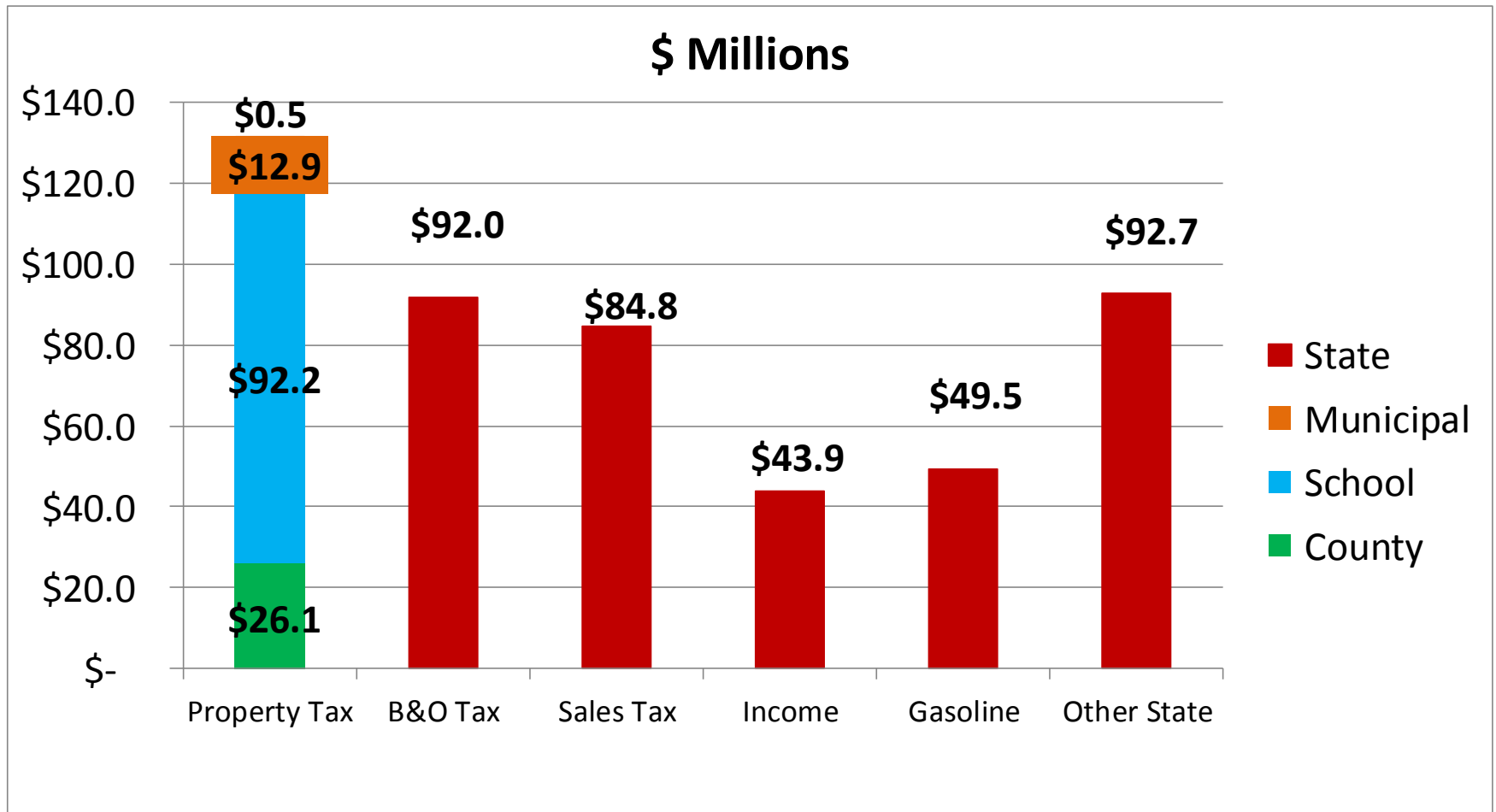


Origin of State Personal Income Tax

- 1935-1943: tax tied to Federal Income Tax
 - Graduated rates: income in excess of \$1,000/\$2,500
 - 7 rate brackets ranging from 1% to 6% on income > \$6,000
- 1961: Income Tax – Federal Adjusted Gross Income
 - 6% of federal tax liability to graduated tax on WV taxable income by 1963
 - Rate increases in 1970, 1971 & 1983
 - 1983: 17 rate brackets from 2.1% to 14.56% (\$60,000/\$120,000) & State AMT
 - Itemized deductions or \$1,000 standard deduction & \$600 personal exemption
 - 1973: \$4,000 senior citizen modification- raised to \$8,000 in 1976
 - 1974: Certain public sector pension exclusions codified
 - 1986 Federal Tax Reform: broadened base & lowered rates
 - 1987 West Virginia Tax Reform: Broadened Base and lowered rates-5 brackets [6.5% max]
 - Eliminated itemized deductions, reduced most pension exclusions
 - 1996: Low-Income Earned Income Exclusion
 - 2001: Homestead Exemption Tax Credit – doubled in 2006
 - 2009: Low-Income Family Tax Credit
 - 2010: Repealed State AMT

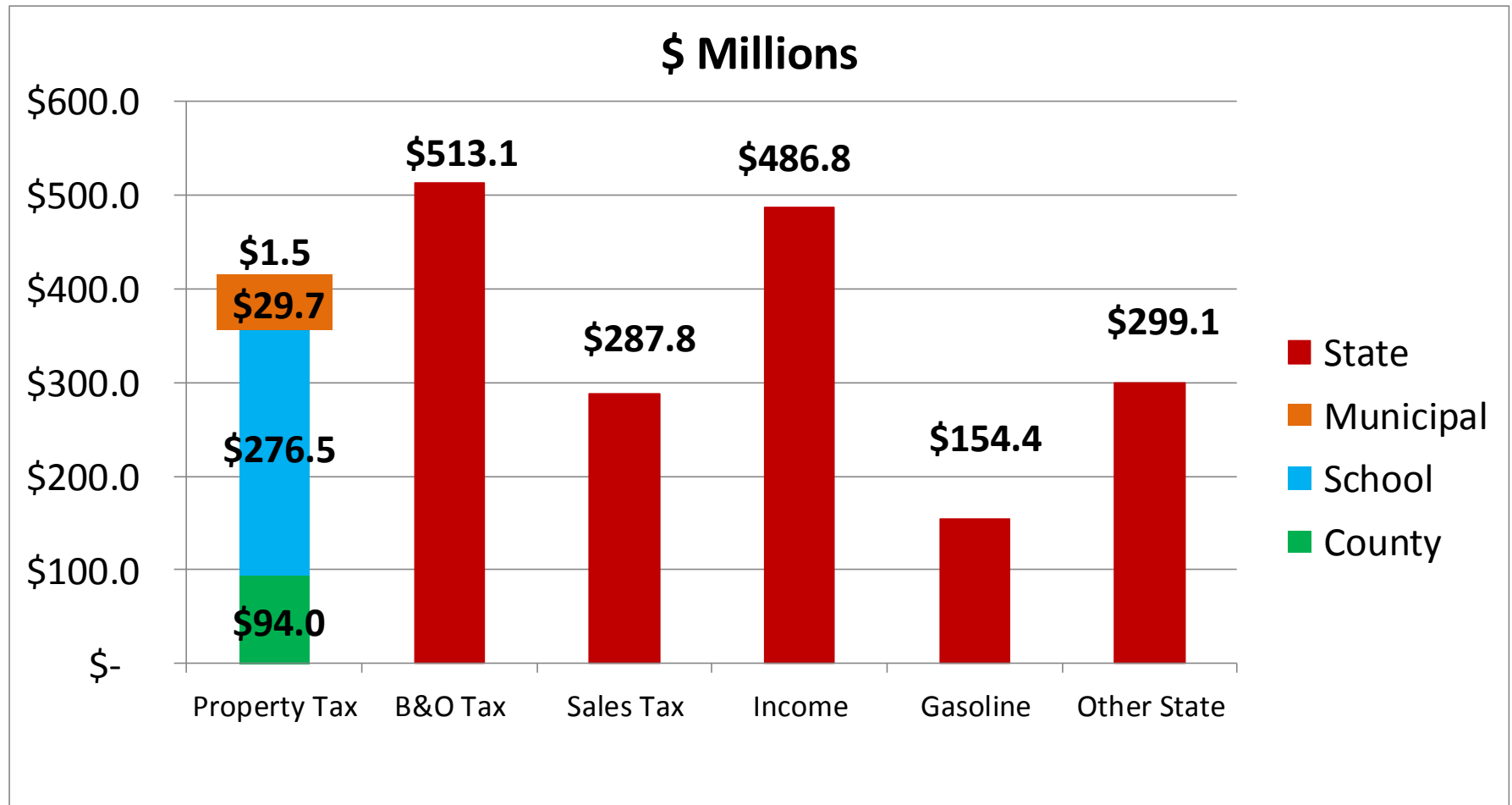
FY1970: Distribution of Tax Collections

Property Tax Largest Source & 30% of Revenue is Local



FY1986: Distribution of Tax Collections

B&O Tax Largest Source & < 25% of Revenue is Local



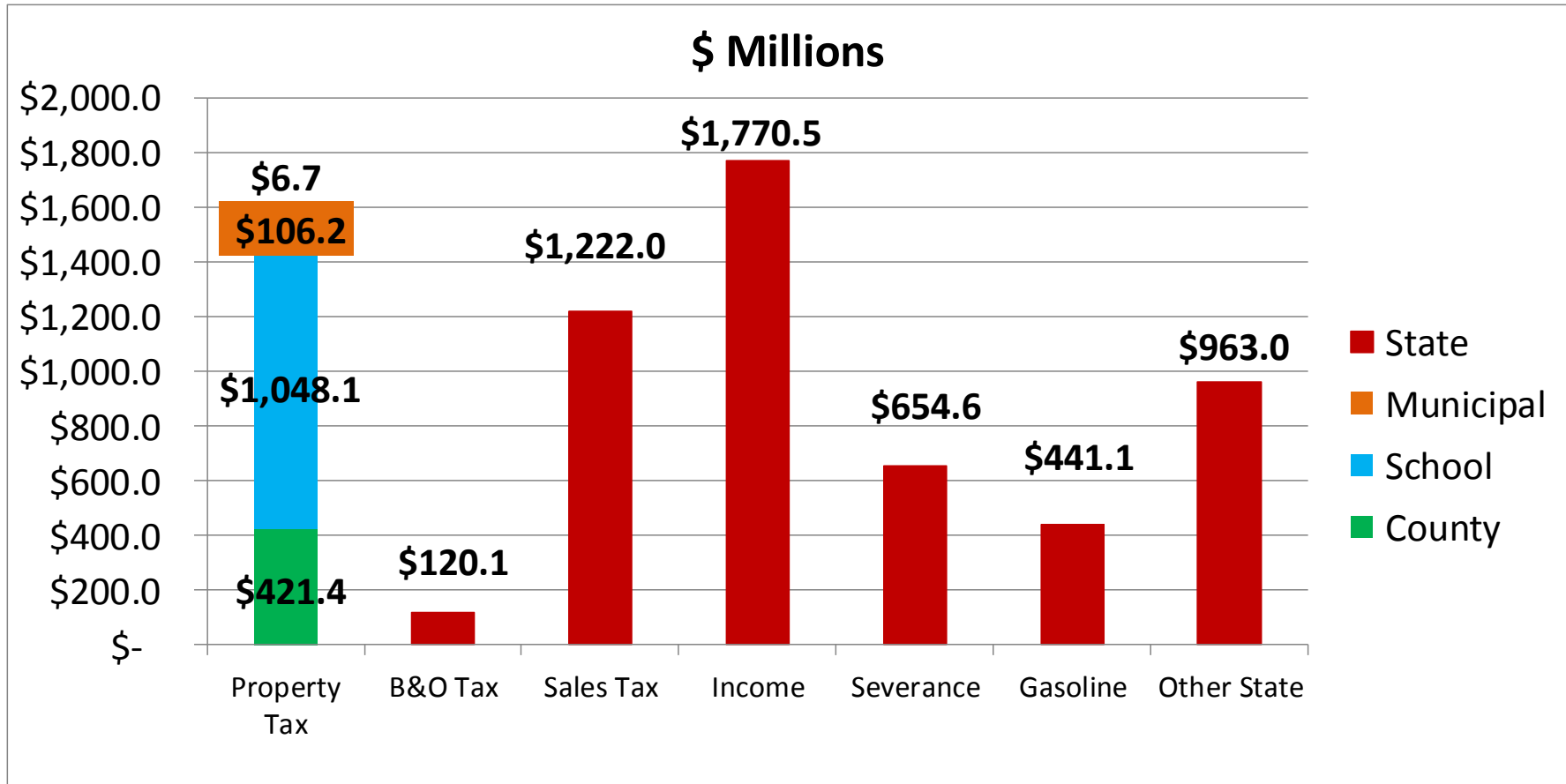
The Current System

State Tax Collections: All Funds

| | \$ Millions | \$ Millions | \$ Millions | \$ Millions | \$ Millions |
|-------------------------------------------------|----------------------------------|----------------------------------|----------------------------------|----------------------------------|------------------------------|
| | FY 2010 Actual Collections | FY 2011 Actual Collections | FY 2012 Actual Collections | FY 2013 Actual Collections | FY2014 Actual Collections |
| Source of Revenue | | | | | |
| Personal Income Tax | \$1,542.252 | \$1,688.569 | \$1,784.363 | \$1,745.567 | \$1,770.466 |
| Consumers Sales and Use Tax* | \$1,156.522 | \$1,210.253 | \$1,277.328 | \$1,255.370 | \$1,221.981 |
| State Road Fund | | | | | |
| Motor Vehicle Sales Tax (Road Fund) | \$ 148.314 | \$172.453 | \$186.293 | \$187.436 | \$194.463 |
| Motor Fuel Excise Taxes (Road Fund) | \$ 390.916 | \$397.749 | \$387.041 | \$408.915 | \$441.095 |
| License & Registration Fees (Road Fund) | \$ 87.388 | \$91.195 | \$90.683 | \$90.252 | \$97.329 |
| Highway Litter Control Fees | \$ 1.539 | \$1.912 | \$1.586 | \$1.724 | \$1.830 |
| Severance Tax* | \$ 425.161 | \$465.390 | \$491.754 | \$433.677 | \$511.685 |
| Workers' Comp Severance Tax (Special-Temporary) | \$ 91.573 | \$93.113 | \$93.947 | \$94.563 | \$109.460 |
| Mining Reclamation/DEP Fees (Special Fund) | \$ 21.120 | \$22.275 | \$20.780 | \$33.459 | \$33.498 |
| Corporate Income/ Business Franchise Tax | \$ 237.159 | \$307.278 | \$192.385 | \$242.430 | \$203.508 |
| Health Care Provider Taxes (State Share Fund) | \$ 160.306 | \$164.855 | \$168.894 | \$217.586 | \$192.363 |
| Business and Occupation Tax | \$ 133.386 | \$127.591 | \$121.031 | \$127.112 | \$120.143 |
| Insurance Tax | \$ 105.232 | \$108.640 | \$111.218 | \$114.179 | \$115.763 |
| Additional Insurance Tax (Local Pension & VFD) | \$ 37.754 | \$37.971 | \$38.262 | \$38.401 | \$38.928 |
| Tobacco Products Tax (Cigarette & Other) | \$ 114.128 | \$110.760 | \$109.609 | \$107.022 | \$101.780 |
| Solid Waste Fees (Special Revenue) | \$ 14.158 | \$16.036 | \$16.712 | \$18.583 | \$20.300 |
| Soft Drinks Excise Tax (Special Fund) | \$ 15.432 | \$16.215 | \$15.495 | \$15.039 | \$14.179 |
| Property Transfer Tax* | \$ 7.933 | \$8.108 | \$8.128 | \$8.776 | \$10.392 |
| Beer Tax and Licenses | \$ 8.435 | \$8.479 | \$8.416 | \$8.415 | \$8.302 |
| Property Tax* | \$ 5.834 | \$6.016 | \$6.051 | \$6.149 | \$6.652 |
| Business Franchise Fees | \$ 2.125 | \$2.239 | \$1.193 | \$0.692 | \$0.698 |
| Wine Liter Excise Tax | \$ 1.841 | \$1.788 | \$2.065 | \$2.108 | \$2.146 |
| Estate Tax | \$ 0.100 | \$0.000 | \$0.016 | \$0.002 | \$0.000 |
| Charter Tax | \$ 0.176 | \$0.151 | \$0.074 | \$0.062 | \$0.228 |
| Telecommunication Tax | \$ 0.076 | \$0.023 | \$0.096 | \$0.061 | (\$0.261) |
| Sub-Total | \$4,708.861 | \$5,059.057 | \$5,133.421 | \$5,157.579 | \$5,216.927 |

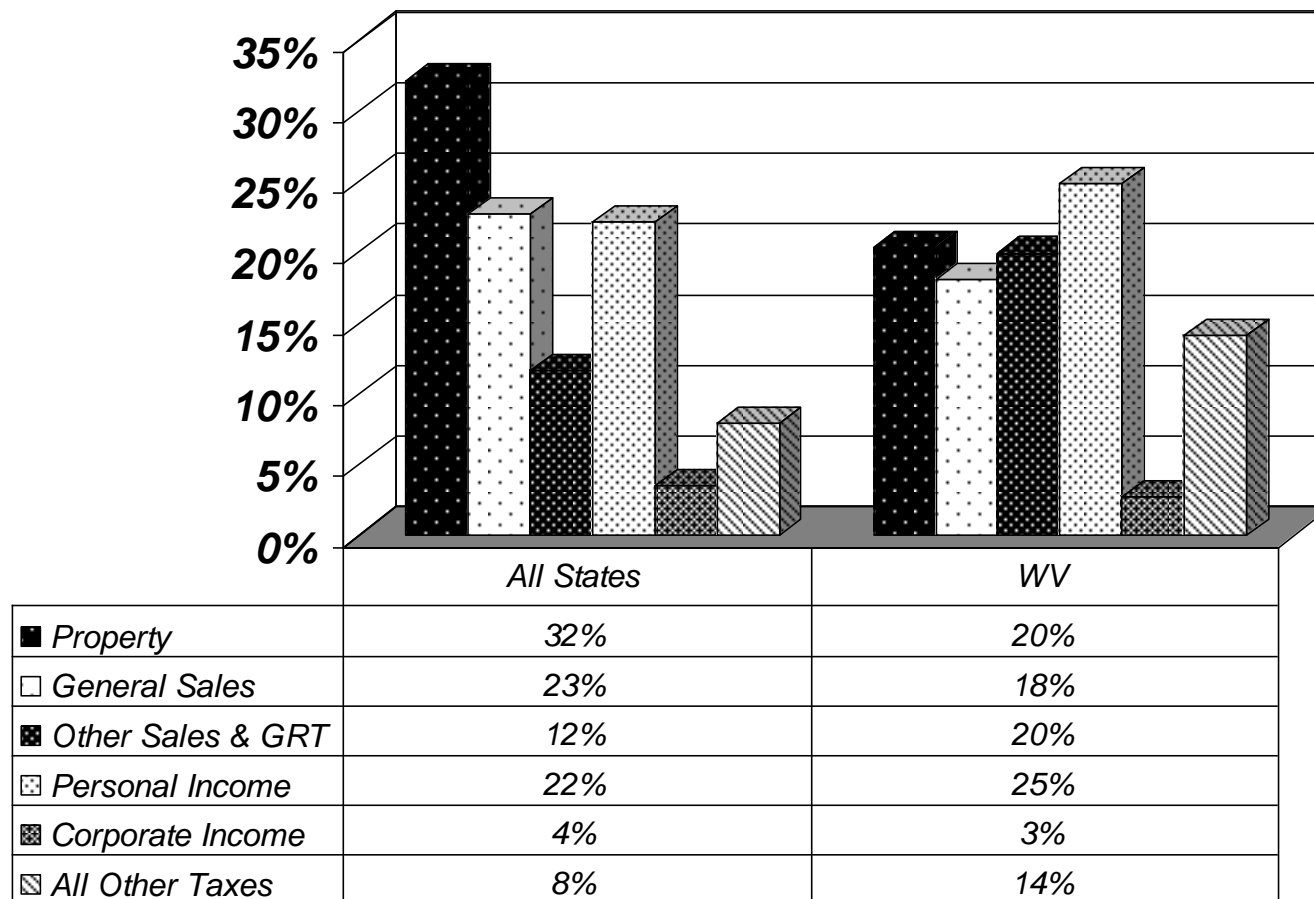
FY2014: Distribution of Tax Collections

Personal Income Tax Largest Source & 25% of Revenue is Local



Distribution of S&L Taxes by Type in FY2012

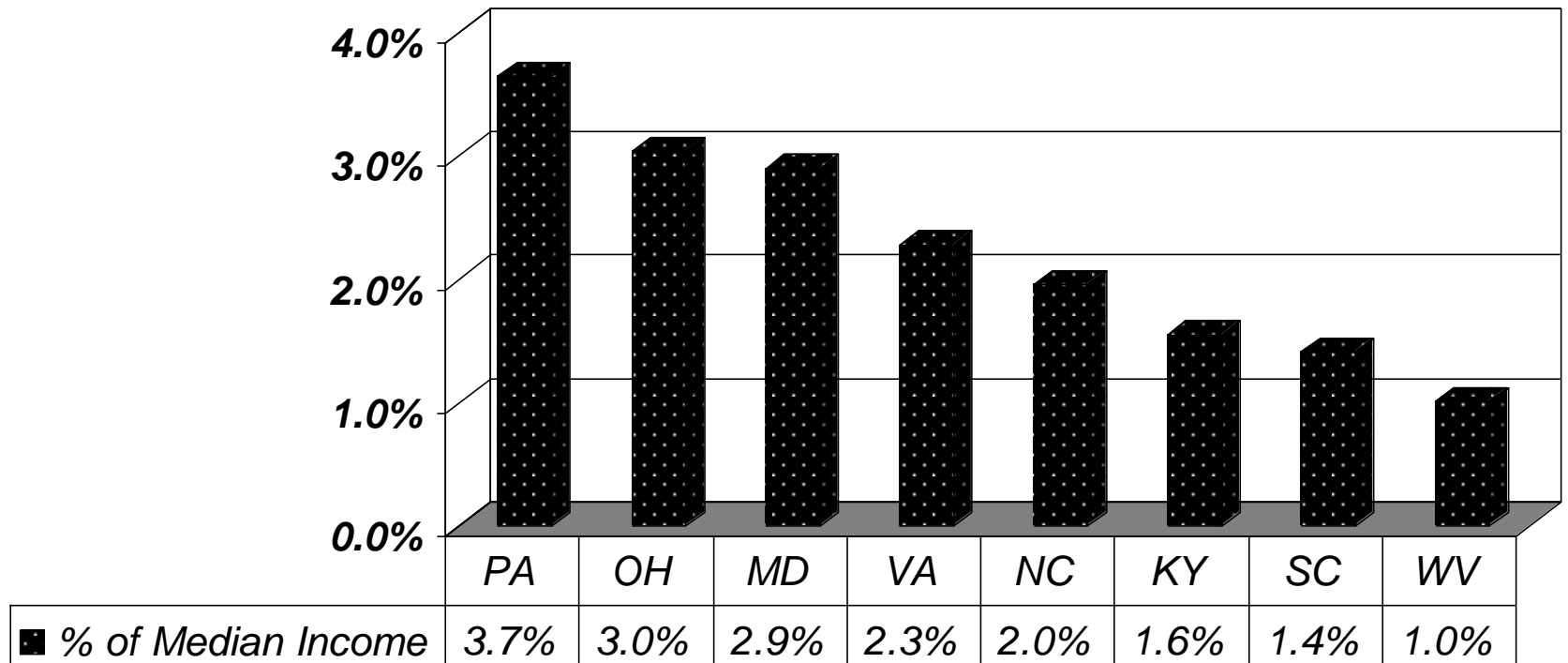
Source: U.S. Census Bureau: State and Local Government Finances



Property Taxes on Owner-Occupied Housing by State: 2006

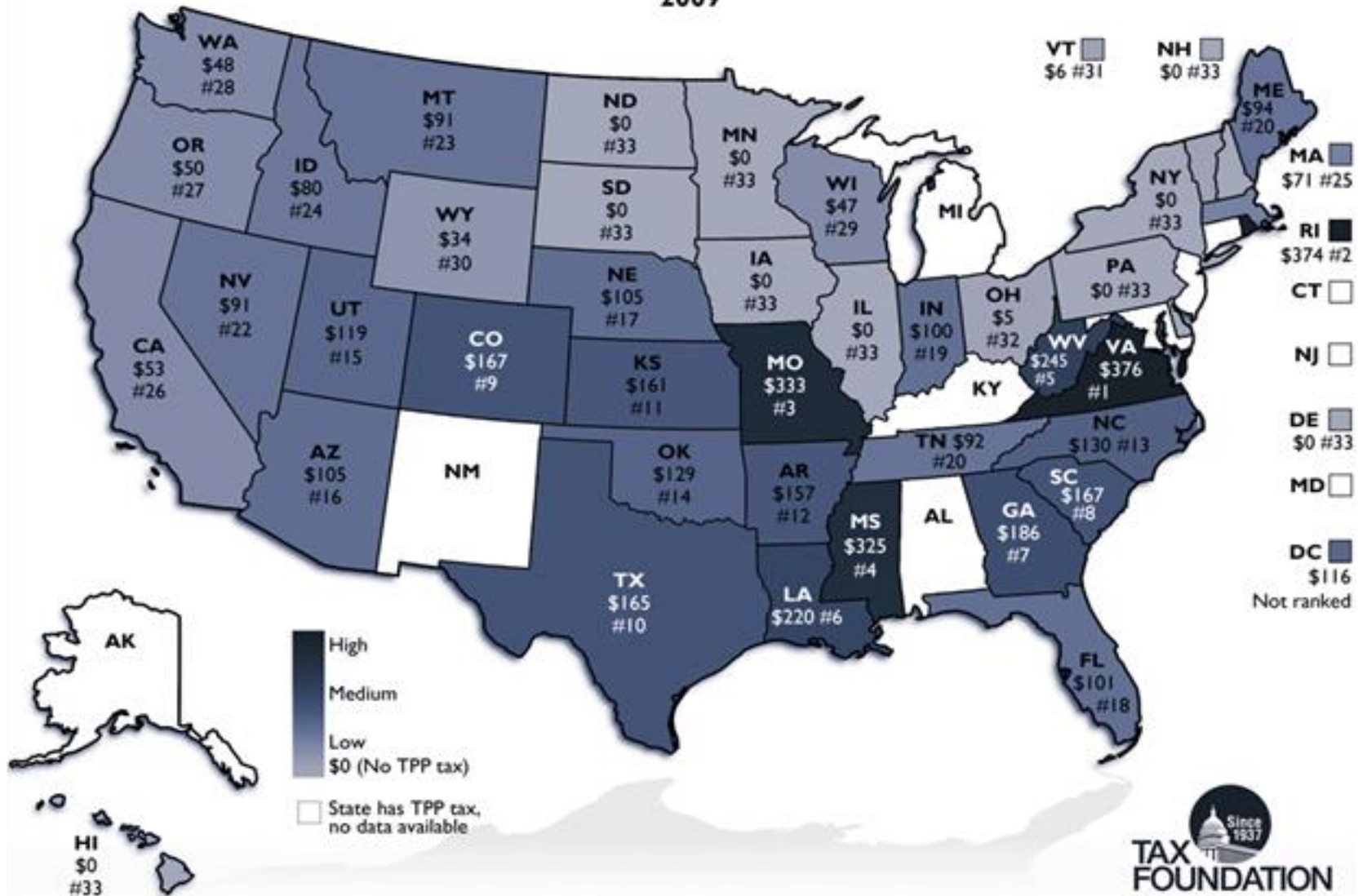
Source: Tax Foundation

Tax as % of Median Family Income



Tangible Personal Property Tax Collections Per Capita

2009

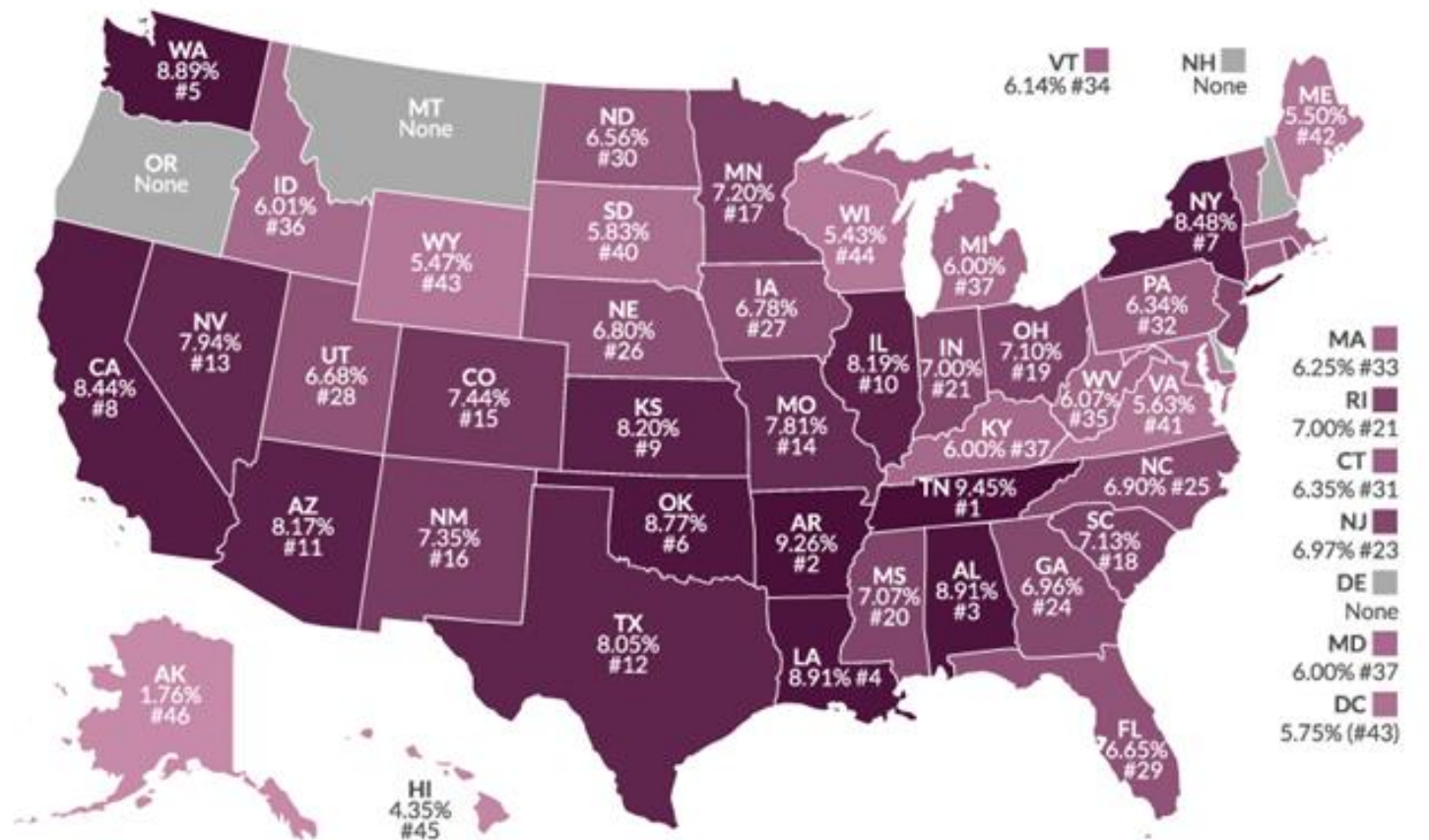


WV Business Real Property Tax Burden Relatively Low

- West Virginia ranked 12th lowest according to results of 2006 study by Ernst & Young, entitled *Property Taxes on Business Capital: Large and Growing Share of State and Local Business Taxes*
 - Tax burden measured at 29% below average for all states
- Minnesota Center for Fiscal Excellence *50 State Property Tax Study 2013* ranked West Virginia as follows:
 - Urban-Charleston: \$100,000 commercial property; tax burden was just 75% of the 50 state average and ranked 33rd
 - Urban-Charleston: \$1,000,000 commercial property; tax burden was just 74% of the 50 state average and ranked 35th
 - Rural-Elkins: \$100,000 commercial property; tax burden was just 71% of the 50 state average and ranked 32nd
 - Rural-Elkins: \$1,000,000 commercial property; tax burden was just 69% of the 50 state average and ranked 32nd
 - This study did not compare tax burden in unincorporated areas where tax burden is lower

How High Are Sales Taxes In Your State?

Combined State & Average Local Sales Tax Rates in 2015



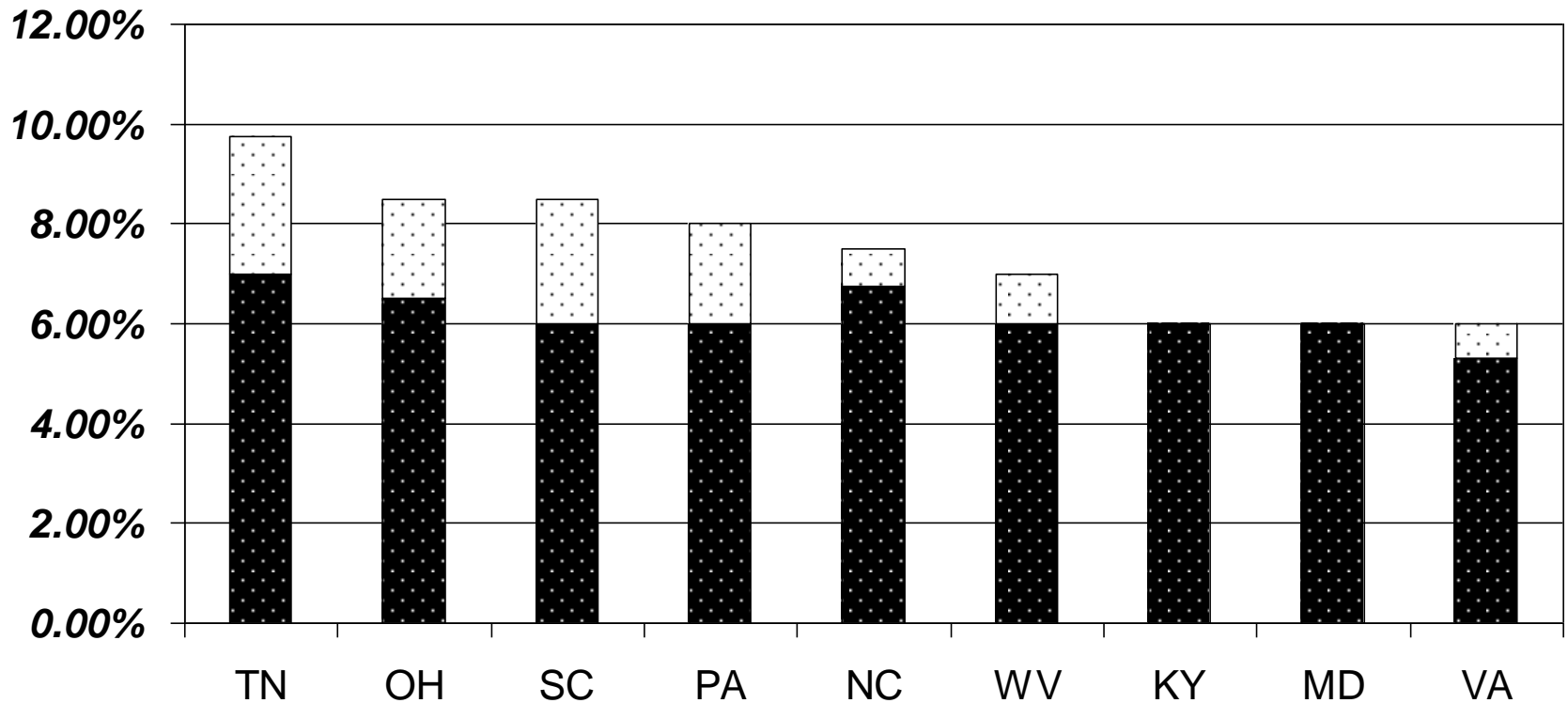
Note: Three states levy mandatory, statewide, local add-on sales taxes: CA (1%), UT (1.25%), VA (1%). We include these in their state sales tax. The sales taxes in HI, NM, and SD have broad bases that include many services. Due to data limitations, this table does not include sales taxes in local resort areas in MT. Salem County, NJ is not subject to the statewide sales tax rate of 7% and collects a total rate of 3.5%. New Jersey's average local rate is represented as a negative.

Sources: Sales Tax Clearinghouse, Tax Foundation calculations, State Revenue Department websites.

State and Local Sales Tax Rates: 2015

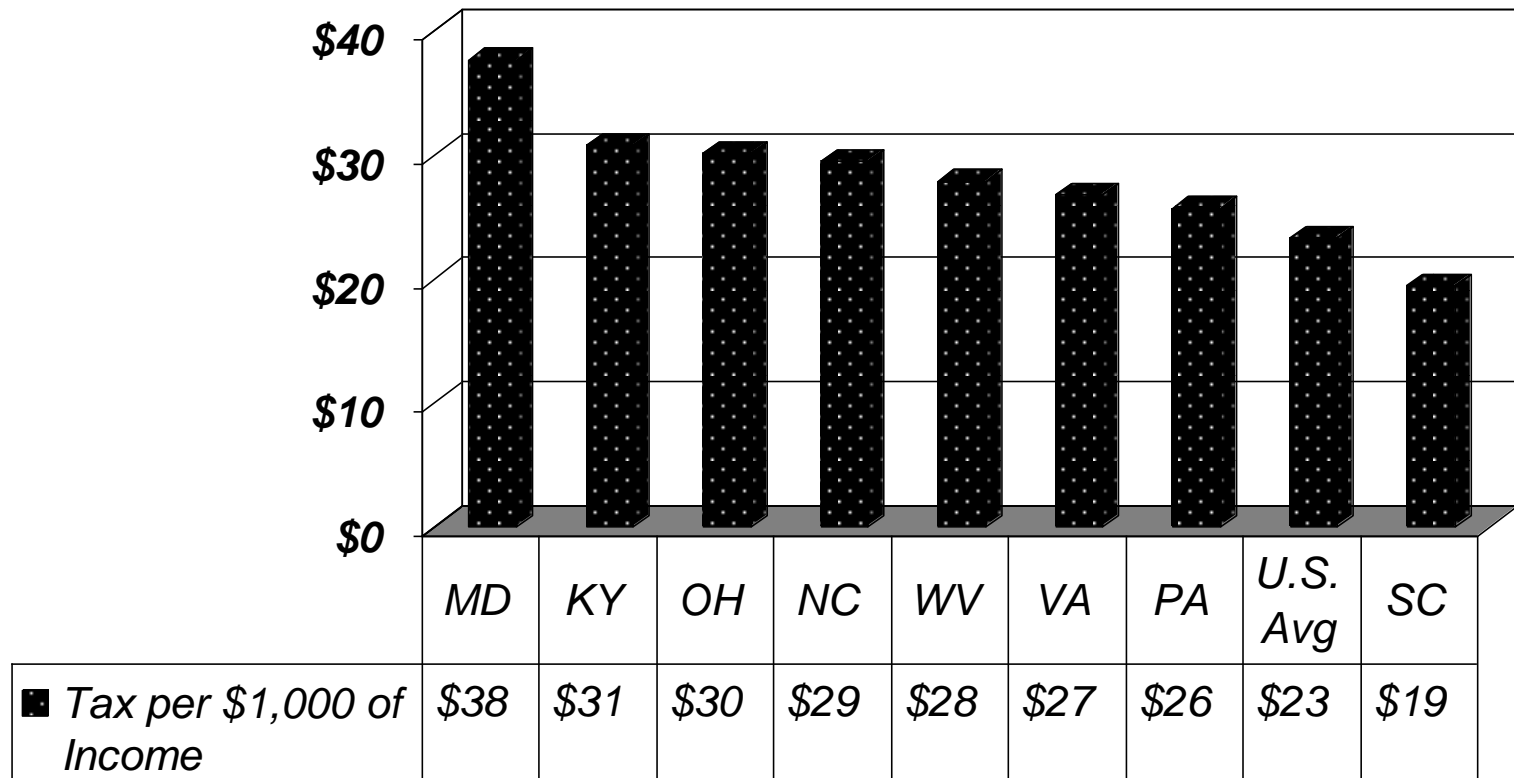
Source: Individual State Web Sites

Minimum & Maximum Tax Rates



State and Local Personal Income Tax Burden Per \$1,000 of State Personal Income: FY2012

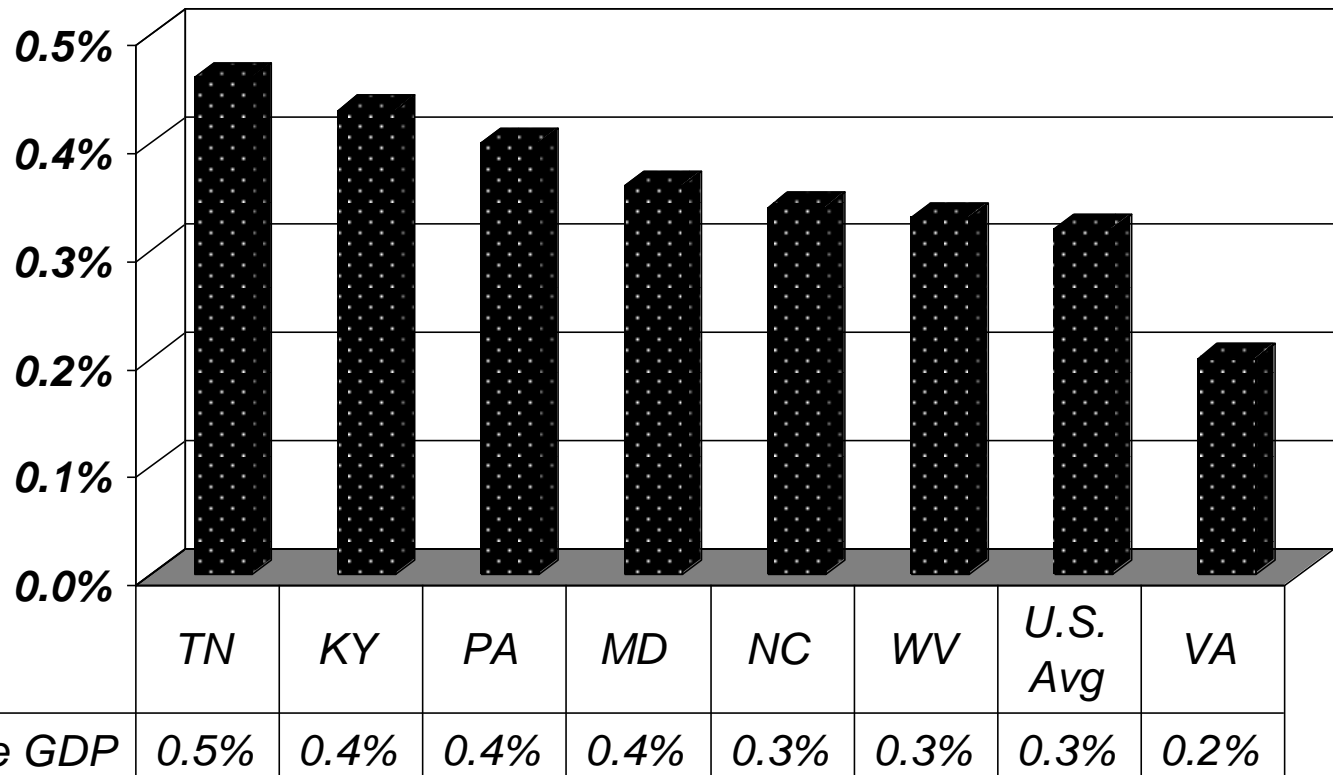
Source: U.S. Census Bureau, State and Local Government Finances & BEA



Corporate Taxes as a Percent of Private Sector Gross Domestic Product: FY2014

Source: U.S. Census Bureau, State Government Tax Collections 2014 and Bureau of Economic Analysis GDP 2013

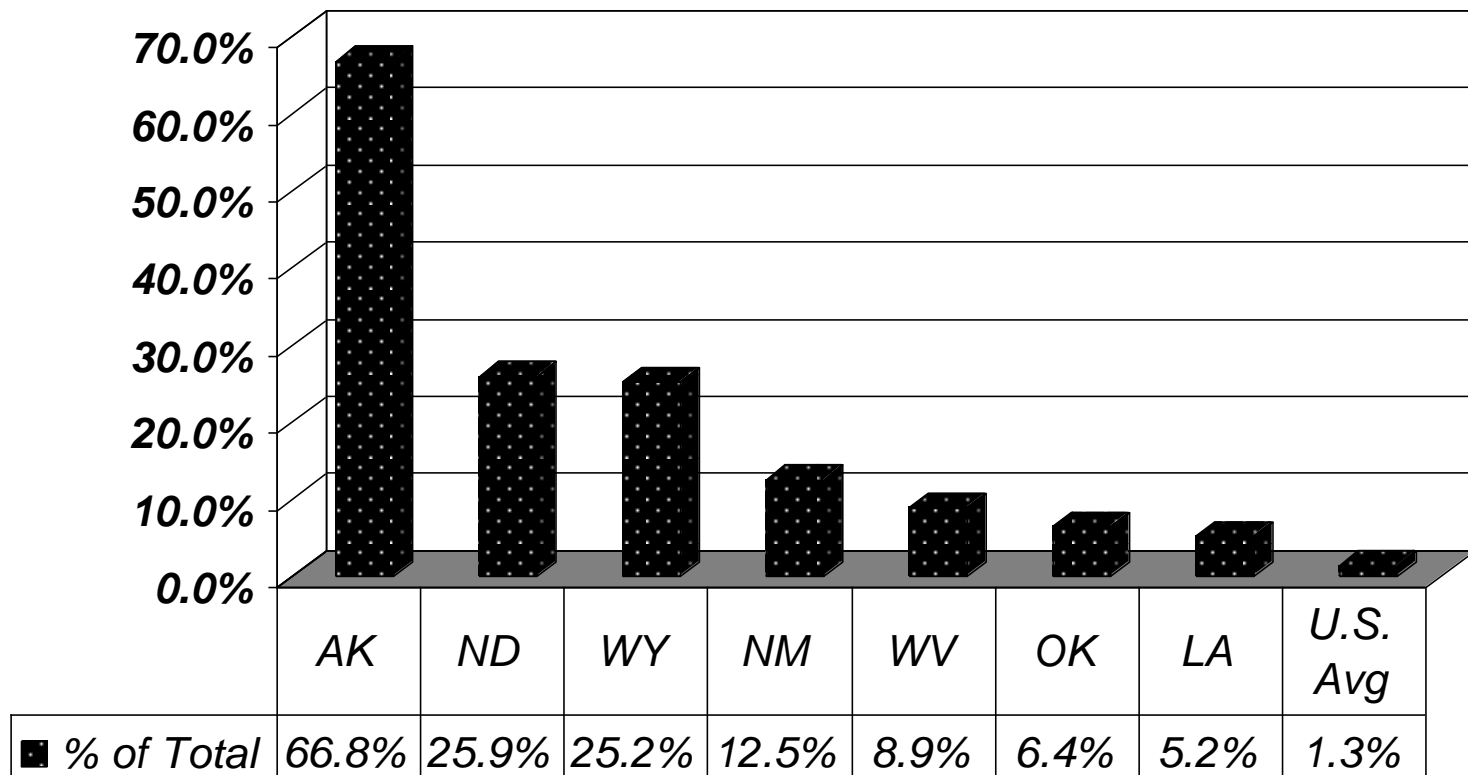
Tax as % of Private Industry GSP



Severance Taxes as a Share of Total State & Local Tax Collections: FY2012

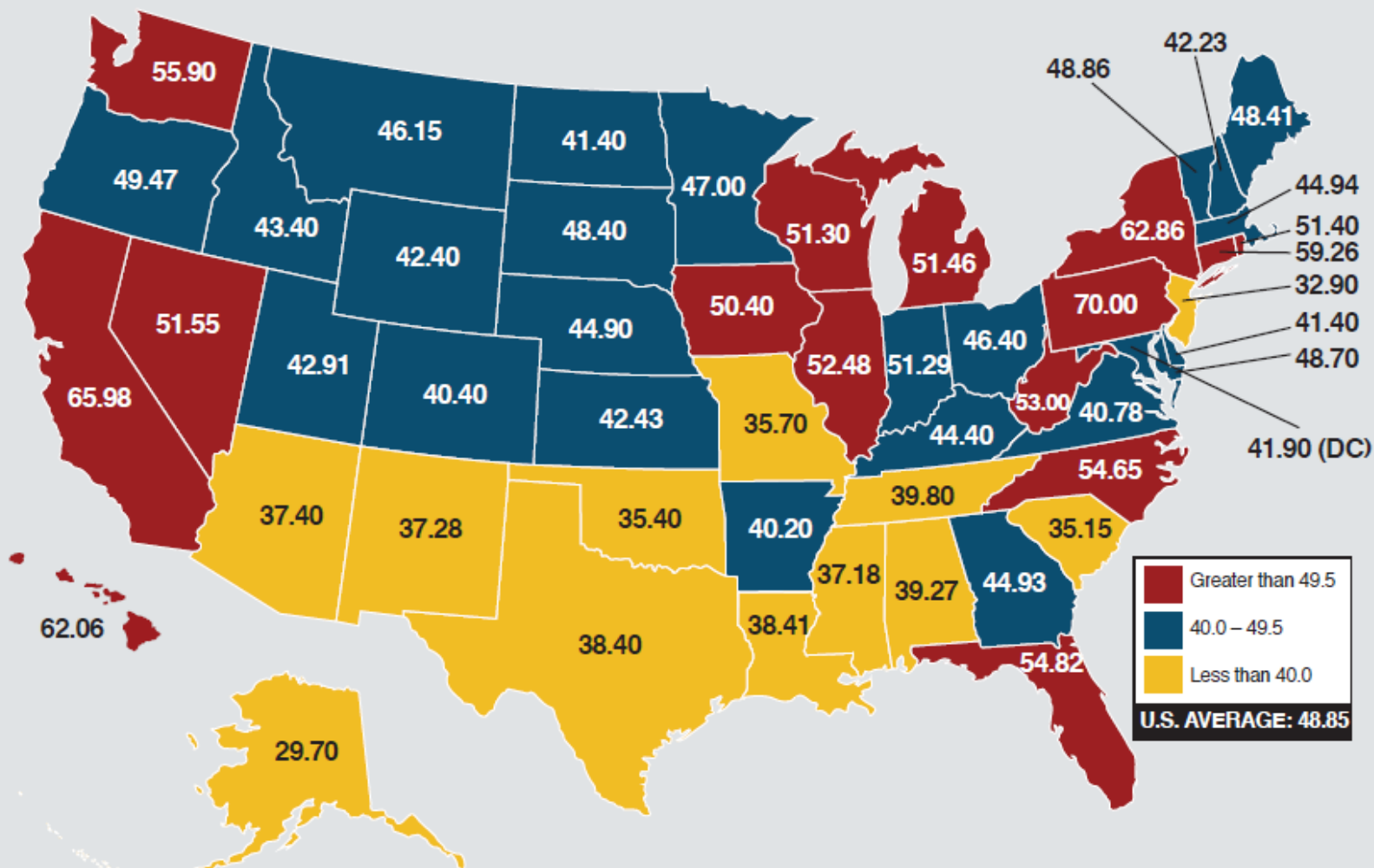
Source: U.S. Census Bureau, State Government Tax Collections and State and Local Government Finances 2012

Severance Tax as Share of Total Tax Collections



GASOLINE TAXES

COMBINED LOCAL, STATE AND FEDERAL (CENTS PER GALLON)
RATES EFFECTIVE 4/01/2015



West Virginia Tax Structure Overview

25% of taxes imposed by local governments [31st in per capita tax burden]

| <u>Tax Type</u> | <u>Share</u> | <u>Per Capita</u> | <u>Average Tax (\$130K Household)</u> |
|-----------------|--------------|-------------------|---------------------------------------|
| Property | 20% | \$ 774 (45) | \$1,560 (50) [1.2% income] |
| Income: | 25% | \$ 946 (26) | \$7,472 (11) [5.8% income] |
| CNIT-Franchise: | 3% | \$ 104 (34) | |
| Sales: | 18% | \$ 689 (44) | |
| Other Sales/GR | 20% | \$ 755 (6) | |
| Other: | 14% | \$ 536 (8) | |

Other Tax Information

| | |
|----------------------------------------|-----------------|
| Average Sales Tax Rate: | 6.07% (35) |
| Number of services taxed (FTA): | 105 (6) |
| Motor Fuel Tax (API): | \$0.346 (9) |
| Centralization (State tax share @75%): | 6 th |



Sources: U.S. Census Bureau (FY2011-2012), Tax Foundation, Internal Revenue Service, FTA, API

W E S T V I R G I N I A



DEPARTMENT OF REVENUE

Questions?

W E S T V I R G I N I A



DEPARTMENT OF REVENUE

Joint Select Committee on Tax Reform Historical Review of Tax Reform Studies

DEPUTY REVENUE SECRETARY MARK B. MUCHOW

West Virginia State Capitol

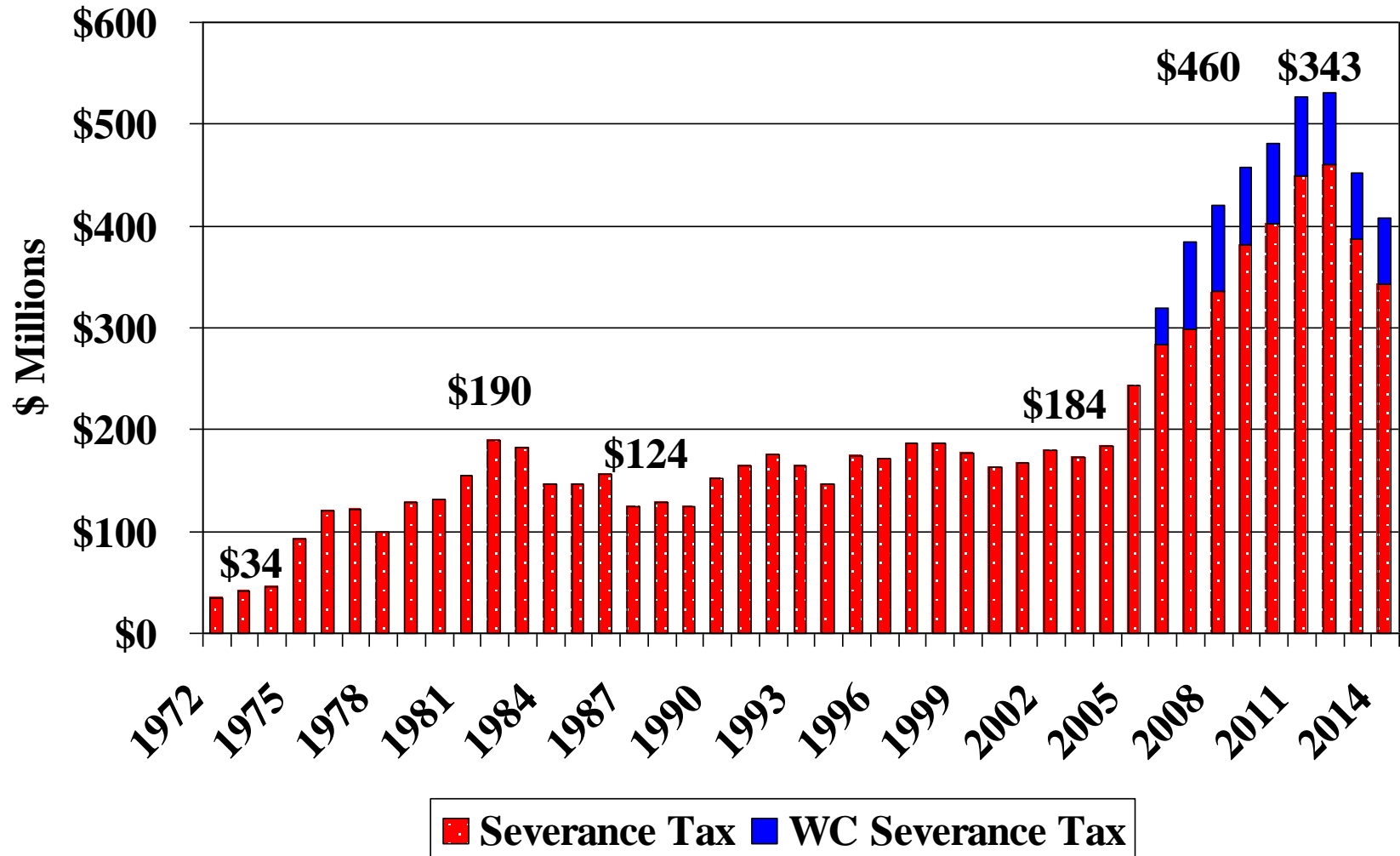
May 4, 2015

Historical Events Shape Tax System

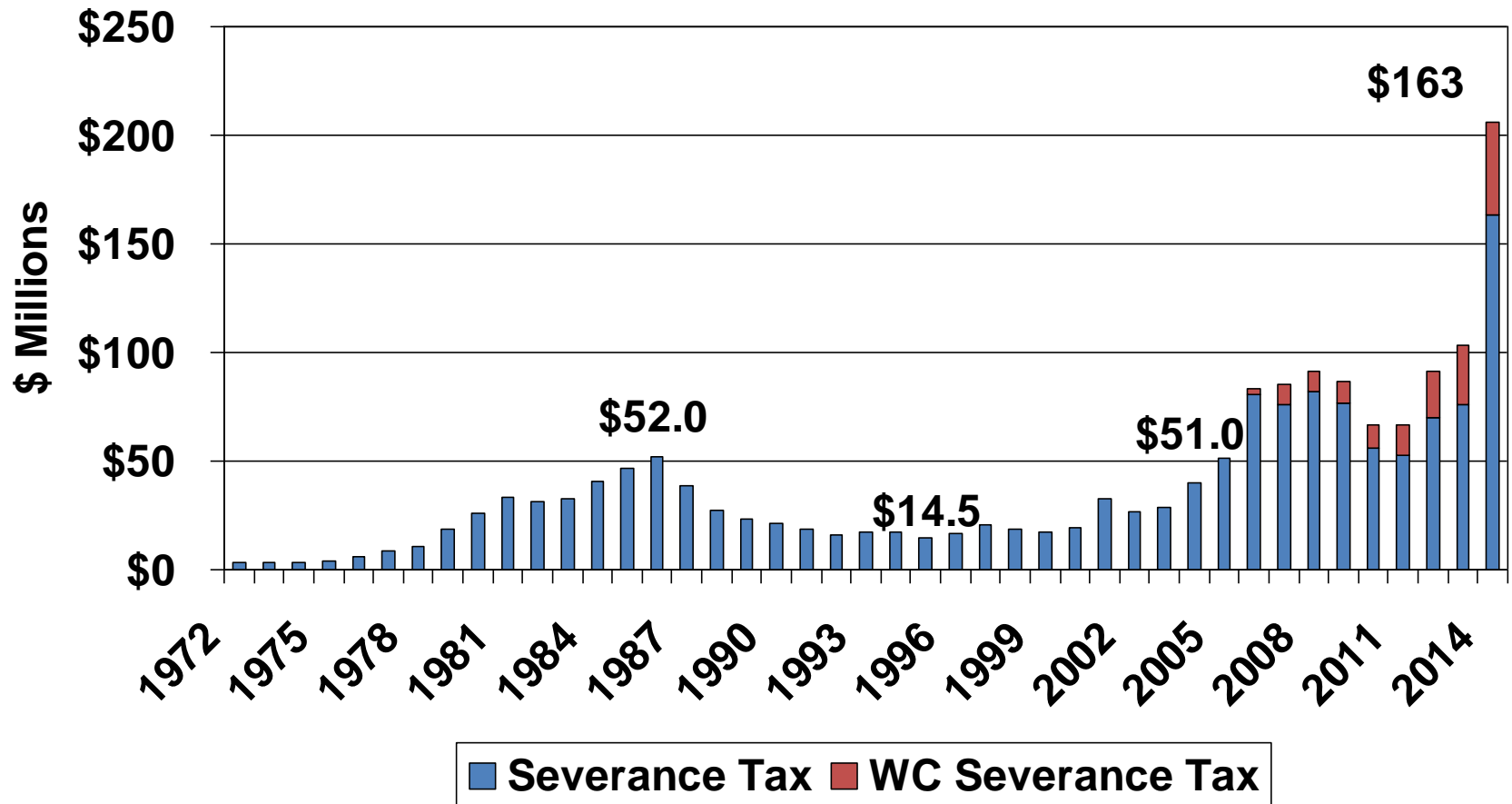
- Prohibition: (WV goes Dry in 1914: New Tax System)
 - Move to State consumption taxes (B&O and gasoline)
- Great Depression of the 1930s
 - Property Tax Revolt (Move toward government centralization)
 - Move to more State consumption taxation (Sales Tax and more)
 - Roads transferred from counties to State
- Educating Baby Boomers in 1960s:
 - Higher sales tax rates
 - Introduction of personal income tax and corporate income tax
- 1970s Energy Boom Followed by Bust in 1980s
 - Significant growth in B&O taxes due to energy and inflation
 - Removal of sales tax on groceries and increase in tax rate
 - Shift from consumption tax (B&O) to income taxes
 - Reinstatement of grocery tax and higher sales tax rate
- 2000s Energy Boom Followed by Recent Downturn
 - Removal of sales tax on groceries
 - Repeal of a number of taxes and other tax relief
 - Record levels of severance tax collection

WV Coal Severance Tax Collections

By Fiscal Year 1972-2014



WV Natural Gas Severance Tax Collections by Fiscal Year 1972-2014



Major Tax Changes in 1985-87

West Virginia Tax Study Commission: A Tax Study For West Virginia In The 1980's
Federal Tax Reform Act

- 1985: Repeal of Inheritance Tax (Estate Tax)
- 1987: Implementation of Business Tax Reform Act of 1985
 - Elimination of B&O Tax as a broad business tax in favor of income base
 - Corporation Net Income Tax base broadened with rate increase from 7% to 9.75%
 - Creation of secondary Business Franchise Tax at rate of 0.55%
 - Mining Industry subject to Severance Tax with rates converging to 4%
 - Electric Power Generation Industry & Public Utilities continue with B&O Tax
 - Informational Tax Returns to be filed for two years reflecting TY1984 & TY1985
 - Elimination of Carrier Income Tax; Telecommunications Tax replacement
- 1987: Personal Income Tax Reform Act
 - State response to 1986 Federal Tax Reform Act
 - Broaden the base & lower tax rates
 - Give back windfall to Taxpayers

Executive & Legislative Disagree on Tax Reform

- Tax Study Commission Created by West Virginia Legislature in 1982
 - Paul Volcker appointed Chairman of Federal Reserve Board-High Interest Rate Medicine
 - 1980-82 Severe National Recession-Transition to Lower Inflation
 - West Virginia enters Recession later in 1982-83
- 1984: Election of Governor Moore – Party Switch
 - Governor has Own Agenda
 - Economic Development Incentives to stimulate economy – Super Tax Credit – Saturn Plant
 - Research & Development, Capital Company, Residential Housing Development, Enterprise Zones
 - Tax Study Commission: “No more need for economic development tax credits after tax reform”
 - A number of tax reform recommendations adopted [Reorganization of Tax Department; Repeal of Inheritance Tax, Freeport Amendment]
- 1984-1988: Economy Weak and Energy Prices Falling
- Governor Wishes to Delay Implementation of Tax Reform; Legislature Disagrees
 - Tax Department measures significant gap & growing gap in revenues under Tax Reform Plan
 - Personal Income Tax: Give back windfall to Taxpayers
 - 1985 Business Tax Reform Act tweaked before implementation (e.g., Telecommunications Tax)
 - General Revenues fall by more than 7.5% between FY1987 and FY1988 (\$115 million)

Major Tax Changes in 1988-93

Numerous Tax Changes to Close Gap, Provide Funding for Roads & Legacy Costs

- 1988: Sales tax rate increased from 5% to 6% & \$50 million state loan for bills
 - Unpaid tax refunds carried over to future fiscal year rise significantly
- March 1, 1989: Fiscal Responsibility Act (Governor Caperton) : \$400 million
 - Increased Gasoline Excise Tax rate from 10.5 cents per gallon to 15.5 cents
 - 6% Sales Tax rate made permanent
 - Sales Tax base broadened to include groceries, purchases by contractors, and some business inputs
 - Business Franchise Tax Rate increased from 0.55% to 0.75% & severance tax offset credit ends
 - Severance Tax rates increase from 4% to 5%
 - New B&O Tax on gas storage facilities
 - B&O Tax on electric power restructured from a gross receipts tax to a kilowatt-hour tax
- 1990: B&O Tax rate increase, Sales Tax change-Gov't Contracts, Super Credit Change
- 1991: HCP Medicaid Tax [January 1992-May 31, 1993]
- 1993: Health Care Provider Taxes replace Medicaid Tax
 - Gasoline Tax Rate increased to 20.5 cents;
 - Additional Super Credit Changes

Period of Relative Tax Stability:1994-2004

- Period of Significant Expansion of Lottery Programs and revenues
- 1995: Kilowatt-hour tax converted to tax on taxable capacity
- 1996: Low-Income Exclusion added to Personal Income Tax
- 1997: Business Franchise Tax rate reduced to 0.7%
- 1997-1999: Governor Underwood's Commission on Fair Taxation
 - Final report issued in September 2009
 - No action taken prior to 2000 General Election
- 2001: 10-year phase-out of certain health care provider taxes begins
- 2001-02: Analysis and Recommendations for West Virginia Tax Incentives
- 2001-03: Medical Malpractice Reform & Tax Credits
- 2002: OTP tax created with 7% rate & Tax Credit Reform Legislation
- 2002: Estate Tax scheduled for repeal when federal death tax credit expires in 2005
- 2003: Cigarette Tax rate increased from 17 cents per pack to 55 cents per pack

Major Tax Changes Since 2005

Some Increases But More Decreases:

Energy Price Boom & Excess Lottery Revenues

- 2005: December 1, 2005: Workers' Compensation Severance Tax
- 2006: January 1, 2006 - Grocery Tax Phase-Out Begins (\$170 million)
- 2007: Business Franchise Tax rate reduced to 0.55% & Corporate Tax rate to 8.75%
- 2007-2009: Combined reporting enacted in 2007 and refined in 2008 to take effect in 2009
 - Phase-out of Business Franchise Tax between 2009 & 2015
 - Phase-down of Corporation Net Income Tax rate from 8.75% to 6.5% from 2009-2013
 - Expanded tax credits for manufacturing, including inventory tax credit
- Other significant tax changes:
 - 2007: Low Income Tax Credits (Family Tax Credit & Doubling Homestead)
 - 2007: Expansion of prescription drug exemption
 - 2007: Expansion of Pass-through Sales Tax Exemption for Contractors
 - 2008: Repeal Corporate Charter Tax
 - 2010: Repeal State AMT – Personal Income Tax
 - 2011-12: Elimination of business registration renewal fees

Centralized Government Responsibility Limits Reform Options

- Successful long-term tax reduction at the State level often depends on some shift of government responsibility down to the local level
- In West Virginia, government responsibilities continue to migrate from the local level to the State level
- K-12 Education is a local responsibility in most states with some aid from State government; In WV, it is a State responsibility with some local government support.

Conclusions

- States reduce taxes during periods of budget surplus and raise taxes during periods of revenue downturn
- Coal industry fortune (natural gas industry) has significant impact on direction of tax policy
- Tax reform is rarely revenue neutral
- Economic gains often associated with government stability
- Measured tax changes may be better than dramatic wholesale change
- The balance budget requirement restricts state policy changes
- The share of funding responsibility at the local level a key to degree of State tax reform