

March 24, 2016

## Revenue Options Crucial to Sustaining Public Investments That Promote Shared Prosperity

Ted Boettner and Sean O’Leary

When lawmakers reconvene this spring to address the state’s looming budget crisis, it is clear that West Virginia should take a balanced approach that includes additional revenue, rather than a cuts-only approach that threatens our state’s struggling economy. Our state’s worsening revenue situation isn’t due entirely to plunging energy prices. Rather, that situation exacerbates the impact of past state tax cuts – including the elimination of the business franchise tax and grocery tax on food, and lowering the corporate net income tax rate from 9% to 6.5%. Those actions are playing a substantial role in our persistent inability to find the resources needed to invest in essential public services.

The Governor’s new revenue estimates make clear that lawmakers will need to address a revenue shortfall of \$239 million for the state budget year that begins July 1<sup>st</sup>. This revenue shortfall comes on top of deep budget cuts over the last several years. For example, investments at our state’s four-year colleges have plummeted while tuition has grown by one-third since 2008.<sup>1</sup> A balanced approach to addressing the state budget deficit cannot rely on cuts alone or more one-time appropriations that shift our budget problems to the next fiscal year.

While some lawmakers may be concerned about raising taxes when our state’s economy is relatively weak, additional budget cuts could do more harm to West Virginia’s economy. During the Great Recession, several prominent economists warned that spending cuts could be more damaging to a state’s economy than certain tax increases and that same rationale applies today to West Virginia.<sup>2</sup> Budget cuts can reduce the total level of spending in the state’s economy, while raising taxes – especially on the highest-income households and large, profitable businesses – results in less economic loss. This is because some of the money used to pay for additional taxes would come from reduced savings and out-of-state consumers.

Since West Virginia has already made large budget reductions – budget cuts in the fiscal year that ends June 30 alone included \$41.5 million to Health and Human Services, \$16.5 million to public education, and \$13.8 million to both higher education and public safety – the common-sense choice for West Virginia is to raise additional revenues to address growing public needs and promote a strong economy.<sup>3</sup> This approach makes sense in light of the fact that tax responsibilities in West Virginia are already the lowest they have been in years. General Revenue Funds as a share of the state’s economy are at their lowest point in over 25 years at just 6.4 percent, compared to a 6.8 percent average from 1990 to 2015 and a high of 7.4 percent in 2005.<sup>4</sup> There are a number of revenue options worth considering to improve the state’s fiscal health and to ensure that more cuts to public investments do not further damage the state’s economy.

**Apply the sales tax to digital downloads:** West Virginia has not updated its sales tax to reflect today's economy. A good step is to cover various goods and services sold and delivered on the Internet – including books, music, movies, and other digital products downloaded electronically. There is an element of equity here because West Virginia taxes the sales of identical items sold in stores. This change would also slightly reduce the extent to which the sales tax falls disproportionately on lower-income households, since most digital goods are more likely to be purchased by higher-income households that make more online purchases. According to the West Virginia Tax Department, the revenue forgone from this exclusion is \$10 million per year.<sup>5</sup>

**Apply the sales tax more widely to personal services:** The sales tax now excludes the money paid to barbershops, beauty and nail salons, massage and tattoo parlors, and private fitness centers. While West Virginia taxes more services than most states, these personal services remain exempt for no discernable reason and should be part of the state's sales tax base. According to the West Virginia Tax Department, the revenue forgone from this exclusion is \$2.0 million for personalized fitness and \$3.8 million for other personal services.<sup>6</sup>

**Scale back personal income tax exemptions:** West Virginians are provided a \$2,000 personal exemption from their state income tax for each household member. Unlike the federal government, which phases out personal exemptions as income rises, West Virginia does not. If the \$2,000 per person exemption were phased out for joint filers between \$150,000 and \$200,000 and eliminated for those over \$200,000, it would increase revenue by an estimated \$9.9 million and help make the state's income tax based more on the ability to pay.<sup>7</sup>

**Modernize Personal Income Tax Rates and Brackets:** West Virginia's personal income tax schedule has not changed since 1987, when the state's top personal income rate was reduced from 13 to 6.5 percent. Adjusting brackets and rates would better reflect modern income levels. This could include adopting a new bracket for higher-income earners and perhaps even lower rates for low- and middle-income residents. For example, a new top bracket of 7.4 percent on taxable income above \$150,000 would increase revenue by an estimated \$44.8 million.<sup>8</sup>

**Increase tobacco taxes:** Governor Tomblin's proposal of a modest tax increase on various tobacco products won't be enough to provide long-term funding for services such as Medicaid nor will it help reduce health care costs and save lives associated with tobacco use. Increasing the cigarette tax to \$1.55 per pack from 55 cents, the wholesale tax on other tobacco products to 50 percent from seven percent, and instituting a 7.5-cent per milliliter tax on electronic cigarettes would provide an additional \$61 million beyond Governor Tomblin's tobacco tax proposal, bringing the total to \$139 million.<sup>9</sup>

**Enact a higher severance tax on natural gas liquids and/or natural gas:** West Virginia now produces over 1 trillion cubic feet of natural gas, with most of it flowing out of state. Research shows that severance taxes have little impact on natural gas extraction and that the tax falls primarily on out-of-state energy companies and customers.<sup>10</sup> If West Virginia increased its severance tax on natural gas liquids to 10 from five percent, it would increase revenue by an

estimated \$18 million in the next fiscal year. If the severance tax on all natural gas were increased to six percent from five percent, it would increase revenue by an estimated \$18.5 million in the next fiscal year.

**Apply the sales tax to telecommunications services:** The governor's proposal to apply the state's sixth percent sales tax to telecommunications services (cellphone, telephone, and some ancillary services) would raise approximately \$60 million per year in revenue. According to a 2014 report by the Tax Foundation, West Virginia has the fourth-lowest wireless state and local tax and fee rate on wireless communications in the nation.

**Increase the Soda Tax:** West Virginia levies an excise tax of one cent on each 16.9 fluid ounces of bottled soft drinks, 80 cents per gallon of soft drink syrup, and one-cent per 28.35 grams of dry mixture for making soft drinks. Bipartisan legislation introduced in the state Senate (SB 604) in 2016 would have raised these taxes five-fold and increased state revenue by an estimated \$50.5 million in the next fiscal year. While a soda tax is not a silver bullet for addressing the state's childhood obesity epidemic, it can, by raising the price of unhealthy beverages, reduce consumption, improve health – especially among low-income populations – and provide much needed revenue for Medicaid in West Virginia.<sup>11</sup>

**Because many of the above revenue options would fall harder on households with lower incomes, policymakers should couple any of these tax increases – including excise taxes and sales tax increases – with a bottom-up tax cut for working families.**

**Here's how -- Enact a West Virginia Earned Income Tax Credit (EITC):** Twenty-six states and the District of Columbia have enacted Earned Income Tax Credits for working people to help them offset the cost of the various state and local taxes they pay. The EITC is a proven tool to fight poverty, increase labor force participation, and help low-income working families afford necessities. The benefits are lasting, such as improving the health, educational achievement, and earnings of children who are EITC recipients. A state EITC at 15 percent of the federal credit would cost approximately \$47 million and could be paired with a tobacco tax increase or a sales tax increase to help offset the impact of other taxes that hit hardest at low income levels.<sup>12</sup>

When all state and local taxes are considered, low-income households pay a higher share of their income in taxes than the wealthy.<sup>13</sup> West Virginia has the opportunity to turn that upside-down system right-side up and raise resources needed to invest in broad prosperity. That is a far better option than more cuts to services essential to West Virginians.

## END NOTES

---

<sup>1</sup> Ted Boettner and Sean O’Leary, “Confronting the Fiscal Gap,” West Virginia Center on Budget and Policy, February 16, 2016. Retrieved from <http://www.wvpolicy.org/wp-content/uploads/2016/02/PDF-FY17-Gov-Budget-Brief-2.16.16-FINAL1.pdf>

<sup>2</sup> See Peter Orszag and Joseph Stiglitz, “Budget Cuts vs. Tax Increases at the State Level: Is One More Counter-Productive than the other during a recession?” *Center on Budget and Policy Priorities* revised November 6, 2008, Retrieved from <http://www.cbpp.org/archiveSite/10-30-01sfp.pdf>; and John Buhl, “Economist Tells Governors to Consider Tax Increases to Balance Budgets,” *Tax Analysts*, February 23, 2010.

<sup>3</sup> Boettner and O’Leary, “Confronting the Fiscal Gap”

<sup>4</sup> Ibid

<sup>5</sup> West Virginia Tax Expenditure Study, “Consumers Sales and Service Tax and Use Tax Expenditures,” West Virginia Tax Department, January 2016. Retrieved from <http://tax.wv.gov/Documents/Reports/ConsumersSalesAndServiceTaxAndUseTaxExpenditures.2016.01.pdf>

<sup>6</sup> Mark B. Muchow and Mark S. Morton, “Consumer Sales and Use Taxes.” WV Department of Revenue, presentation to Joint Select Committee on Tax Reform, August 31, 2015. Retrieved from [http://www.legis.state.wv.us/legisdocs/2015/committee/interim/TAX/TAX\\_20150831132032.pdf](http://www.legis.state.wv.us/legisdocs/2015/committee/interim/TAX/TAX_20150831132032.pdf)

<sup>7</sup> Estimates provided by the Institute for Taxation and Economic Policy

<sup>8</sup> Ibid

<sup>9</sup> Boettner and O’Leary, “Confronting the Fiscal Gap”

<sup>10</sup> See Sean O’Leary, “Investing in the Future: Making the Severance Tax Stronger for West Virginia.” West Virginia Center on Budget and Policy, December 13, 2011. Retrieved from <http://www.wvpolicy.org/wp-content/uploads/2012/06/SeveranceTax022812.pdf>

<sup>11</sup> Steven L. Gortmaker et al, “Three Interventions That Reduce Childhood Obesity Are Projected To Save More Than They Cost To Implement,” *Health Affairs*, November 2015. Retrieved from <http://content.healthaffairs.org/content/34/11/1932.long>

<sup>12</sup> Boettner and O’Leary, “Confronting the Fiscal Gap”

<sup>13</sup> Ibid