

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



# DEPARTMENT OF REVENUE

## Joint Select Committee on Tax Reform Income Taxes

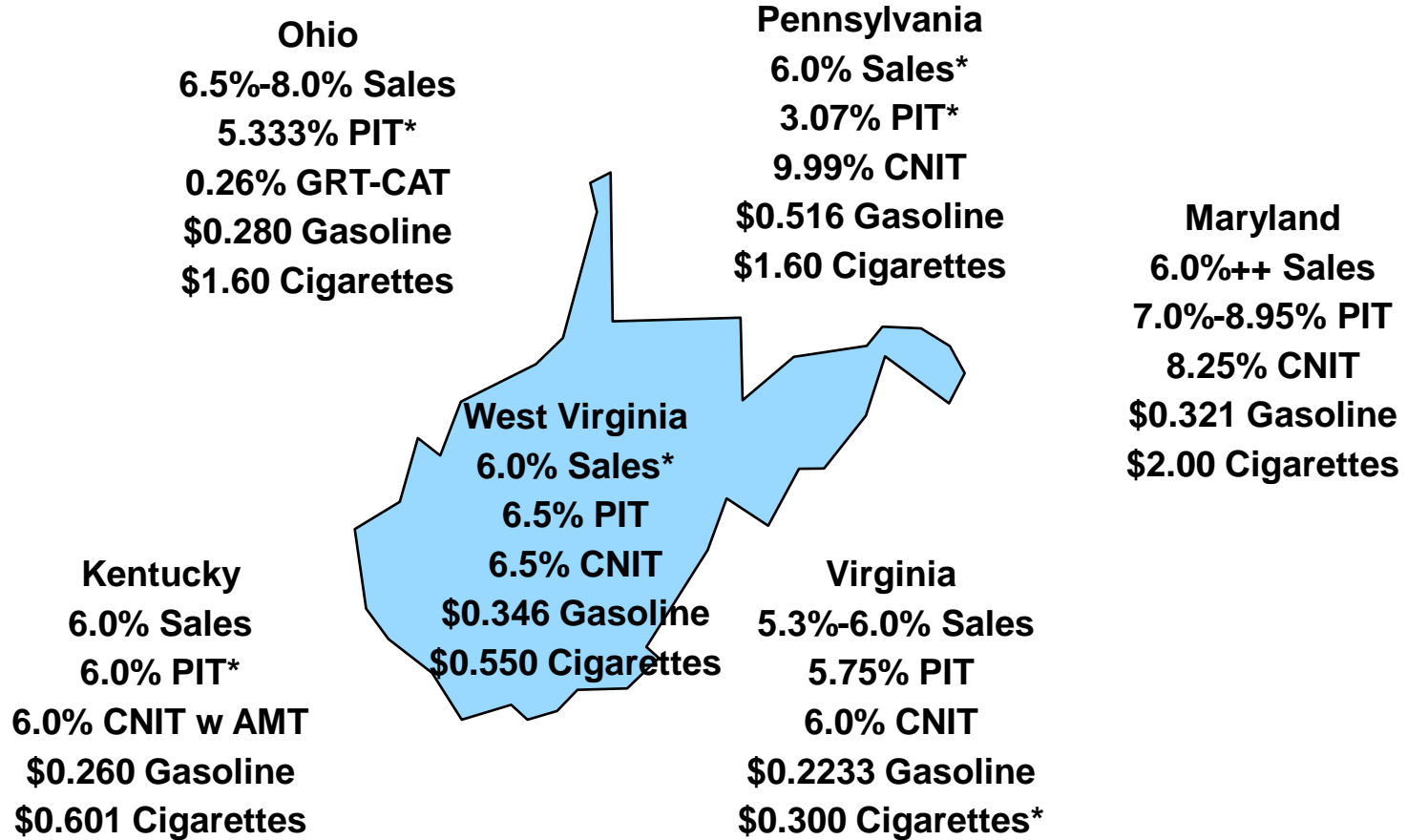
DEPUTY REVENUE SECRETARY MARK B. MUCHOW  
GENERAL COUNSEL MARK S. MORTON

West Virginia State Capitol  
August 17, 2015

# COMPARATIVE TAX RATES

As of July 1, 2015

\* Additional local taxes may apply



# Personal Income Tax

# West Virginia Personal Income Tax Structure

More Than \$1.932 Billion Yield in FY2015

- **Linked to Federal definitions for tax base**
  - **WV link is Federal Adjusted Gross Income (AGI)**
    - More than \$36.6 billion on full-year resident returns in TY2012
    - More than 762,000 full-year resident returns filed
    - Roughly 69,000 part-year or non-resident returns filed
  - 29 states and DC use Federal AGI as starting point
  - 7 states: Federal Taxable Income link (CO, ID, MN, OR, SC, VT)
  - 5 states: Independent (AL, AR, MS, NJ, PA)
  - 0 states start with Federal Income Tax Liability
  - 2 states have limited interest & dividends tax base (NH and TN)
  - 7 states: no personal income tax (AK, FL, NV, SD, TX, WA, WY)

# Increasing Modifications

Roughly \$100 million added: Full-Year Resident Returns

- Federal obligation interest/dividends not exempt from state tax
- Interest or dividend income on non-WV state and local bonds
  - Largest source of additions for non-resident returns
- Interest on money borrowed to purchase tax exempt bonds
- Qualifying 402(e) lump-sum distributions
- Section 199 Deduction for U.S. Production Activities
  - Federal return statistics indicate more than \$21.7 million for WV on 1,340 returns
- Withdrawals from a WV Pre-paid Tuition/SMART 529 Savings Plan not used for qualifying expenses
  - Roughly \$0.6 million added

# Decreasing Modifications

Roughly \$1.4 Billion subtracted on resident returns

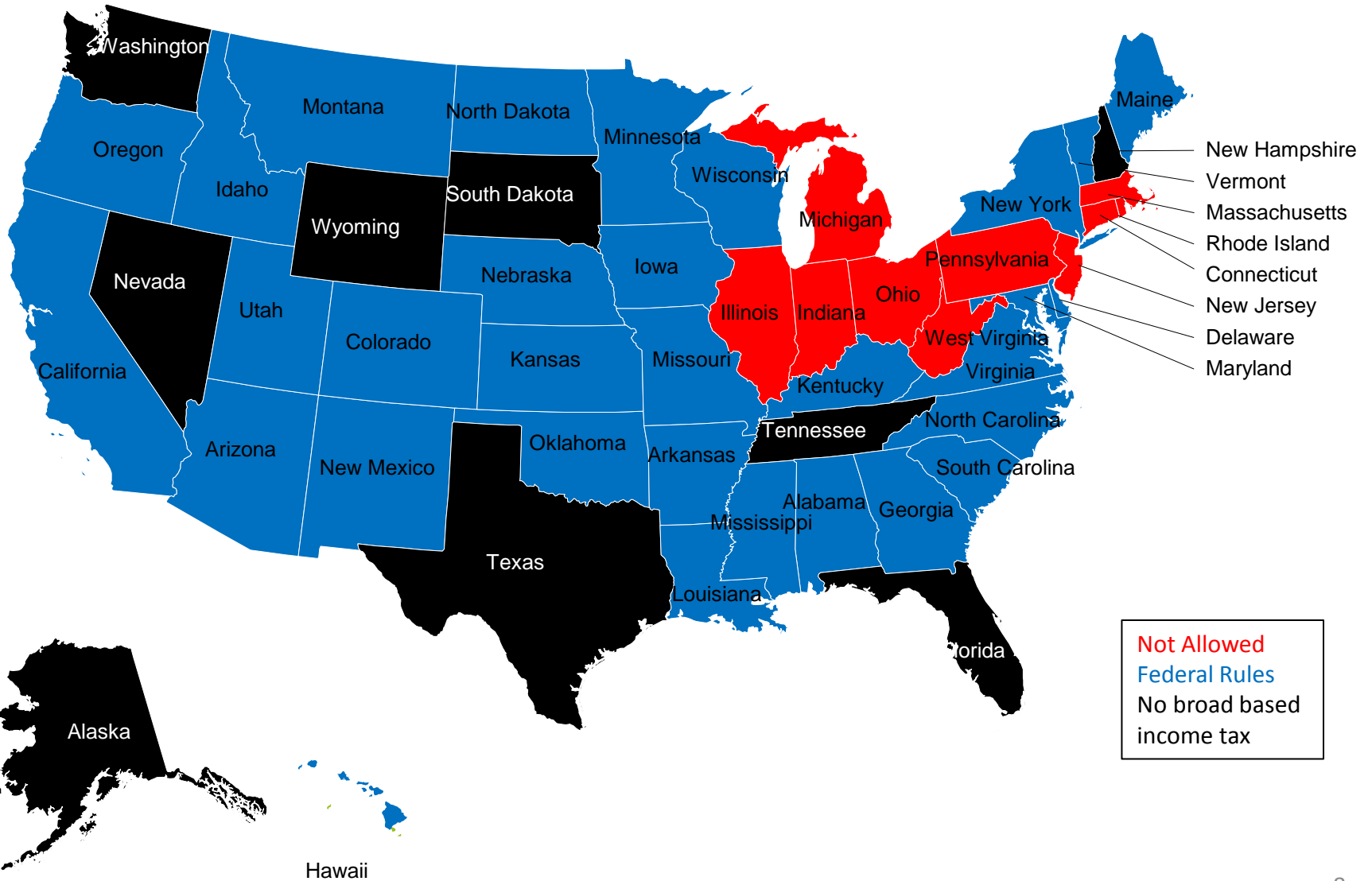
- U.S. obligation interest/dividends & WV Obligations exempt from state tax but not federal tax
- Refunds of State & Local Taxes Reported on Federal Tax Return
- Federally required: Income from Railroad Retirement Board
- Contributions to WV Pre-paid Tuition /SMART529 Savings Plans
- Long-Term Care Insurance Premiums
- Contributions to State Medical Savings Accounts up to \$2,000
- EZ Pass (PAC) Toll Fees of at least \$25 but no more than \$1,200
- Autism Trust Fund contributions up to a maximum of \$1,000 (\$2,000 joint)
- Active duty military pay during year of separation from active service & active duty pay for National Guard or armed forces reserve pursuant to Executive Order of President in Operation Enduring Freedom or for domestic security

# Decreasing Modifications Continued

Roughly \$1.4 Billion subtracted on resident returns

- Benefits received from any WV state or local police, deputy sheriff's or firemen's retirement system
- Up to \$2,000 of certain public sector retirement benefits received (federal civil service, military, TRS and PERS)
- Up to \$20,000 in additional military retirement benefits received not elsewhere deducted
- Up to \$8,000 (\$16,000 joint) of income not otherwise deducted for individuals over age 65 or permanently disabled
- Up to \$8,000 of income not otherwise deducted for a surviving spouse of an individual age 65 or older or permanently disabled

# Itemized Deductions





# Determination of WV Tax

More than \$32.1 Billion in WV Taxable Income & \$1.6 Billion in Pre-Credit Tax Due on Full-Year Resident Returns in TY2012

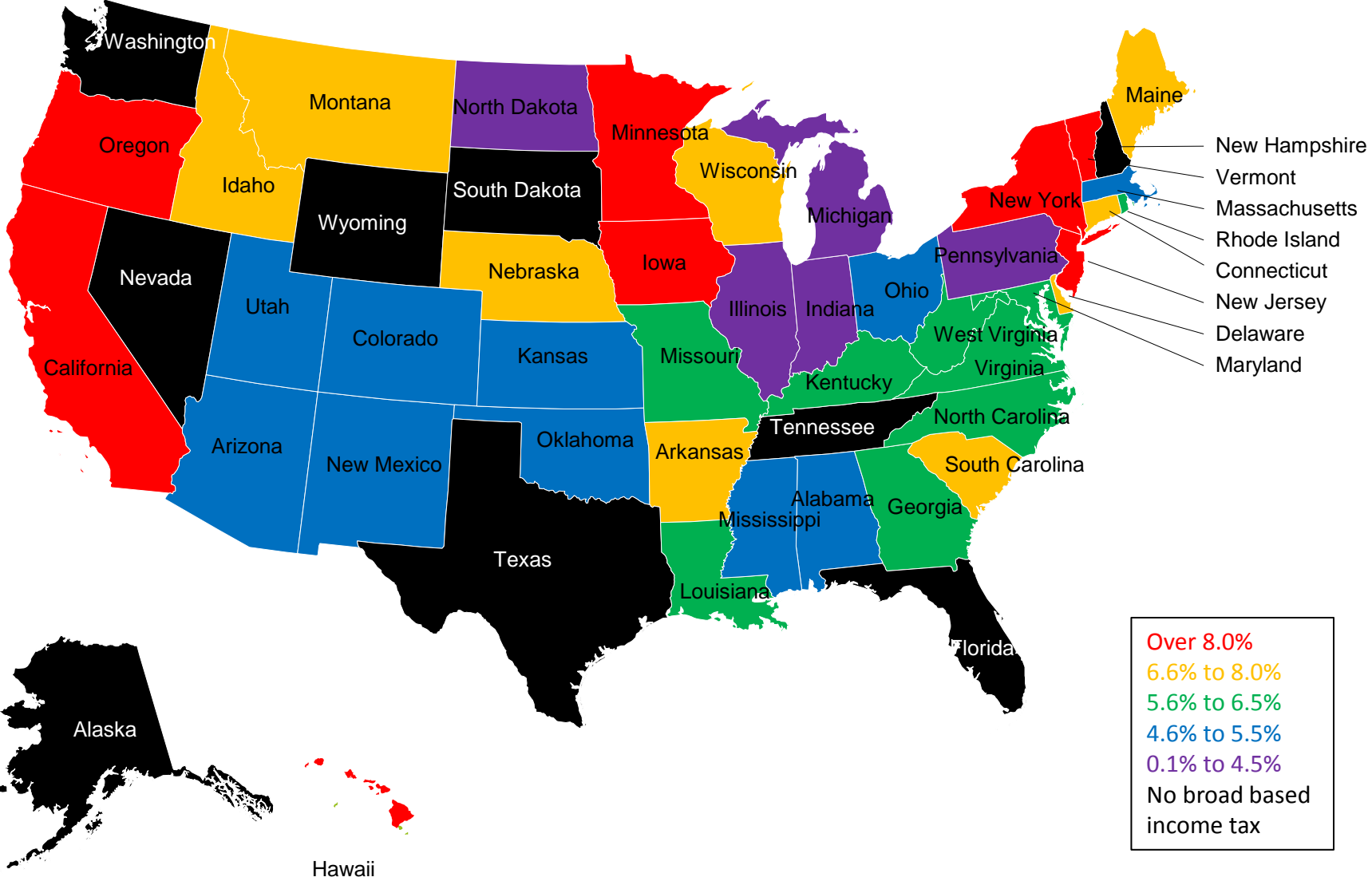
- Federal AGI + (Increasing Modifications – Decreasing Modifications) = WV AGI
- WV Taxable Income = WV AGI – Personal Exemption Allowances
  - Number of exemptions claimed on federal tax return x \$2,000 per allowance
  - Additional \$2,000 for a surviving spouse for 2 years
  - \$500 allowance for a dependent tax return when federal exemption is 0
  - Low-income earned income exclusion for those with AGI ≤ \$10,000 (\$5,000 MFS)
- West Virginia Tax before Credits = WV Taxable Income x graduated tax rates

<u>Joint Head of Household or Single</u>	<u>Married Filing Separate</u>
– \$0 + 3% on first \$10,000 of WVTI	[3% on first \$5,000 of WVTI]
– \$300 + 4% on next \$15,000 of WVTI	[\$150 + 4% on next \$7,500 of WVTI]
– \$900 + 4.5% on next \$15,000 of WVTI	[\$450 + 4.5% on next \$7,500 of WVTI]
– \$1,575 + 6% on next \$20,000	[\$787.50 + 6% on next \$10,000 of WVTI]
– \$2,775 + 6.5% on WVTI > \$60,000	[\$1,387.50 + 6.5% on WVTI > \$30,000]

# Personal Income Tax Rates

## Top Marginal Tax Rate

### 2015



Source: Federation of Tax Administrators Annual Survey

# Determination of State Income Tax Liability

\$1.72 Billion in Pre-Credit Tax - \$60.9 million in Tax Credits = \$1.66 billion in Net Tax  
Full-Year Residents \$1.54 Billion & Part-Year/Non-Residents \$122 Million

- Credit for Income Tax Paid to Other States \$20.6 million (7,400)
- Low-Income Relief Tax Credits
  - Family Tax Credit: \$17.6 million for (90,500)
  - Senior Citizen Homestead: \$10.8 million (55,000)
  - Homestead Excess Property Tax \$ 2.9 million (7,100)
- Other Tax Credits
  - Adoption \$1.2 million ( 250)
  - Neighborhood Investment \$2.2 million (1,900)
  - Alternative Fuel Motor Vehicle\* \$32.4 million (9,350)
  - Apprenticeship Training \$0.3 million
  - Rehabilitated Buildings (2) \$0.7 million
  - Film \$0.3 million
  - Solar\* \$0.2 million
  - All Others < \$0.1 million



# Federal Earned Income Tax Credit

Originally Intended to Offset Social Security Taxes

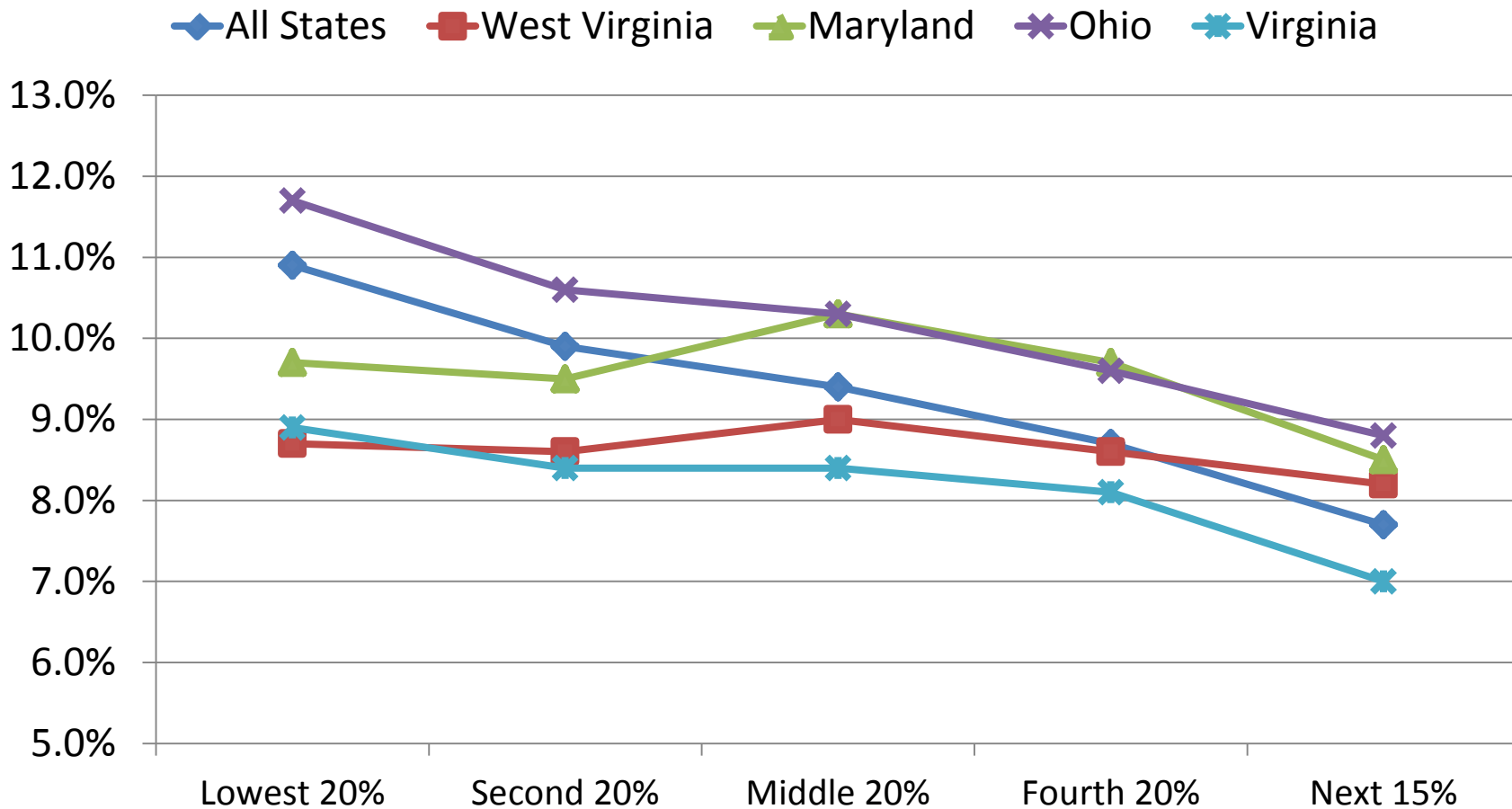
Major Expansion to Alleviate Poverty Began in 1993

- West Virginia Beneficiaries TY2012
  - 159,830 returns [20% of all filers]
  - \$341.1 million in benefits (91.5% refundable)
- Positive Benefits
  - Encourages employment for certain lower income workers
  - Lowers net tax burden for some lower income families
- Costs and Other Concerns
  - High marginal tax rates for those in phase-out range
  - Cost shifted to other taxpayers/other taxes
  - Significant noncompliance See <http://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>

# States With Earned Income Tax Credit Tend To Impose Higher Tax Burden On Lower Income Residents Than West Virginia

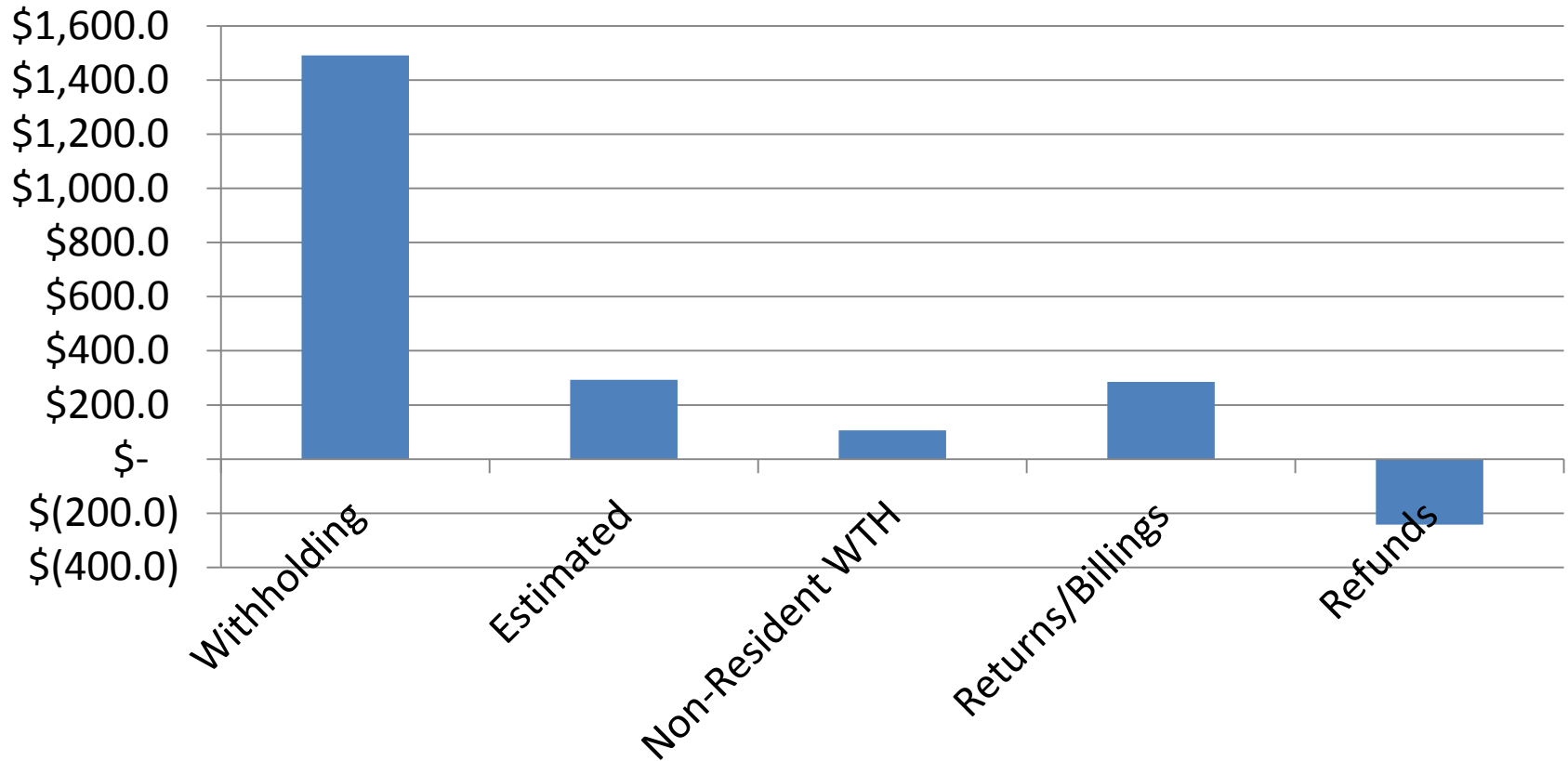
## Estimated Tax Burdens By Income Level: Non-Elderly

Source: Institute on Taxation & Economic Policy: *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States* January 2015



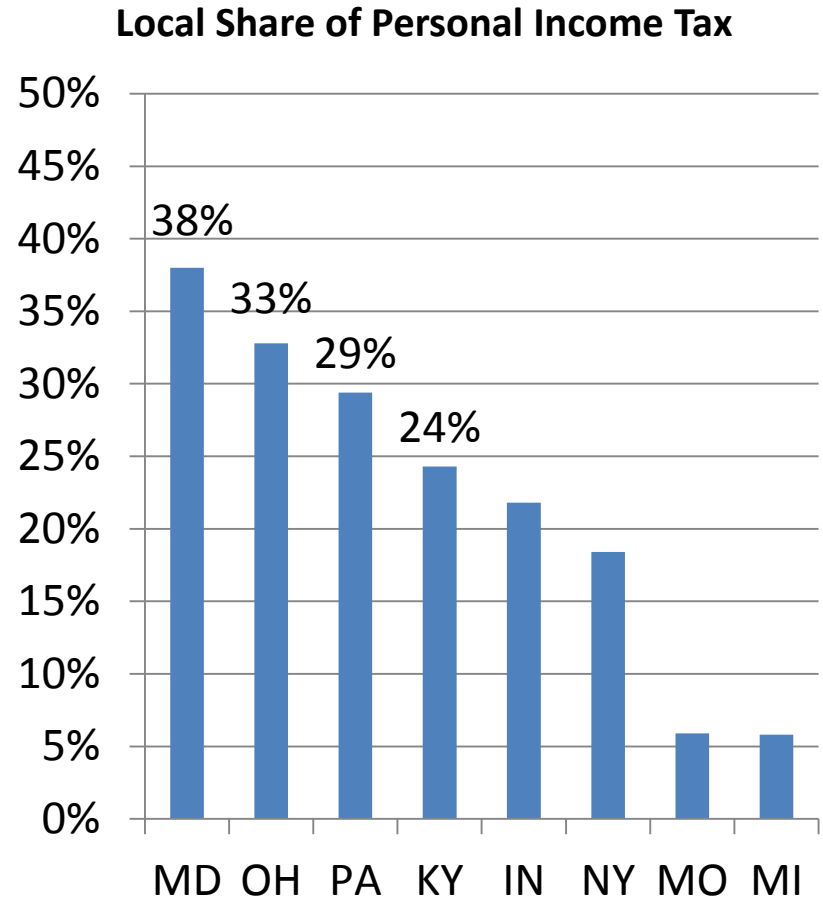
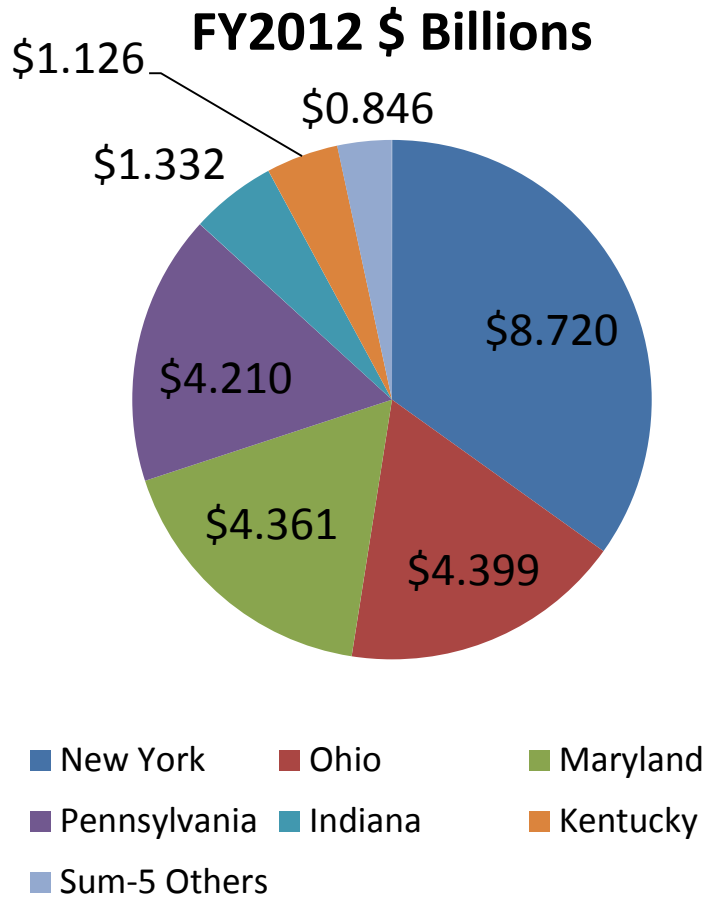
# Components of FY2015 Personal Income Tax

**\$ Millions**



# Local Income Taxes: 4.3% of Total Local Taxes

West Virginia's Contiguous Neighbors Account for 53% of \$25.15 Billion





# Government Finance Statistics

## States Without Broad-Based Personal Income Taxes & WV

State	Property Tax Rank	Property Tax \$130K	Per Capita Rank	Per Capita Sales Tax	Rank Sales Tax Rate	Hybrid Business Taxes (CNIT*)	K-12 Funding
AK	(19)	\$4,167	(47)	\$ 288	(46)	*	5
FL	(13)	\$4,499	(17)	\$ 1,111	(29)	*	44
NV	(33)	\$2,853	( 9)	\$ 1,383	(13)	Wage Tax /GRT	43
NH	( 3)	\$7,188	(48)	\$ 0	--	BPT/BET	13
SD	(21)	\$3,889	( 8)	\$ 1,390	(40)		41
TN	(34)	\$2,781	(10)	\$ 1,331	( 1)	*	46
TX	( 7)	\$5,491	(15)	\$ 1,191	(12)	Gross Margins	40
WA	(15)	\$4,358	( 3)	\$ 1,917	( 5)	B&O	30
WY	(45)	\$2,166	( 1)	\$ 2,119	(43)		6
<b>WV</b>	<b>(50)</b>	<b>\$1,560</b>	<b>(44)</b>	<b>\$ 689</b>	<b>(35)</b>	<b>*</b>	<b>23</b>

# Corporation Net Income Tax

# West Virginia Corporation Net Income Tax Structure

More Than \$190 Million Yield in FY2015

- **Federal definitions for tax base Federal Taxable Income (FTI)**
  - 46 states and DC use some definition of Federal Taxable Income
  - 6 states: no corporate net income tax (NV, OH, SD, TX, WA, WY)
    - Ohio & Washington impose business gross receipts tax
    - Nevada imposes an employer wage tax & is implementing an additional business gross receipts tax
    - South Dakota imposes income tax on financial institutions
    - Texas imposes a gross margins tax

# Increasing Modifications

- Interest/dividends from any state and local bonds
- U.S. Obligation interest/dividends net of expenses not exempt from State tax
- State & Local Income Taxes deducted on federal return & foreign taxes
- Federal depreciation for qualifying WV water/air pollution control facilities
- Unrelated business income of a corporation exempt from federal tax
- Federal net operating loss deduction & net operating loss from sources outside of U.S.
- Production income deduction under IRC §199
- Neighborhood investment tax credit charitable contributions
- Expenses related to REITS and Regulated Investment Companies & certain interest and intangible expenses

# Decreasing Modifications

- West Virginia state income tax refunds included in FTI
- Foreign Dividend Gross-Up, Subpart F Income & taxable income from sources outside of U.S.
- Cost of West Virginia water/air pollution control facilities if not otherwise allocated
- Salary expense not allowed on federal return due to federal jobs credit
- Employer contributions to a WV medical savings account not deductible on federal tax return
- U.S. Obligation, West Virginia Obligation and Residential Property Obligation allowance [share of total assets multiplied by adjusted taxable income]

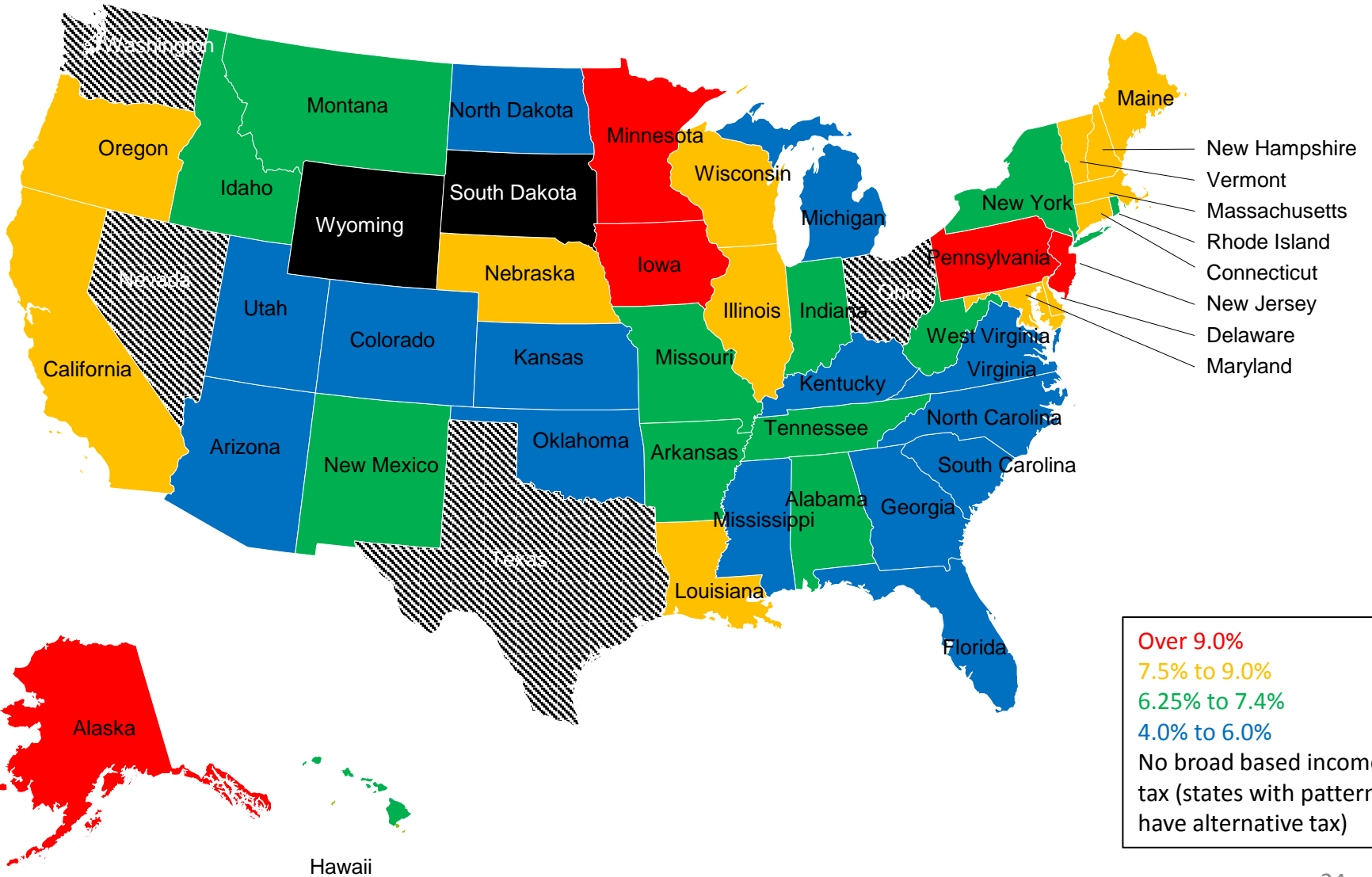
# Allocation & Apportionment

- Multi-state firms apportion WV adjusted FTI to determine share to be taxed in WV
  - 50% weight on sales
  - 25% weight on property
  - 25% weight on payroll
  - Special formula for financial organizations
- Non-business income is allocated to source state
  - rents, royalties, capital gains, interest, dividends
  - cost of pollution control facilities
  - gain on sale of natural resources
- Allocated West Virginia Net Operating Loss Deduction

# Hypothetical Tax Calculation for Single Multi-State Corporation

- ABC has \$10,000,000 in federal taxable income
- ABC has \$500,000 in increasing modifications and \$800,000 in decreasing modifications
- ABC has \$50,000 in allocated income outside of West Virginia
- Apportionment Factor =  $[1.3334\% + 1.3334\% + 6.25\% + 9.0\%]/4 = 4.4792\%$ 
  - Sales: \$0.4 million in WV & \$30 million everywhere = 1.3334%
  - Property: \$5.0 million in WV & \$80 million everywhere = 6.25%
  - Payroll: \$0.18 million in WV & \$2 million everywhere = 9.0%
- Pre-credit tax: \$10,000,000 in FTI - \$300,000 in net modifications - \$50,000 in allocated income = \$9,650,000 x 4.4792% apportionment = \$432,243 + \$0 in WV allocable income = \$432,243 in West Virginia taxable income x 6.5% WV tax rate = \$28,096 in WV tax liability

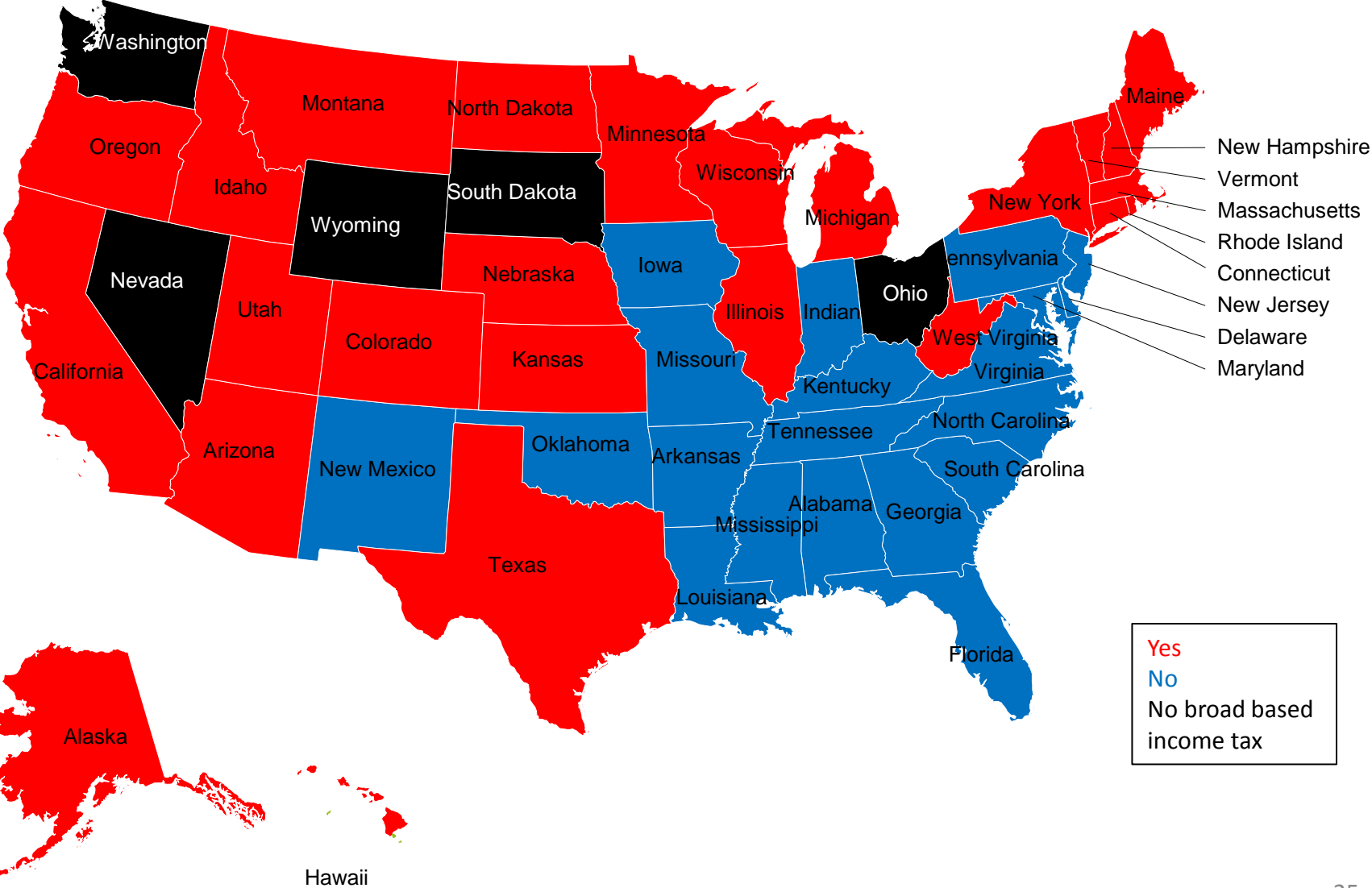
# Corporate Net Income Rates



Over 9.0%  
 7.5% to 9.0%  
 6.25% to 7.4%  
 4.0% to 6.0%  
 No broad based income tax (states with pattern have alternative tax)



# Does Your State Have Mandatory Combined Reporting?



# What is Combined Reporting?

- (1) Members of a **unitary group**
- (2) Determine net income based on the activities of the unitary group **as a whole**.
- (3) Each unitary group member with WV nexus apportions **total group income** to West Virginia, and pays its tax.

# What is combined reporting?

The Taxpayer will typically file a **separate return**, along with a combined report, but the income shown will be the unitary group income apportioned to WV based on the unitary apportionment factors of the Taxpayer.

# What is combined reporting?

Unitary business” means a **single economic enterprise** that is made up either of **separate parts of a single business entity** or of a **commonly controlled group of business entities** that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts.

# Joyce or Finnigan

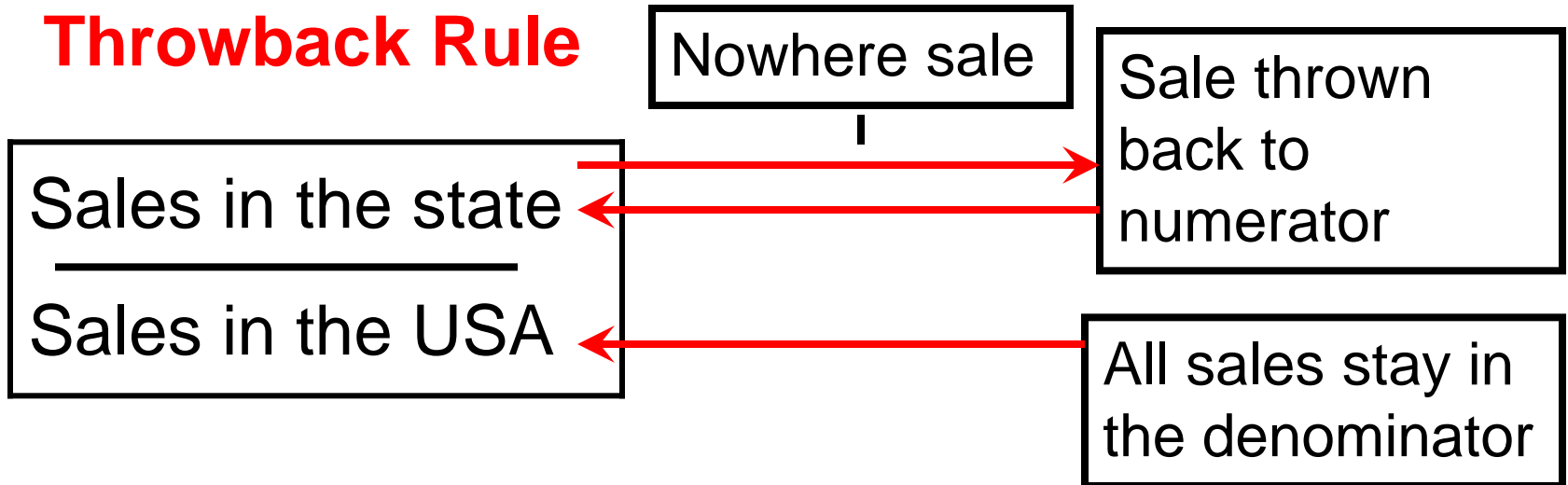
**West Virginia is a Joyce State with a Throw-Out Rule**

**Joyce** – If a member has nexus, then WV sales are included in the sales factor numerator.

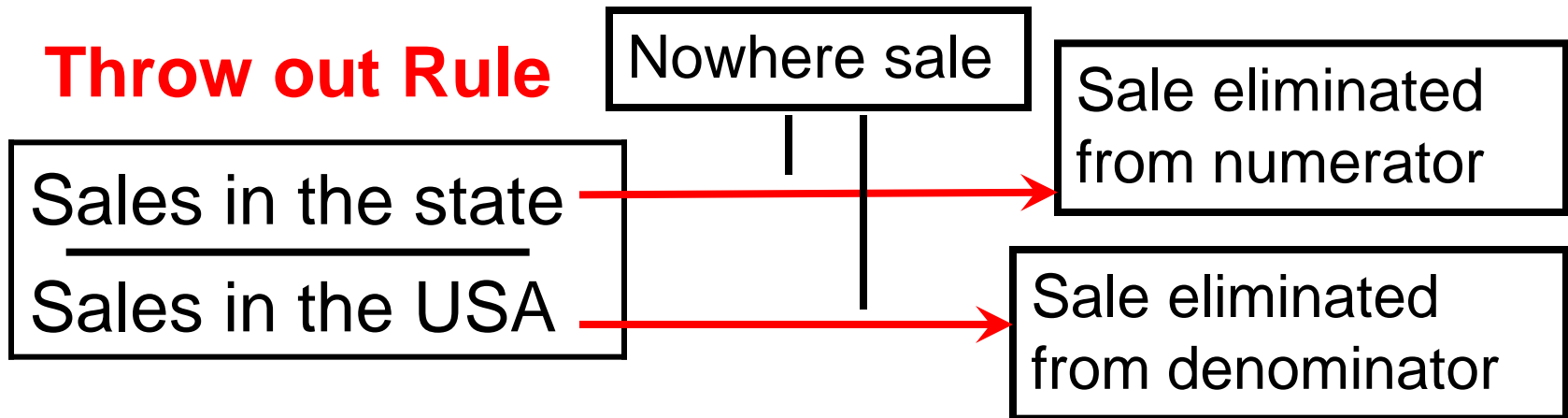
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**Finnigan** – If a member is a unitary group member, **regardless of nexus**, then sales are included in the sales factor numerator.

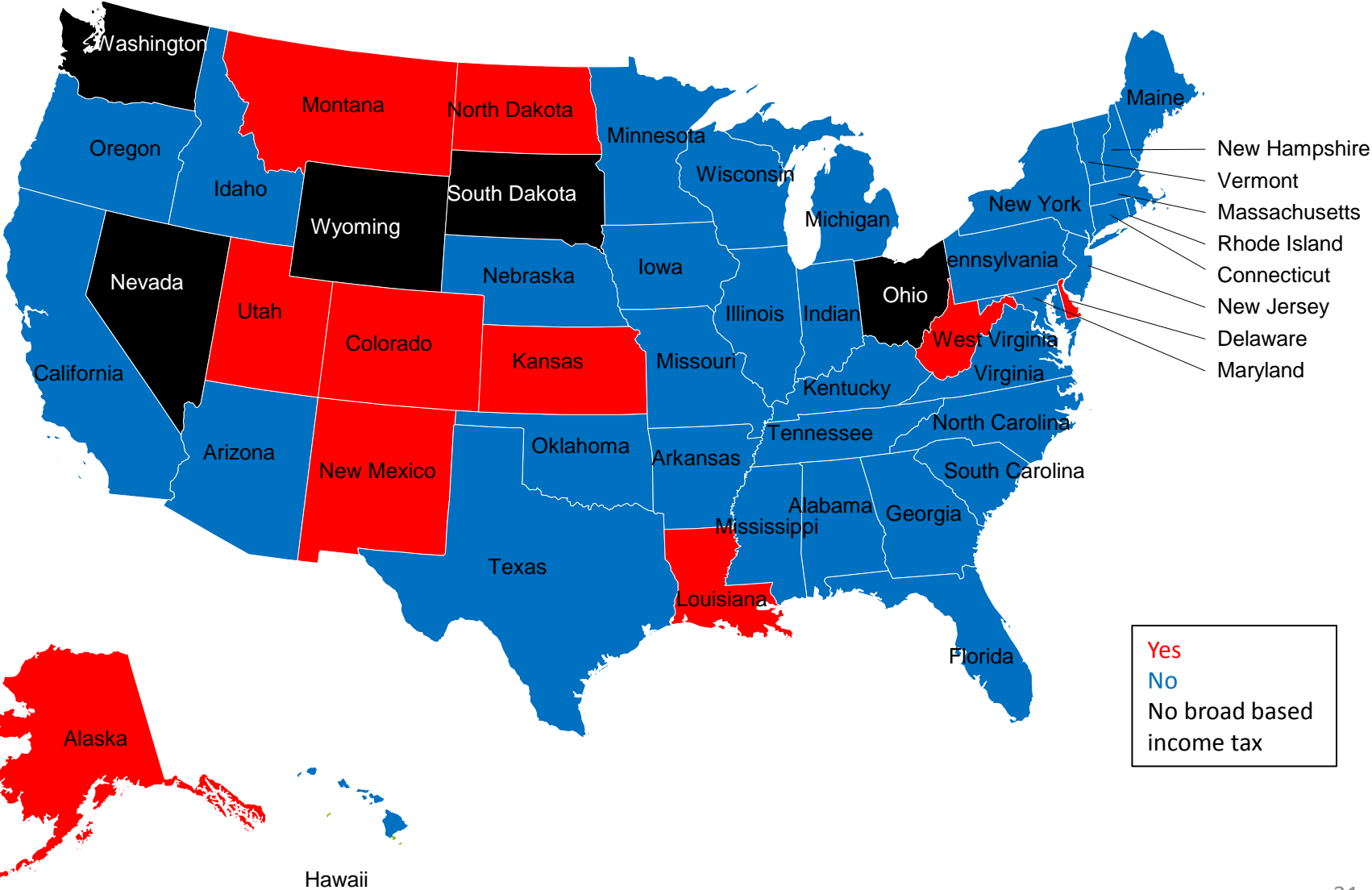
## Throwback Rule



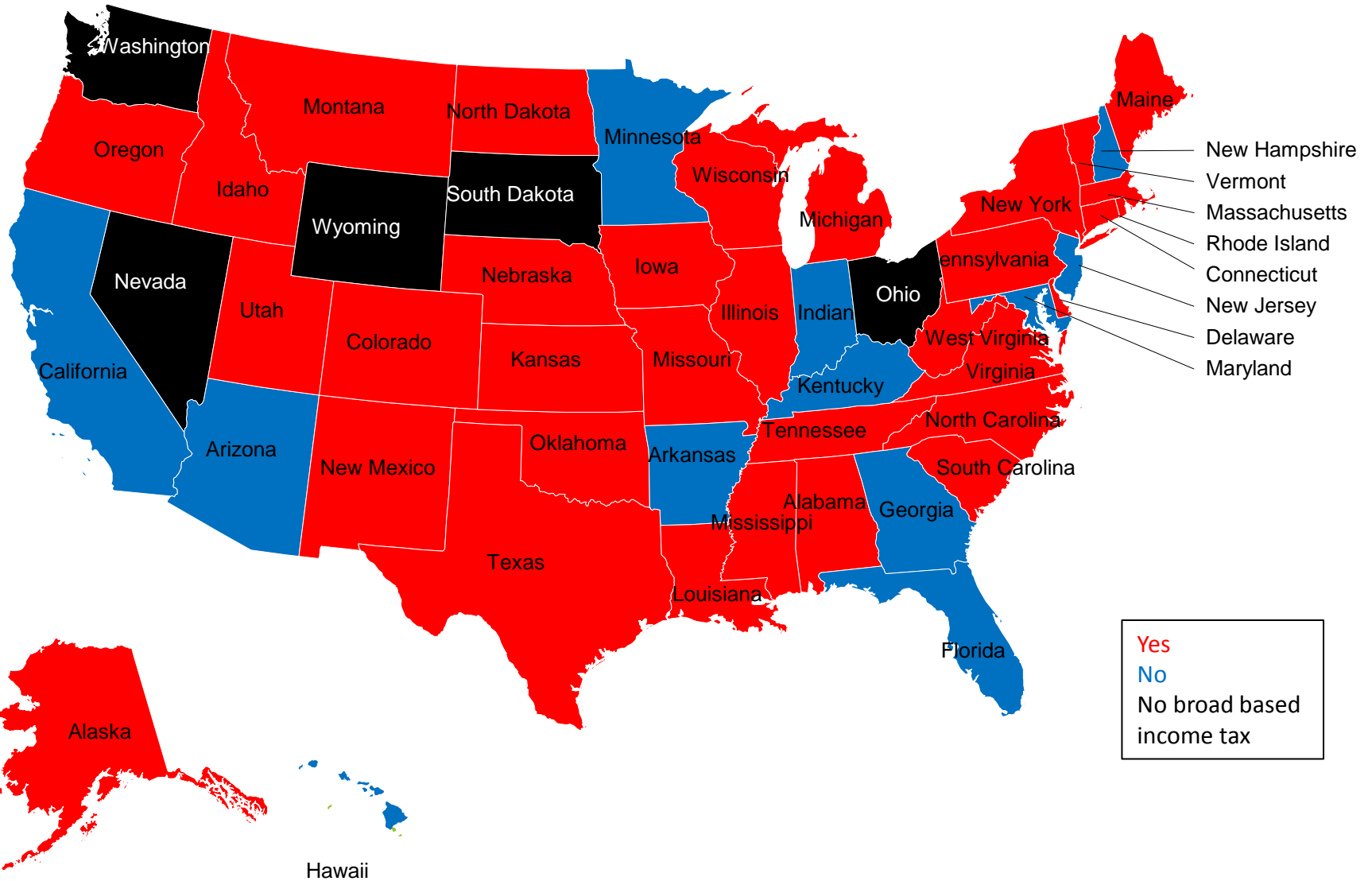
## Throw out Rule



# Consistent Conformity with Federal Bonus Depreciation

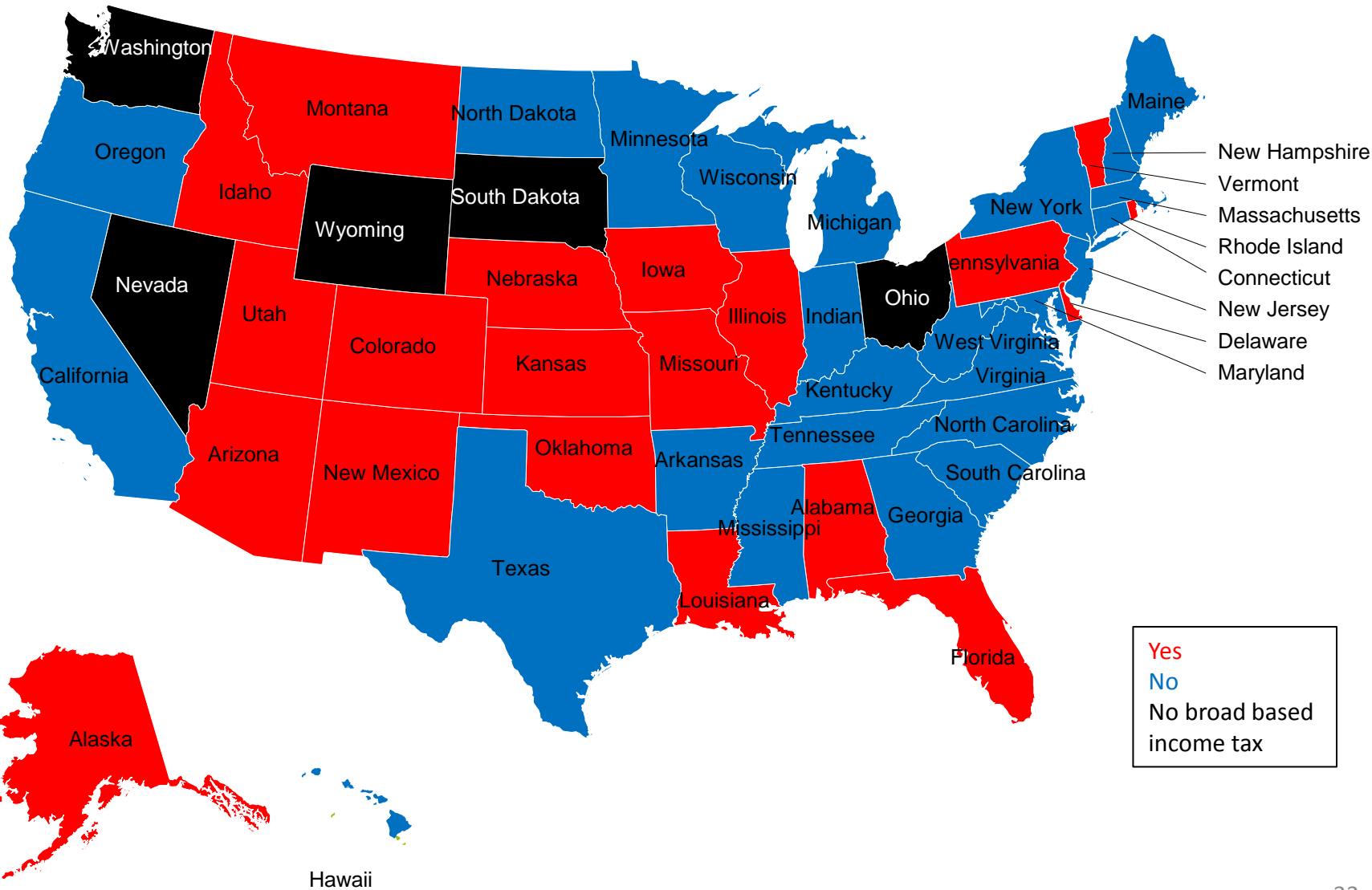


# Conformity with §179 Federal Small Business Expensing Rules





# Conformity With Section 199 Qualified Production Income Deduction



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Questions?

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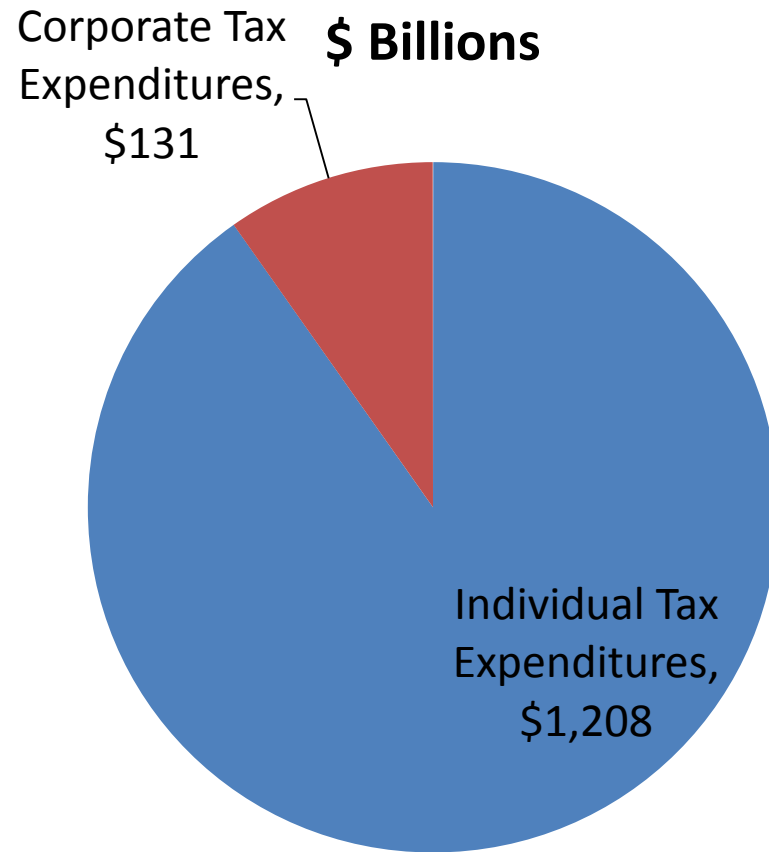
## Joint Select Committee on Tax Reform West Virginia Tax Credits

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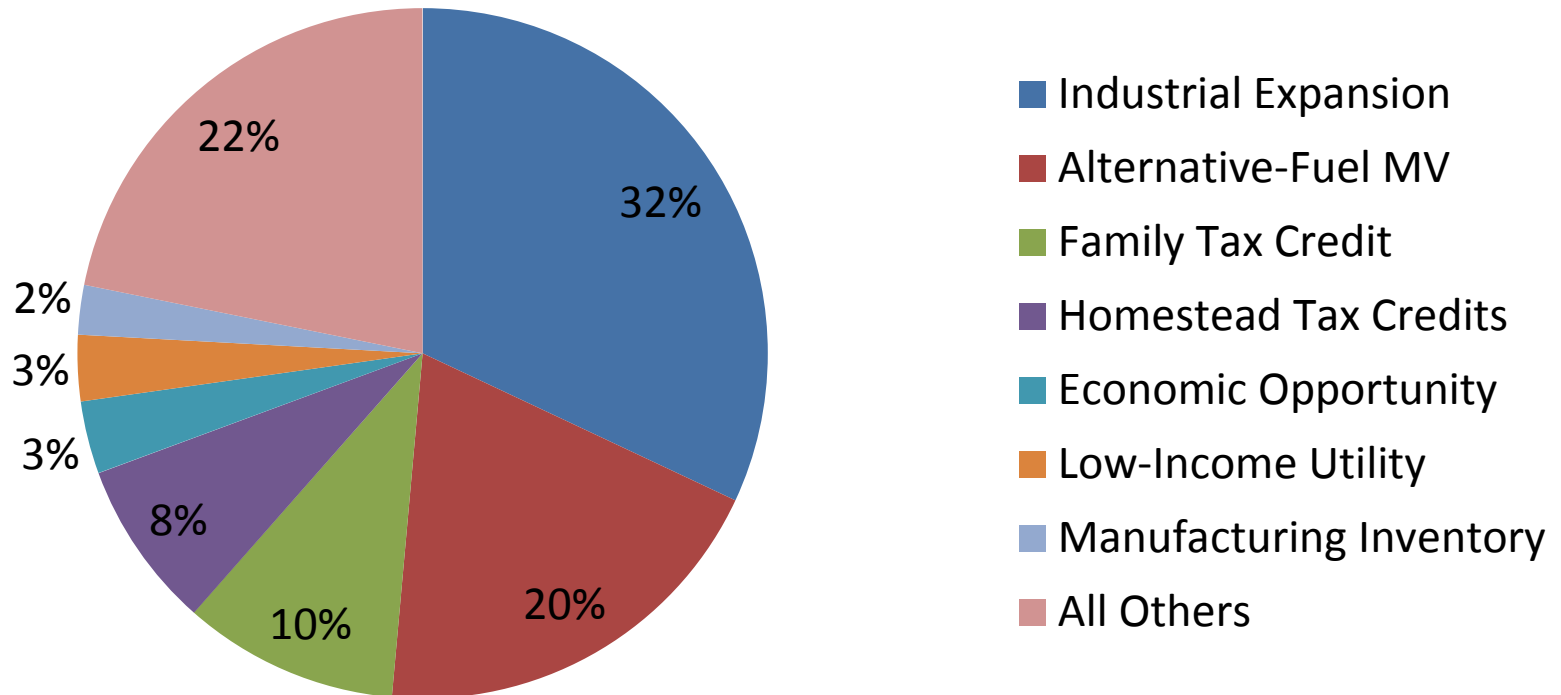
# 90% of Federal Tax Expenditures in 2015 Go to Individuals

Source: *Corporate and Individual Tax Expenditures* by Alan Cole, Tax Foundation Fiscal Fact August 2015 No. 476



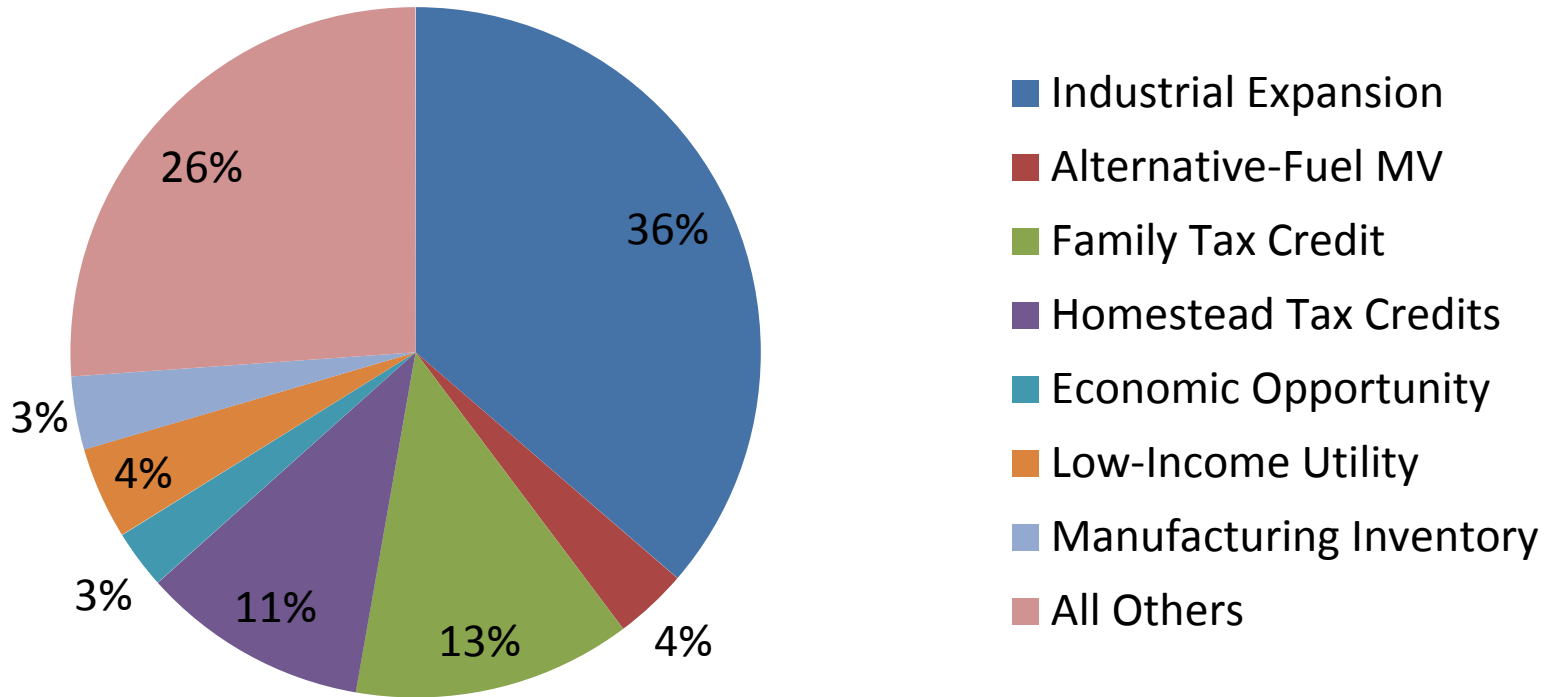
# Distribution of WV Tax Credits:2012

**\$ 175 Million**



# Estimated WV Tax Credits: FY2016

**\$ 146 Million**



# Why are Tax Credit Costs Falling?

- Repeal of > 95% of Alternative Fuel Motor Vehicle Tax Credit Program in 2013
- Electric Power Industry factors
- No more Business Franchise Tax
- Lower Corporate Net Income Tax rate
- Elimination of several tax credit programs

# Alternative-Fuel Motor Vehicle Tax Credit

Total Cost from TY2011 to TY2014 to date is \$75 million

- Original Tax Credit: 2011-April 14, 2013
  - \$7,500 tax credit for buying natural gas, electric, hybrid or flex-fuel vehicle
  - Up to \$25,000 for a qualified commercial vehicle
  - Home infrastructure tax credit of up to \$10,000
  - Commercial infrastructure tax credit of 50% up to \$312,500
- Modified in 2013 with new sunset date of December 31, 2017
  - Tax credits restricted to natural gas vehicles
  - Commercial infrastructure of 20% up to \$0.4 million



# Electric Power Industry

Cost Likely to Decrease Significantly Over Next Couple Years

- Industrial Expansion Tax Credit
  - 10% of qualified capital investment
  - Tax credit pro-rated for use over 10 years
  - Applies against B&O Tax
    - Unique tax to West Virginia
    - Most Other States tax consumer sales of electricity
- Huge Investments in Scrubber Technology & Other Environmental Remediation (2007-09)
  - 2007 tax credits expire after 2016
  - 2009 tax credits expire after 2018

# No More Business Franchise Tax

- Business Franchise Tax absorbed significant tax credit claims in past years
  - Average of more than \$14 million/year since 1992
  - 2008-2012: between \$10-\$15 million per year
  - More than \$13 million in TY2012
- As of 2015, the Business Franchise Tax expired

# Lower Corporation Net Income Tax Rate

From 9% to 6.5%

- Use of Tax Credits Against Corporate Tax
  - Average of roughly \$10 million/year since 1992
  - 2008-2012: Average of less than \$9 million/year

# Legislative Action Repealing Tax Credits

## List of Repealed Programs

<u>Name of Program</u>	<u>Code</u>	<u>Expiration Date</u>
Capital Company	§5E-1	2007
Business Investment & Jobs Expansion	§11-13C	2003
Industrial Expansion/Revitalization*	§11-13D	2003
Research & Development	§11-13D	2003
Residential Housing Development	§11-13D	2003
Management Information Services Facilities	§11-13D	1993
Coal-Based Synthetic Fuels	§11-13D	2003
Aerospace Industrial Facilities	§11-13D	2003
Increased Generation of Electricity	§11-13H	2002
Former Colin Anderson Center Employment	§11-13I	1999
High-Growth Business Investment	§11-13U	2008
Value-Added Wood Manufacturing	§11-13M	2002

# Legislative Action Repealing Tax Credits continued

## List of Repealed Programs

<u>Name of Program</u>	<u>Code</u>	<u>Expiration Date</u>
New Steel Manufacturing Operations	§11-13N	2002
New Aluminum or Polymer Operations	§11-13O	2002
Medical Liability Insurance Premiums	§11-13P	2005
Strategic Research & Development	§11-13R	2014
Combined Medical Malpractice & Tail Liability	§11-13T	2004
Residential Solar Energy	§11-13Z	2013
Non-Incentive	§12-7-8a	2005
Value –Added Agricultural Products Production	§11-23-24a	2002

# Active Tax Credits

## List of Current Programs

<u>Name of Program</u>	<u>Code</u>	<u>Sunset Date</u>
Alternative-Fuel Motor Vehicles	§11-6D	2017
Industrial Expansion/Revitalization (Electric)	§11-13D	No
Coal-Loading Facility	§11-13E	No
Utility Low-Income	§11-13F	No
Telephone Low-Income	§11-13G	No
Neighborhood Investment	§11-13J	2016
Environmental Agricultural Equipment	§11-13K	No
Natural Gas Industry Jobs Retention	§11-13L	No
Economic Opportunity	§11-13Q	No
Manufacturing Investment	§11-13S	No
Film Industry Investment	§11-13X	No
Commercial Patent Incentives	§11-13AA	2016

# Active Tax Credits

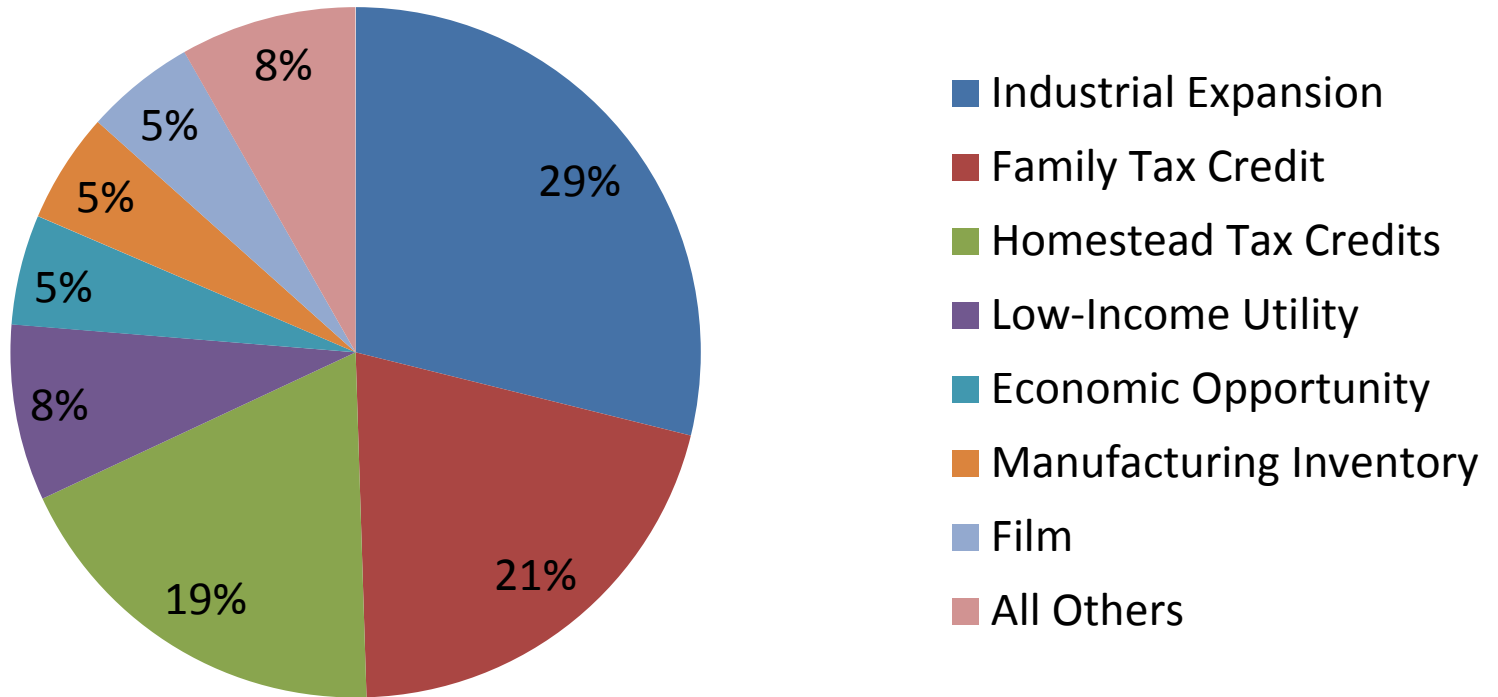
## List of Current Programs

<u>Name of Program</u>	<u>Code</u>	<u>Sunset Date</u>
Mine Safety Technology	§11-13BB	2018
Energy Intensive Industrial Consumers	§11-13CC	2021
Tourism Development	§5B-2E	2019
Rehabilitated Buildings Commercial	§11-21-8a	No
Residential Rehabilitated Buildings	§11-21-8g	No
Non-Family Adoption	§11-21-10a	No
Senior Citizen Homestead	§11-21-21	No
Low-Income Family	§11-21-22	No
Excess Homestead	§11-21-23	No
Utility Taxpayers With Net Operating Loss Carryover	§11-24-11b	No
Military Incentive	§11-21-42	No
Wind Power Community Contribution	§11-13-2p	2017

# Estimated WV Tax Credits: FY2020

Assuming No Policy Changes To Add or Modify Programs

**\$ 97 Million**





# Conclusions: Tax Credit Expenditures

- Values are decreasing due to:
  - More emphasis on lower tax rates
  - No Franchise Tax
  - Repeal or sunset of many programs
- Outlook for FY2020
  - \$97 million – decrease of 45% from TY2012
  - Roughly 50% relate to individuals
  - Electric power still accounts for nearly 30%
  - Roughly \$20 million relate to economic development
    - Economic Opportunity: Job Creation
    - Manufacturing Investment
    - Manufacturing Inventory
    - Film
    - Tourism
    - Historic Building Rehabilitations