WEST VIRGINIA CENTER ON
BUDGET & POLICY

Who pays?

Rethinking West Virginia's Tax System

Introduction

To get a sense of a state's values, one often need look no further than its tax system.

What a state spends its tax dollars on and how it acquires those tax dollars typically reveals a lot about the priorities of its people—what they care about and what they stand for. In theory, it's a direct reflection of their collective values. But this doesn't seem to be the case for West Virginia.

As it currently stands, West Virginia's tax system places an unreasonable burden on working families and those who have the least. In the past two decades, state taxes paid by individuals and families increased while taxes paid by businesses declined. At the same time, low- and middle-income families have been paying a greater share of their income in taxes than wealthier West Virginians.

This is a system that is neither fair, nor strong, nor sustainable. It demonstrates little respect for those among us who are working hardest to put food on their tables and provide for their families, and it certainly does not uphold the promise of the American Dream: that through hard work, upward social mobility (and, in the very least, some amount of financial security) is possible. In fact, it does just the opposite, perpetuating income inequality and preventing honest, hard-working West Virginians from achieving success.

Clearly, our state tax system and collective values are in severe misalignment. Where the former should be giving hard workers a hand up, it is holding them back. Where it should be promoting fairness and equality, it is widening an already tremendous divide. But we made this system—and we can remake it to better represent the values of the West Virginia we all know and love.

The purpose of this guide is thus not only to explain how the state gets its resources, but also to respond to the pressing need for re-examination, re-organization, and re-alignment of West Virginia's tax system. In this document, you will find a thorough exploration of the strengths and weaknesses of our state's tax system, along with recommendations informed by the West Virginia Center on Budget and Policy's research. Ultimately, its objective is to identify viable ways of creating a more effective and structurally-balanced tax system, one that can help our state both produce a stable budget and achieve a fairer and more equal economy. Because West Virginia's tax system should reflect West Virginia's values.

How to Use This Guide

Reading Time

The stopwatch icon and number indicate an approximate reading time for each section.

In order to make navigating this guide as easy as possible, we have provided brief descriptions of the material covered in each of the five chapters and included estimates of read-times for chapter sections below. **This guide is intended to serve as a resource, introducing you to West Virginia's tax system or bolstering your knowledge of it in whatever way is best suited to you**: you might use it to enhance your overall understanding of the tax structure in our state, or you might refer to it for a quick refresher on a particular topic of interest. You might choose to read it all at once, from start to finish, or select a specific chapter or even chapter section. However you decide to use this guide, we hope that it will help demystify the complexities of taxes in West Virginia and illuminate pathways toward a stronger and more balanced tax system.

If you want to know about **West Virginia's state and local tax system**, read chapter one. PAGE 8

Where does the state's money come from? What are its main sources of revenue? Who bears the greatest tax responsibility? Chapter 1 answers these questions by providing an in-depth review of West Virginia's state and local tax system. You will find explanations of the specific taxes upon which the state relies, as well as analyses of the strengths and weaknesses of West Virginia's tax structure. Areas of particular imbalance are identified.

If you want to know about **needs and challenges**, read chapter two. PAGE 46

This chapter explores key indicators of economic performance and well-being in West Virginia, revealing that low income levels, high rates of unemployment, and low levels of educational attainment are some of the primary challenges to progress in our state.

If you want to know about **tax equity**, read chapter three. PAGE 52

The primary focus of this chapter is fairness and equality within the West Virginia tax system. Here we discuss the features of a balanced tax system, the concepts of "vertical" and "horizontal" equity, and the "ability to pay" principle. Our analysis leads us to the conclusion that, overall, West Virginia's tax system is imbalanced, with lower-income families paying a greater share of their income in taxes than higher-income families. Exportable taxes are recognized as a viable way to increase revenue without adding to income inequality.

If you want to know about **taxes and economic performance**, read chapter four. PAGE 60

In Chapter 4, you will find an assessment of the tenuous relationship between tax levels and state economic growth. Ultimately, we arrive at and explain the following positions: first, that tax cuts for high-income people and large businesses do not grow state economies; and second, that investments in physical and human capital upon which businesses depend to survive have a far greater investment rate of return (ROI).

If you want to know about **tax policy for a shared prosperity**, read chapter five. PAGE 68

This final chapter outlines proposals for tax policy changes based on our analyses and findings described in the chapters prior. If implemented, our policy recommendations would help create a fairer and more balanced tax system as well as raise the state's total revenue.

CHAPTER 1

West Virginia's State and Local Tax System

PERSONAL INCOME TAX

The personal income tax is the state's largest source of tax revenue.

In FY 2019, West Virginia collected **$2.096 billion** in personal income taxes.

Over the past two decades the state has relied more heavily on personal income taxes as a source of state revenue, growing from 37% of General Revenue collections in FY 2000 to 44% in FY 2019. **By FY 2024, personal income taxes are expected to make up more than 46% of General Revenue Fund collections.**[1]

1. West Virginia FY 2020 Budget

West Virginia is one of 43 states that has a personal income tax. The state's personal income tax was established in 1961 and applies to most types of money income including:

- **wages and salaries**
- **interest**
- **rental income**
- **capital gains**
- **some business and pension income**

During the 2019 Legislative Session, West Virginia exempted social security income from the state income tax for taxpayers with incomes below $100,000 (filing jointly).[2]

West Virginia has a graduated, marginal income tax rate that begins at 3% and ends at 6.5%. This means that **as income increases, so does the rate at which it is taxed.** The effective rate is the average rate of taxation for all taxable income.

Example

Let's say your taxable income is $65,000—after any deductions—and that you're married, filing jointly.

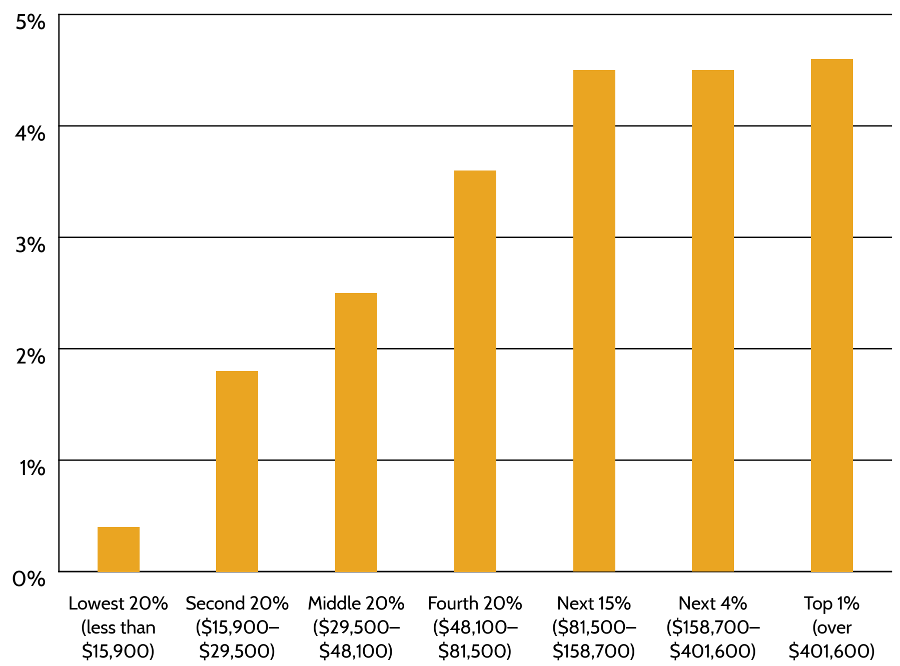
The first **$10,000**	is taxed at **3%.**
The next **$15,000**	is taxed at **4%.**
The next **$15,000**	is taxed at **4.5%.**
The next **$20,000**	is taxed at **6%.**
The final **$5,000**	is taxed at **6.5%.**

Your effective tax rate would be about 4.8%. Even those with incomes above $200,000 pay an effective tax rate below 6.5%.

2. HB 2001, 2019 West Virginia Legislative Session

West Virginia's personal income tax is structured such that **higher-income residents pay a larger share of their income in personal income taxes** compared to low- and middle-income residents.[3] In addition, families whose income is below the federal poverty threshold ($25,100 for a family of four in 2018) can receive the Family Tax Credit that eliminates or decreases their income tax liability.

PERSONAL INCOME TAX AS A SHARE OF FAMILY INCOME



3. Institute on Taxation and Economic Policy, Who Pays 2018

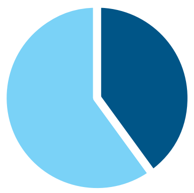
The personal income tax is usually the fairest source of revenue collected by state and local governments.

When properly structured, the personal income tax can:

- **ensure that wealthier taxpayers pay their fair share**
- **allow for lower rates on middle-income families**
- **exempt the poor and allow "refundable" tax credits**
- **provide a counterweight to less balanced taxes**

For the most part, West Virginia's personal income tax meets these standards, although it falls short in several areas.

The best feature of West Virginia's personal income tax is its graduated rate structure, making it a tax that benefits the working and middle class. Higher rates on wealthier tax payers allow for lower rates on everyone else. However, West Virginia's graduated rate structure has remained unchanged for decades. **The state's top rate starts at $65,000, which means that roughly 40% of West Virginia families pay it.** Since the state's brackets are not indexed to inflation, this problem grows every year, with more families falling into the top bracket.



Another aspect of the state's personal income tax that creates imbalance is the personal exemption. West Virginians are provided a $2,000 personal exemption from their state income tax for each household member regardless of their income level. **The personal exemption is much more valuable for high income families than low and middle income families.**

A family of four in the top tax bracket would save $520 in personal income taxes due to the personal exemption.

A family of four in the second tax bracket would save only $320.

West Virginia also no longer has an estate tax, or any other form of wealth tax, that would help to balance our tax system. The estate tax is the only state tax that is paid almost entirely by the wealthy. The federal estate tax, owed only by estates worth $5.45 million or more and $10 million for couples, applies to only 2 out of every 1,000 households. **Estate taxes can cover otherwise untaxed income**, which allows large concentrations of wealth to continue to be passed along from generation to generation, contributing greatly to income inequality.

West Virginia's Family Tax Credit makes the personal income tax more balanced by reducing or eliminating income taxes for low-income families. However, unlike some states which feature Working Families Tax Credits, **West Virginia's Family tax credit is not refundable**—recipients cannot get back more than they paid in taxes. Making the credit refundable would partially offset the cost to low-income families of other taxes they pay, like sales and gasoline taxes.

3

SALES AND USE TAX

The sales and use tax is the state's second largest source of tax revenue.

In FY 2019, West Virginia collected $1.37 billion in sales and use tax revenue. **Sales and use taxes have declined as a share of the General Revenue Fund**, decreasing from about 35% in FY 2000 to 29% in FY 2019.[4]

West Virginia's sales tax was enacted in 1934. The state applies a **rate of 6%** to sales of goods and services unless they are specifically exempted. Exemptions to the sales tax include:

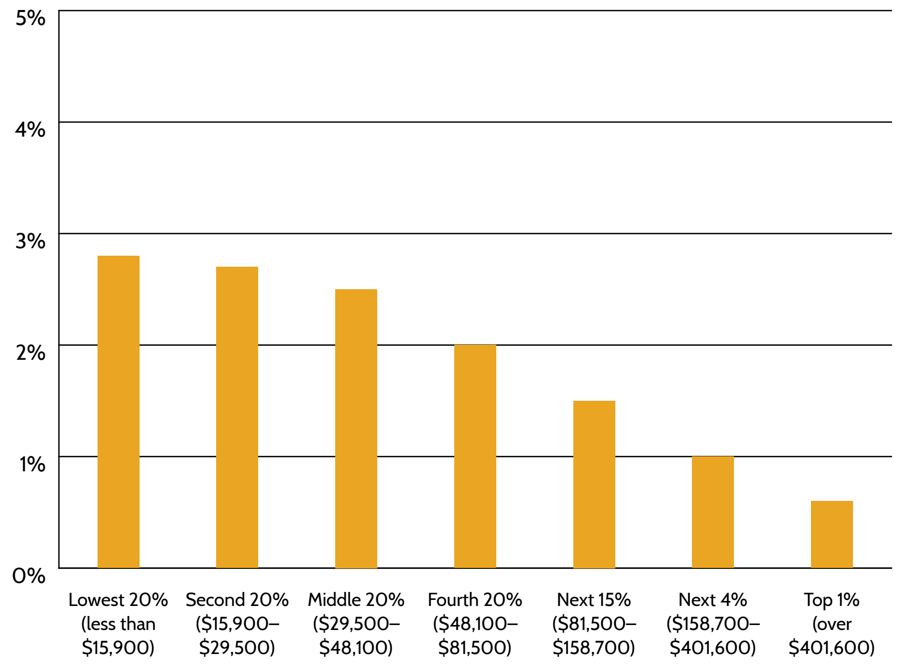
- **prescription drugs**
- **cellular services**
- **groceries**

Growth in sales tax revenue has declined as the state has added exemptions and as the national economy has shifted from producing goods to providing services. While West Virginia ranks 4th for the number of services taxed,[5] there are many personal services (e.g., haircuts, health clubs, etc.) and professional services (lawyers, accountants, engineers, etc.) that are exempt from the sales tax.

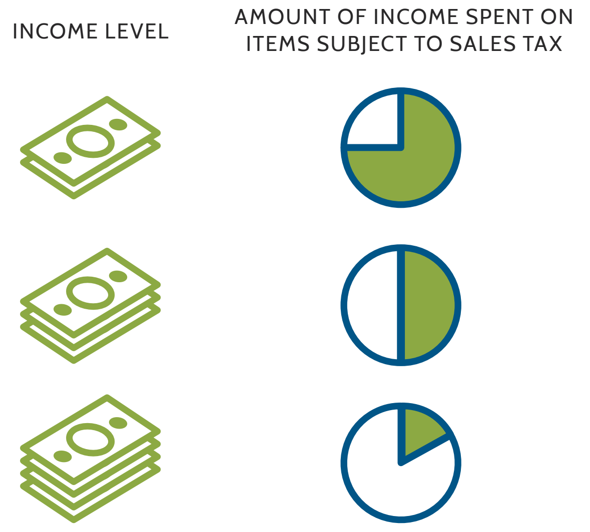
4. West Virginia FY 2020 Budget
5. Federation of Tax Administrators

West Virginia's sales tax is structured so that **low- and middle-income taxpayers pay a larger share of their income in sales taxes than the wealthy**. This is because, in general, low- and middle-income families and individuals spend a greater share of their income than the wealthy, who are more likely to save.

SALES TAX AS A SHARE OF FAMILY INCOME



Low-income families typically spend three-quarters of their income on things subject to sales tax, while middle-income families spend about half of their income on items subject to sales tax, and the richest families spend only about a sixth of their income on sales-taxable items.[6]



A broader sales tax base can make the system fairer.

Most state sales taxes were enacted early in the twentieth century, at a time when most of the things people purchased were tangible goods like cars, furniture, or books. But **in recent decades, consumer purchases have changed dramatically**, shifting toward services like gym memberships and cable television subscriptions.

6. U.S. Bureau of Labor Statistics, Consumer Expenditure Survey, 2018, by income group. https://www.bls.gov/cex/2018/combined/decile.pdf

Compared to most states, West Virginia does well on applying the sales tax to services, with only Hawaii, South Dakota, and New Mexico having a more comprehensive service tax base. However, West Virginia still exempts a number of personal services for no real discernible reason, including:

- **barbershops**
- **beauty and nail salons**
- **massage and tattoo parlors**
- **private fitness centers**

Taxing personal services makes the sales tax fairer in two ways. First, **taxing services helps ensure that the amount of sales tax anyone owes will depend primarily on how much they spend—not what they spend it on.** There is nothing inherently better (or worse) for society in spending money on services as opposed to goods. Taxing goods but not services discriminates in favor of consumers who prefer services and against those who prefer goods.

Second, **taxing services can also make the sales tax more balanced since many services are "luxuries"** that are more often purchased by high-income households than middle or low-income ones.

Applying the sales tax to various goods and services sold and delivered on the Internet—including books, music, movies, and other digital products downloaded electronically—would also make the sales tax fairer.

West Virginia's exemption of groceries makes the sales tax more balanced as a much higher portion of the income of poorer families goes toward food and groceries.

4

CORPORATE NET INCOME TAX

Corporate net income taxes have been declining as a share of total state tax revenue,

particularly since the tax cuts of 2007. West Virginia collected $198 million in corporate net income tax revenue in FY 2019. In FY 2000, corporate net income tax revenue, along with business franchise tax revenue, accounted for 8.3% of the state's General Revenue Fund. **In FY 2019, the share had fallen to 4.1%**.[7]

The corporate net income tax is a tax on the net profits of incorporated entities doing business in West Virginia. It **applies only to taxable "C" Corporations**—not to S Corporations, Limited Liability Companies, or other unincorporated entities (The owners of the latter kinds of businesses include their share of the businesses' income on their individual personal income tax returns.)

The corporate income tax is **a tax on corporate profits**. Profits are defined as receipts minus expenses. A corporation that does not realize a profit in any one year does not owe any corporate income tax that year.

7. WV State Budget Office, FY 2020 Budget

Corporate income is differentiated as either "business" or "nonbusiness." "Business" income is the profits a company earns from its day-to-day business operations. After determining how much business income there is in total, the state must determine what portion is "in-state" (which is taxable in the state) and what portion is "out-of-state" (which is not taxable in the state). West Virginia uses an apportionment formula to determine this.

Nonbusiness income comprises profits from certain irregular transactions and "passive" investments, such as certain rents, royalties, capital gains, interest, and dividends. It is not apportioned by formula but instead is assigned to one specific state—often the state in which the corporation receiving it is headquartered.

Having determined the share of its total taxable income that is attributable to West Virginia—the sum of its apportioned business income and any nonbusiness income—the state's corporate income tax rate is then applied to the total.

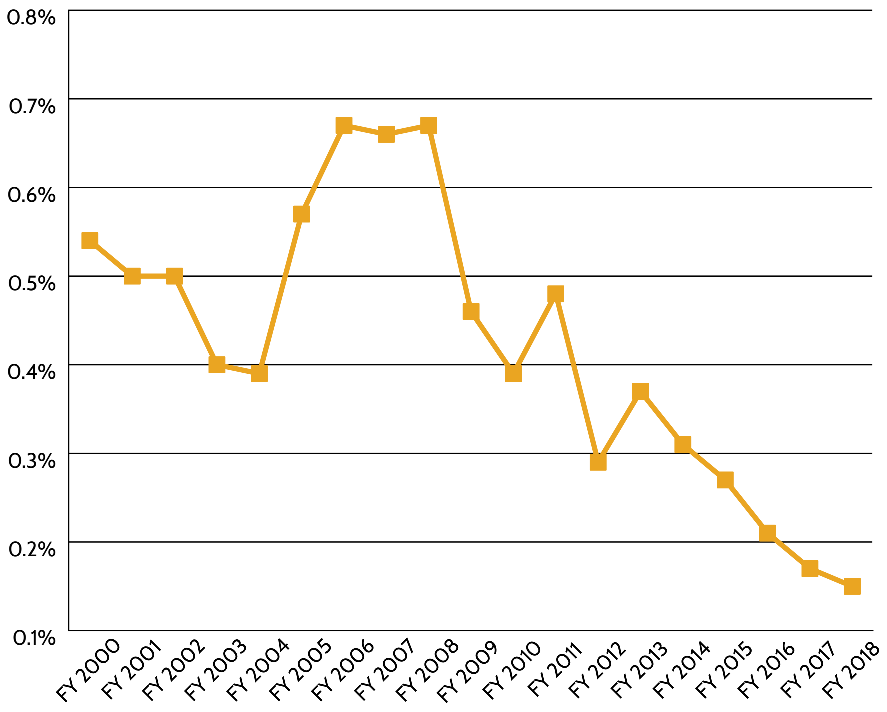
West Virginia's Apportionment Formula

The apportionment formula includes:	The apportionment formula weights these variables:
The percentage of a corporation's nationwide sales made to residents of West Virginia	50%
The percentage of a corporation's nationwide property that is located in West Virginia	25%
The percentage of a corporation's nationwide payroll paid to residents of West Virginia	25%

West Virginia's current corporate net income tax rate is 6.5%. The corporate net income tax rate underwent a series of reductions from 2007 to 2015, decreasing from 9% to 6.5%. Additionally, the state reduced and eventually eliminated the business franchise tax over that same time period. Together **these tax cuts resulted in an estimated annual revenue loss of $205 million.**

Corporate income taxes have decreased significantly as a share of the economy since the tax cuts went into effect.[8] Taxes targeted at corporations have now fallen to less than one-third of their FY 2000 share of total state personal income.[9]

CORPORATE INCOME AND BUSINESS FRANCHISE TAX
SHARE OF TOTAL STATE PERSONAL INCOME



8. In FY 2000, the corporate net income tax and the business franchise tax together were 0.54% of total state personal income. By FY 2008, this share had grown to 0.67%. In FY 2009, as cuts to the corporate net income tax and the phase out of the business franchise tax began, these taxes fell to 0.46% of personal income. Revenues steadily decreased in ensuing years and in FY 2018, the corporate net income tax is equal to just 0.15% of personal income. Over this nineteen-year period, taxes targeted at corporations fell to less than one third of their FY 2000 share of personal income.
9. WVCBP analysis of Bureau of Economic Analysis and WV State Budget Office data

The corporate income tax is one of the few taxes available to states that can be used to offset the disproportionate costs that sales, sin, and property taxes place on low-income households. Stock ownership is concentrated among the very wealthiest of taxpayers, so **the corporate income tax falls primarily on the most affluent**.

Because most multi-state corporations have shareholders around the country and around the world, the bulk of a state's corporate income tax will fall on residents of other states and countries. This is appropriate, because **these stockholders are benefiting from the services like worker education and good roads and bridges that enable the corporations they own to be profitable.**

It is important to note that corporate income taxes are deductible when determining federal income tax liability. Since the federal corporate income tax rate is 21%, **as much as 21% of a state's corporate income tax will ultimately be paid not by the businesses themselves, but by the federal government** (in the form of reduced federal corporate income tax collections).

As mentioned earlier, corporate income taxes in West Virginia as a share of state personal income in 2018 were roughly one-third their 2000 level. Corporations are contributing less income tax to the state than they have in decades, despite continuing to use public services.

West Virginia is a combined reporting state, which means that corporations are prevented from shifting their taxable profits to low-tax jurisdictions. Combined reporting makes the system fairer for small businesses doing business in only one state, because they have no business units in other states to shift their income to in order to avoid taxes like large multi-state corporations can.

West Virginia's cuts to the corporate income tax rate and elimination of the business franchise tax over the last decade have led to sharp revenue declines.

West Virginia's natural resources are one of its greatest assets and an important source of wealth.

But the extraction of those resources can come at a heavy price, creating stress on the environment, infrastructure, and local communities. Like many other natural resource-rich states, West Virginia levies a severance tax on the extraction of its natural resources. The revenue from the severance tax allows the state to capture natural resource wealth and use it for important purposes like education, infrastructure, health care, and countless other priorities for the state. It also provides a way for the state to bear the costs imposed by natural resource extraction.

Currently the state's third-largest source of revenue, the severance tax accounted for 9.7% of the General Revenue Fund in FY 2019, at $462 million. **The state has grown more reliant on the severance tax as a source of revenue in recent years**, particularly as natural gas production has fueled revenue growth. In FY 2000, the severance tax accounted for only 5.6% of total general revenue funds.[10]

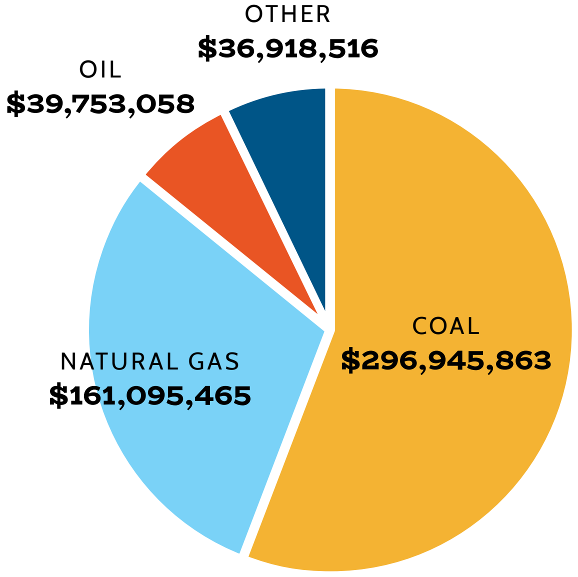
The severance tax is a 5% gross receipts tax levied on businesses that sever, extract, and/or produce natural resource products in West Virginia including oil, coal, natural gas, and other natural resource products.

10. WV State Budget Office, FY 2020 Budget

In FY 2019, West Virginia collected $296.9 million from the severance tax on coal, $161.1 million from natural gas, and about $76.7 million from oil and other minerals.[11]

Historically, coal was overwhelmingly the largest source of severance tax revenue—but with declining coal production and a boom in natural gas production, that has begun to change. In FY 2019, coal production accounted for 55.5% of severance tax revenue, and natural gas accounted for 30.0%. In contrast, in FY 2011, coal accounted for 88% of severance tax revenue, and natural gas accounted for only 10%.[12]

SHARE OF TOTAL SEVERANCE TAX REVENUE, FY2019



11. WV Tax Department
12. WV Tax Department

While West Virginia's base rate of 5% is uniform for all natural resources except for timber, there are several exemptions, limits, and deductions that lower the rate. There are reduced severance tax rates for thin-seam coal produced from underground mines. In FY 2019, **the value of these reduced rates was $41 million.**[13]

In addition, HB 3142 (passed during the 2019 Legislative Session) will reduce the severance tax on steam coal to 3%. **This is expected to diminish severance tax revenue by $64 million per year.**

As mentioned previously, the severance tax is highly exportable, meaning that **the burden of the tax falls primarily on out-of-state consumers and stockholders of natural resource companies.**[14] Given this, and considering evidence that the severance tax does not significantly discourage natural resource production, it seems that **the best severance tax is a high severance tax.**

A significant amount of severance tax revenue is allotted to local governments:

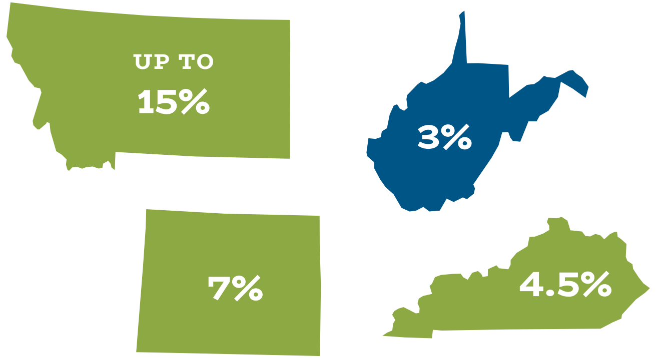
- The revenue raised through the severance tax rate of **0.35 percent on coal production goes to West Virginia's counties and municipalities.**[15] In FY 2019, that amounted to $17.2 million.[16]
- Another **5% of coal severance tax revenue is distributed to the state's coal producing counties** through the Coal County Reallocated Severance Tax Fund, enacted in FY 2011. In FY 2019, $12.6 million was distributed through the fund.[17]
- **Local governments receive 10% of oil and natural gas severance tax revenue.** In FY 2019, $15.4 million was distributed to local governments.[18]

13. WV State Budget Office, FY 2020 Budget

14. Robert Tannenwald, "Fiscal Disparity Among the States Revisited," New England Economic Review, July/August 1998, pp.7 & Mark Robyn and Gerald Prante, "State-Local Tax Burden Falls in 2009 as Tax Revenues Shrink Faster than Income," Tax Foundation, February 2011, pp.68

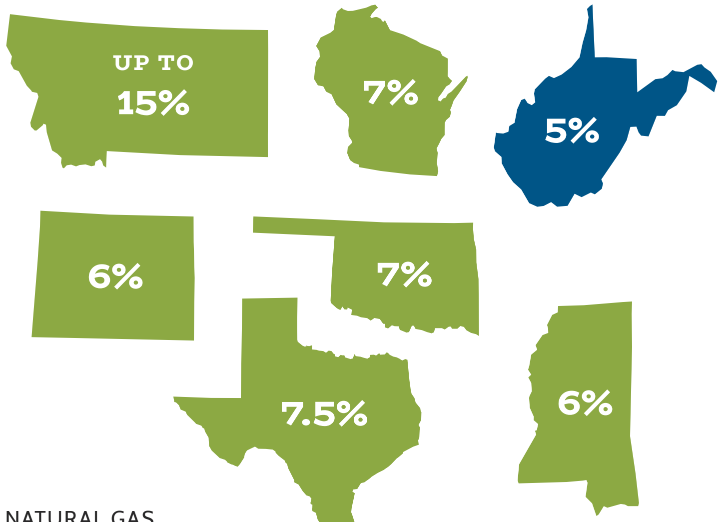
15. The 5 percent severance tax on coal is actually two taxes. A 0.35 percent tax and a 4.65 percent tax. The 0.35 percent tax goes to local governments, and the 4.65 percent tax goes to the state.

Unfortunately, **West Virginia is moving in the wrong direction with its severance tax.** West Virginia's former rate of 5% on coal production was already lower than that of other major coal producing states, including Montana (which has a severance tax of up to 15% depending on the quality of coal and type of mine), and Wyoming (7%). Due to recent legislation that lowered the severance tax on steam coal to 3%, West Virginia's tax is now even lower than that of neighboring Kentucky.



COAL SEVERANCE TAX RATES

The same is true for natural gas. **West Virginia's rate of 5% is in the middle of the pack compared to other states.** States with higher natural gas severance taxes include Mississippi (6%), Montana (up to 15% according to the type of well and type of production), Oklahoma (7%), Texas (7.5%), Wisconsin (7%), and Wyoming (6%).



NATURAL GAS
SEVERANCE TAX RATES

16. WV Tax Department

17. WV State Auditor's Office

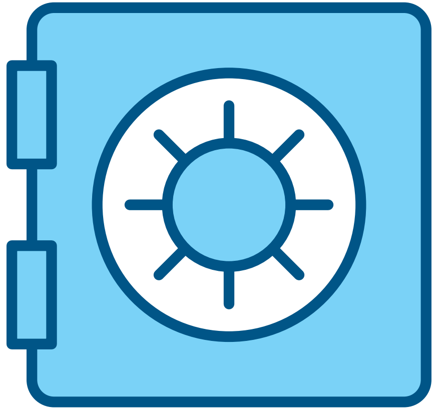
18. WV Tax Department

West Virginia also lacks a permanent mineral trust fund supported by severance taxes on coal and natural gas. Since the 1970s, several Western states created trust funds to ensure that they would benefit from mining production even during times of declining production and eventual exhaustion of the natural resource. For example, Wyoming has approximately $13 billion in mineral wealth assets across four trusts that are used to fund education and general revenue expenditures.

In 2014, West Virginia passed a “Future Fund” to act as a permanent mineral trust fund to receive revenues contingent on certain benchmarks and thresholds yet to be met.

Had West Virginia enacted a Future Fund in 2012 and funded it with a 1% additional severance tax on oil, natural gas, and coal, it would have a balance of over $800 million today. Setting aside tax revenues from the state’s non-renewable and disappearing natural resources is one of the most effective ways to fund economic diversification efforts, especially as the mining industry is at the heart of the state’s boom and bust economy. A well-funded Future Fund can transform our non-renewable natural resource assets into a permanent source of wealth, allowing the state to both diversify its economy and provide a bridge to a more prosperous future.

$800 million



West Virginia’s property tax is primarily a local tax.

Almost all the revenue is raised by county and municipal governments, as well as county school boards. **In tax year 2018, state and local governments collected $1.7 billion in property tax revenue.** Of that, $7 million was collected by the state, $122 million by municipalities, $466 million by counties, and $1.1 billion by school districts.[19]

Since 1932, **property has been divided into four classifications for tax purposes**. These classifications separate property by type and location. Class I property includes personal property used in agriculture and intangibles and is exempt from the property tax. Class II property includes owner-occupied residencies and farm real estate. Class III and IV property includes all other property, including vacant land, rental property, vehicles, commercial real estate, and equipment and inventory. Class III property is located outside a municipality, while Class IV property is located within.

Property tax rates vary not only by property class, but also by the **four separate governing bodies that have the power to tax: the state, counties, county school boards, and municipalities**. The West Virginia Constitution sets the maximum tax rate for each taxing body and property class. For each governing body, the rate for Class III and IV is twice the rate for Class II. Every taxable property, regardless of classification, is assessed at 60% of its fair market value before the tax rate is applied.

19. WV Tax Department

WEST VIRGINIA MAXIMUM PROPERTY TAX RATES
(PER $100 OF ASSESSED VALUE)

	Class II	Class III and IV
State	0.5¢	1¢
County	28.6¢	57.2¢
School district	45.9¢	91.8¢
Municipality	25¢	50¢

Counties, school districts, and municipalities may temporarily exceed these maximum rates through an excess levy. This levy is an additional property tax used to provide supplemental funding for libraries, ambulance service, school buildings, extracurricular activities, and other essential community services.

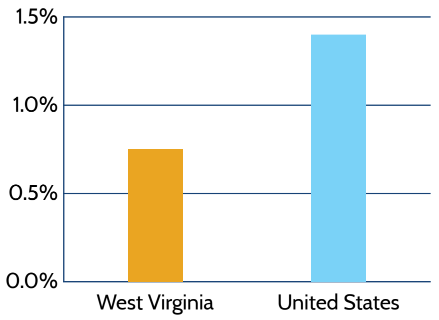
Counties, school districts, and municipalities may also levy a property tax based on any bonds they may have issued. This tax rate is determined by the amount of money that must be raised to pay the principal and interest of the bond and, when combined with the regular county, school, or municipal rate, may not exceed the maximum rate for that taxing authority.

Although taxing authorities can raise their tax rates to the maximum rate, **legislation in West Virginia has placed caps on annual property tax revenue growth**. Counties and municipalities can increase property tax revenue by 1% each year, while school districts have a 2% cap. Public hearings can be held to allow revenue to increase by up to 10%. Tax rate increases that cause revenues to exceed the cap are only applied to the point where the revenue limit is reached. The full increase is applied in yearly increments as allowed by the revenue caps.[20]

West Virginia state taxpayers pay less in property taxes than people in almost any other state, largely because of low rates on real property for both individuals and businesses—made possible by a broad tax base that includes business personal property.

20. West Virginia Code §11-8-6e

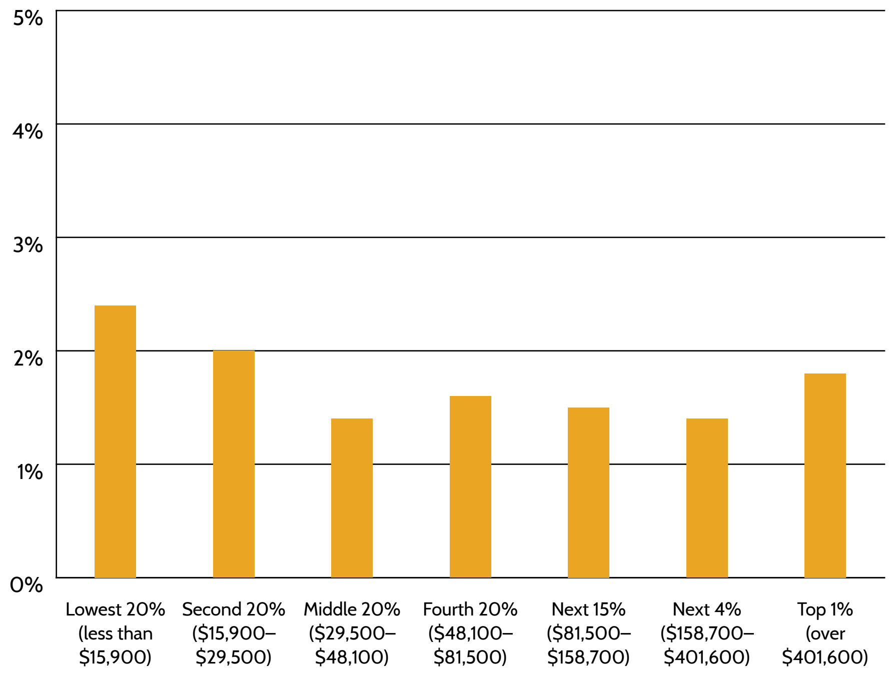
EFFECTIVE PROPERTY TAX RATE
ON A $150,000 HOME



West Virginia's average property tax on a home valued at $150,000 is 0.752%, while the national average is 1.397%.[21]

Although not to the extent of the sales tax, **property taxes are slightly imbalanced**. While middle- and high-income families pay roughly the same share of their income in property taxes, low-income families pay more.

PROPERTY TAX AS A SHARE OF FAMILY INCOME

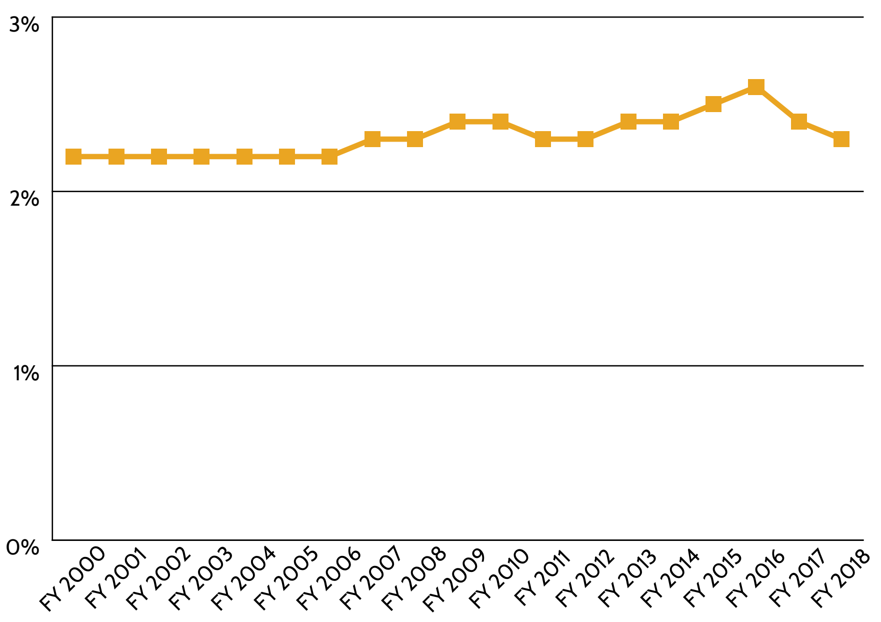


21. WVCBP analysis of Bureau of Economic Analysis and WV Tax Department data

Additionally, property taxes are not responsive to variations in taxpayers' income: someone who suddenly loses his job will find that his property tax bill is generally unchanged, even though his ability to pay it has drastically fallen. A similar problem occurs for elderly and retired taxpayers, who can find themselves **"property rich" but "cash poor."**

State and local property taxes have been a stable source of revenue over the past two decades. As a share of personal income, state and local property taxes have averaged 2.3% since 2000, never falling below 2.2% or rising above 2.6%.[22]

STATE AND LOCAL PROPERTY TAXES AS A SHARE OF STATE PERSONAL INCOME



22. WVCBP analysis of Bureau of Economic Analysis and WV Tax Department data

One of the balanced features of West Virginia's property tax is the inclusion of business personal property in its property tax base. In general, the wealthy own far more business property than do middle- and low-income people.

West Virginia provides property tax relief for seniors and low-income households. West Virginia's Homestead Exemption provides for a $20,000 exemption against the total assessed value of an owner-occupied residence for those aged 65 or older or permanently disabled. While limited to seniors and the disabled, there is no income limit to the Homestead Exemption, and it is available to low and middle-income taxpayers as well as the wealthiest taxpayers. The Homestead Exemption also provides no benefit to renters, even though renters generally pay some property tax indirectly in the form of higher rents.

West Virginia also offers a property tax circuit breaker to protect low-income residents from a property tax "overload." West Virginia's program **allows for a refundable credit for property taxes** paid in excess of 4% of gross household income for households at or below 300% of the federal poverty level.

West Virginia's caps on property tax rates and revenue growth restrict the ability of local governments to raise revenue. As mentioned, West Virginia's property tax rates are capped by the state constitution, and local governments are prohibited from increasing overall property tax collections beyond a set amount. Rate and revenue caps reduce both the revenue-generating potential of the property tax and the ability of local lawmakers to stabilize property tax collections through periodic adjustments in the tax rate. This hinders local governments' ability to provide a consistent and adequate level of services.

In recent years, there have been multiple pushes to eliminate the property tax on business personal property. **In tax year 2016, business personal property tax revenue totaled $388 million—roughly 23% of total property tax revenue.** This includes property taxes on business machinery and equipment, inventory, and other business personal property like computers and fixtures, as well as the working interest from oil and natural gas property.

Eliminating the business personal property tax without replacing the revenue would be a fiscal disaster for local governments and schools, which rely heavily on property taxes.

And while the tax may be unpopular with some in the business community, state-level inventory and other personal property taxes rarely impact business location decisions or have a significant effect on employment in manufacturing, wholesale, and retail industries. The tax is closely tied to direct benefits businesses receive from local governments: police and fire protection for the personal property itself and high-quality local schools that attract and educate employees.[23]

23. Larry Deboer, "Taxing Inventory: An Analysis of its Effects in Indiana," Indiana Business Review, Fall 1999; Sian Mughan and Geoffrey Propheter, "Estimating the Manufacturing Employment Impact of Eliminating the Tangible Personal Property Tax: Evidence From Ohio," Economic Development Quarterly, September 26, 2017

Tobacco Tax

Tobacco taxes are often known as "sin taxes." **Sin taxes are applied to items whose consumption is deemed to be detrimental to society.** The goal of these taxes is to increase the price of an item in order to discourage both its consumption and the societal ills associated with such consumption, such as increased rates of cancer and other health problems that result from tobacco use.

Tobacco taxes are very effective at discouraging tobacco use. Every 10% increase in the price of cigarettes can be expected to reduce overall cigarette consumption by roughly 3 to 5%. Cigarette price increases are especially effective among children and young adults who, because of the price increase, are two to three times more likely to stop smoking. But given the addictive qualities of nicotine, many smokers will simply pay the higher tax, regardless of the rate, and continue their habit.[24]

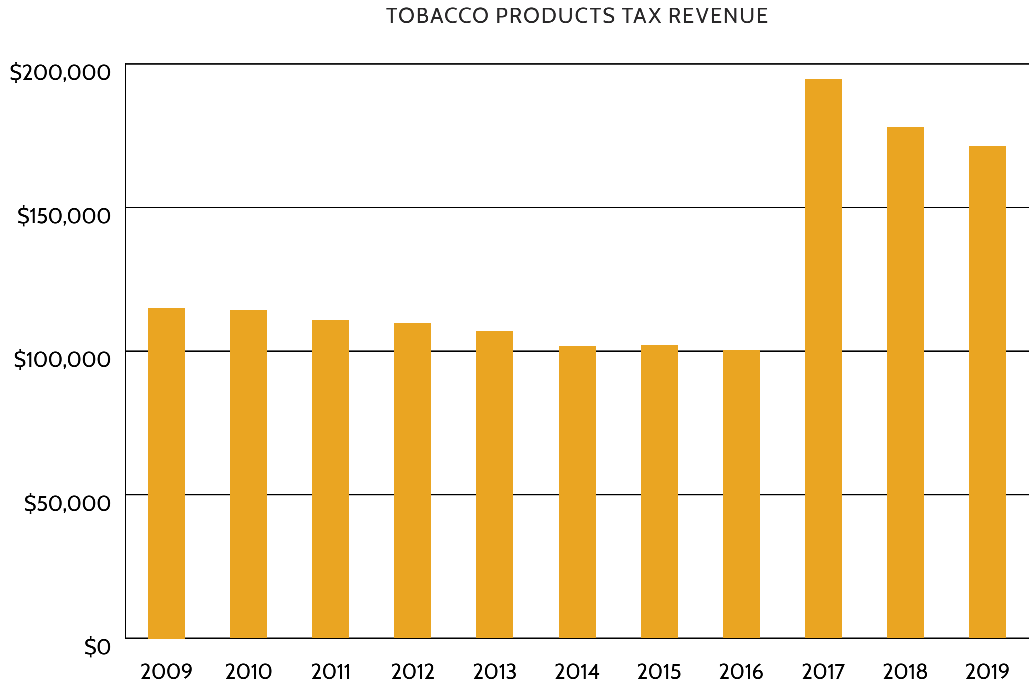
10%▲ = 3-5%▼

increase in cigarette price = **decrease in overall cigarette consumption**

West Virginia's tobacco products tax includes a tax of $1.20 per pack of cigarettes, a 12% wholesale tax on other tobacco products, and a $0.075 per milliliter tax on e-cigarette liquids. **In FY 2018, West Virginia collected $178 million in tobacco taxes.**[25] West Virginia ranks 33rd highest among the 50 states for tobacco taxes.[26]

24. Centers for Disease Control and Prevention, "Economic Trends in Tobacco," Fast Facts and Fact Sheets
25. WV State Budget Office, FY 2020 Budget
26. Janelle Cammenga, "How High Are Cigarette Taxes in Your State?" Tax Foundation, April 10, 2019

Over the past decade, **revenue from the tobacco products tax has been declining** due to continuing efforts to discourage tobacco products' consumption. Revenue was boosted in 2017 with an increase in both the cigarette tax and the creation of the tax on e-cigarette liquids. However, long term, tobacco tax revenue is still expected to decline.



Low- and middle-income taxpayers pay more of their income in cigarette taxes, on average, than do upper-income families. In 2015 the poorest 20% of Americans spent 0.8% of their income, on average, on cigarette taxes while the wealthiest 1% spent less than 0.1% of their income on these taxes.

Cigarette taxes disproportionately affect low-income taxpayers because the fixed amount of tax on a pack of cigarettes represents a larger share of income for low-income smokers. Low-income individuals are also disproportionately affected because they are more likely to smoke than their upper-income neighbors. The prevalence of smoking is higher among individuals living below the poverty line.[27]

Alcohol Tax

The state's alcohol tax is another "sin tax" designed to discourage alcohol consumption and the negative actions associated with it, including drunk driving, violence, and health problems. Like tobacco taxes, **alcohol taxes are very effective at reducing drinking and problems such as cirrhosis deaths**. A 10% increase in the price of alcohol decreases the death rate from alcohol-caused diseases by 9% to 25%, not including alcohol-related deaths due to violence, car crashes, and other causes.[28]

10% = **9-25%**

increase in alcohol price — **decrease in death rate from alcohol-related diseases**

West Virginia levies an excise tax on beer and wine vendors. Wine vendors are responsible for paying a state excise tax of $0.26406 per liter for all wine sold, while beer vendors pay $5.50 per 31-gallon barrel for all beer sold. Wine and beer sales are also subject to the sales tax. West Virginia ranks 13th highest for wine taxes and 28th highest for beer taxes among the 50 states.[29]

West Virginia collects roughly $7.5 million from the excise tax on beer and $2.1 million from the excise tax on wine. While revenue from the excise tax on wine has increased in the past decade, up from $1.7 million in 2009, revenue from the beer excise tax has declined, down from $8.6 million in 2009.

27. Centers for Disease Control and Prevention, "Cigarette Smoking and Tobacco Use Among People of Low Socioeconomic Status," Tobacco Related Disparities
28. David Roodman, "The impacts of alcohol taxes: A replication review," Open Philanthropy Project, July 2015
29. SalesTaxHandbook, "West Virginia: Alcohol Excise Taxes," https://www.salestaxhandbook.com/west-virginia/alcohol

Alcohol taxes tend to be more balanced than tobacco and soda taxes since high-income groups spend more money on alcoholic drinks than on tobacco or soda, but low- and middle-income taxpayers remain disproportionately affected.

Soda Tax

Soda taxes are another example of a "sin tax" used to discourage consumption and improve health. There is a substantial amount of scientific research that links consumption of sugar-sweetened beverages to obesity and chronic illnesses like diabetes.[30]

West Virginia's soda tax, however, was not imposed to curb consumption. Instead, the tax was created—and the generated funds are still reserved—for the sole purpose of the construction, maintenance, and operation of a four-year school of medicine, dentistry, and nursing at West Virginia University.

West Virginia currently has an excise tax of $0.01 per bottle on the sale, use, handling, or distribution of bottled soft drinks, syrups, and powder bases prepared for mixing soft drinks. **West Virginia collects approximately $15 million annually from this tax.** The rate has not increased since its creation in 1951.

In light of links between sugary drinks and adverse health effects, a number of local governments have implemented soda taxes designed to reduce consumption and improve health, at much higher rates than existing state excise taxes. **At its current rate, West Virginia's soda tax is too low to significantly curb consumption**, therefore failing to achieve the health benefits associated with higher soda taxes.

As with the tobacco tax, **lower-income populations are disproportionately affected by the soda tax**.

Motor Fuel Excise Tax

West Virginia's motor fuel excise tax and motor carrier road tax contain both a variable rate and a flat rate. The current flat rate is $0.205 per gallon, while the variable rate is equal to 5% of the average wholesale price of motor fuel. **This tax provides funding to the Division of Highways, Division of Motor Vehicles, and the Office of Administrative Hearings.** In FY 2019 West Virginia collected $443 million in motor fuel taxes.[31]

Since West Virginia's motor fuel tax is dedicated to funding the maintenance and expansion of the state's transportation infrastructure, **it can be described as a "user fee" on drivers for their use of the state's roads**. Those who drive the furthest distances (or the heaviest vehicles) produce more wear-and-tear on the roads and therefore generally pay more in gasoline taxes.

Revenue from the motor fuel and motor carrier taxes have declined in recent years, falling from $441 million in FY 2014 to $381 million in FY 2017, as low gas prices lowered the revenue from the variable rate. In 2017 the flat rate increased by $0.035 per gallon, and revenues increased to $443 million in FY 2019. However, projections from the state's budget office show that revenues will continue to decline in the future due to increasing fuel efficiency and, subsequently, a need to purchase less fuel.

In 2018, West Virginia's motor fuel tax ranked 13th highest among the 50 states.[32]

Automobile Sales Tax

The automobile sales tax is 6% of the value of a vehicle imposed at the time of purchase or lease. **Revenue from the automobile sales tax is appropriated to the State Road Fund.** In FY 2018, the automobile sales tax yielded $227 million.[33]

The automobile sales tax operates under the same principle as the motor fuel tax. Those who buy and own cars benefit from the state's road system, while contributing to its wear and tear.

Health Care Provider Tax

The Health Care Provider tax, paid by service providers, produces revenue that is used for the state's share of the Medicaid Program. The tax applies to services of ambulatory surgical centers, independent laboratory and x-ray facilities, inpatient and outpatient hospitals, intermediate care facilities for mentally handicapped patients, managed care organizations, and nursing homes. West Virginia collected $195 million from the Health Care Provider Tax in FY 2018.[34]

30. Friedman, R. R., & Brownell, K. D. (2012, October). Sugar-Sweetened Beverage Taxes: An Updated Policy Brief. Rudd Report

31. WV State Budget Office, FY 2020 Budget
32. Katherine Loughead, "State Gasoline Tax Rates as of July 2018," Tax Foundation, August, 2018
33. WV State Budget Office, FY 2020 Budget
34. WV State Budget Office, FY 2020 Budget

Since the revenue from the provider tax is used to match federal Medicaid funding, the $195 million in provider taxes helps bring in $565 million in federal dollars for the state's Medicaid program at the current match rate.[35]

Insurance Premium Tax

West Virginia levies a 4% tax on insurance premiums for insurance products such as life, health, property, and casualty insurance. Three-quarters of the revenue from this tax (an estimated $111 million) is allotted to the General Revenue Fund. The remaining quarter of the revenue is dedicated to the Municipal Pensions and Protection Special Revenue Fund, which is used for municipal police and fire pensions, volunteer fire departments, and the teachers' retirement system.

West Virginia's insurance premium tax is above the national average of 2.1% to 2.6%, depending on the type of insurance.[36]

Business and Occupation Tax

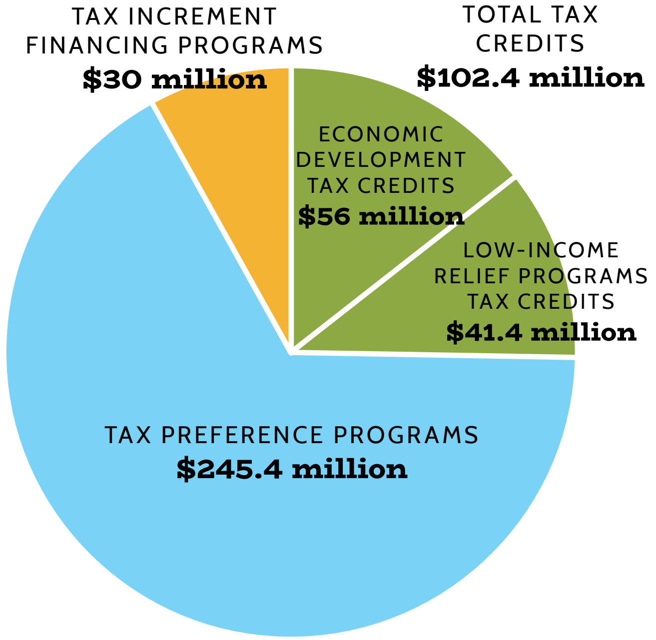
The state's business and occupation tax is applied to public utilities, electric power generators, and natural gas storage. The rates and base vary with type of utility and generator. **In FY 2018, West Virginia collected $115 million from the Business and Occupation tax.**[37]

35. Kaiser Family Foundation, "Federal Medical Assistance Percentage (FMAP) for Medicaid and Multiplier FY 2019," State Health Facts
36. "WV Insurance Premium Taxes and Surcharges," Presentation to the Joint Select Committee on Tax Reform, West Virginia Legislature, September 15, 2015.
37. WV State Budget Office, FY 2020 Budget

One often-overlooked aspect of tax policy is tax expenditures.

Tax expenditures are tax credits and other tax preferences—such as special exemptions, deductions, rebates, and rate reductions—that reduce the amount of tax a person or a business owes in order to encourage specific activities and to aid taxpayers in "special circumstances."

TAX EXPENDITURES
FY 2020 ESTIMATED COSTS



West Virginia has 22 active **tax credit programs** in the State Tax Code with a total FY 2020 value of $102.4 million. Economic development tax credits make up over half of the total value, with $56 million in total tax credits. Tax credits that act as low-income relief programs account for $41.4 million of the total.[38]

$2 million
TOURISM DEVELOPMENT TAX CREDIT
25% of approved costs over 10 years

$33 million
INDUSTRIAL EXPANSION/REVITALIZATION TAX CREDIT
10% Investment Credit—electric power producers

$1.2 million
COAL-LOADING FACILITIES TAX CREDIT
10% investment credit—coal loading facilities

$2 million
TOURISM DEVELOPMENT TAX CREDIT
25% of approved costs over 10 years

$33 million
INDUSTRIAL EXPANSION/REVITALIZATION TAX CREDIT
10% Investment Credit—electric power producers

$1.2 million
COAL-LOADING FACILITIES TAX CREDIT
10% investment credit

$6.7 million
LOW-INCOME ELECTRIC, GAS, AND TELEPHONE TAX CREDIT
Reimburses utility for low-income resident discount

$3 million
NEIGHBORHOOD INVESTMENT PROGRAM TAX CREDIT
50% credit for charitable contributions

Minimal
AGRICULTURAL EQUIPMENT TAX CREDIT
25% up to $2,500—Environmental equipment

$1 million
NATURAL GAS JOBS RETENTION TAX CREDIT
$1,000/job—Natural Gas Storage Tax

38. WV State Budget Office, FY 2020 Budget

$6.5 million
ECONOMIC OPPORTUNITY TAX CREDIT
Investment Credit—new jobs & select industries

$4.5 million
MANUFACTURING INVESTMENT TAX CREDIT
5% Investment Credit

$.3 million
APPRENTICESHIP TRAINING TAX CREDIT
$2/hour or $2,000/year—Training Tax Credit

$3 million
WEST VIRGINIA FILM TAX CREDIT
27% to 31% of costs for making WV Film

$6 million
MANUFACTURING PROPERTY ADJUSTMENT TAX CREDIT
Manufacturing Inventory Tax Credit

Minimal
MINE SAFETY TECHNOLOGY TAX CREDIT
50% Investment Credit—Mine Safety Equipment

Up to $20 million
ENERGY INTENSIVE INDUSTRIAL CONSUMER TAX CREDIT
Up to $20 million—Coal Severance Tax

Minimal
FARM TO FOOD BANK TAX CREDIT
10% value of donated, edible agriculture products up to $2,500/year

$1.5 million
REHABILITATED BUILDINGS TAX CREDIT
25% of qualified costs

$.3 million
RESIDENTIAL REHABILITATED BUILDINGS TAX CREDIT
5% of qualified costs

$1.7 million
NONFAMILY ADOPTION TAX CREDIT
$2,000 per qualified adoption

$12.2 million
SENIOR CITIZEN HOMESTEAD TAX CREDIT
Local tax paid on first $20,000 of taxable valuation

$20 million
LOW-INCOME FAMILY TAX CREDIT
Up to 100% of pre-credit income tax

$2.5 million
EXCESS PROPERTY TAX CREDIT
Excess over 4% of gross income up to $1,000

Minimal
MILITARY INCENTIVE TAX CREDIT
30% of first $5,000 of Wages Paid

In addition to tax credits, West Virginia has multiple **tax preference programs** that involve exclusions, special valuation provisions, or tax rate preferences. These totaled an estimated $245.4 million in FY 2020.

Unknown
PILOT-COUNTY
Payment in Lieu of Tax—new facilities

$21.8 million
POLLUTION CONTROL SALVAGE VALUE
State portion of $72.6 million

$29.7 million
HOMESTEAD EXEMPTION & TAX RATE
Over 65/disabled—state portion of $99 million

$.6 million
MANUFACTURING PRODUCTION PROPERTY
Salvage value—state portion of $2.0 million

$15.8 million
CERTIFIED CAPITAL ADDITIONS
Salvage value—existing manufacturing—state portion of $37.7 million

$.5 million
SPECIAL AIRCRAFT PROPERTY
Salvage value—state portion of $1.7 million

$0
HIGH-TECHNOLOGY BUSINESS PROPERTY
Salvage value—state portion of minimal $0.1

$134.5 million
RESIDENTIAL/FARM PREFERENCE
50% Tax rate preference—state portion of $448 million

$41 million
THIN-SEAM COAL RATES
Reduced tax rates on thin-seam coal (60%–80%)

$1.5 million
NATURAL GAS/OIL EXCLUSIONS
Low-volume/shut-in well gross receipt exclusions

The state also uses **tax increment financing programs**, where increases in tax revenue above a baseline are rededicated to a specific development project. West Virginia uses both sales tax and property tax increment financing programs. These programs totaled an estimated $30 million in FY 2020.

$9.6 million
PROPERTY TAX INCREMENT FINANCING
ECONOMIC DEVELOPMENT DISTRICT
Property increment-state portion of $20 million total

$21 million
SALES TAX INCREMENT FINANCING
6% state sales tax re-designated as local tax

Personal Income Tax

Strengths

Graduated rate structure

Family tax credit

Weaknesses

Personal exemption does not phase out

No estate tax

Family tax credit is non-refundable

Sales Tax

Strengths

Exempts groceries

Applies to most services

Weaknesses

Does not apply to digital downloads

Corporate Income Tax

Strengths

Combined reporting

Weaknesses

Recent cuts to rates

Severance Tax

Strengths

Revenue shared with local governments

Future Fund established

Weaknesses

Rates are low and have been cut recently

Future Fund has not been funded

Property Taxes

Strengths

Broad base includes real and personal property

Homestead exemption and circuit breakers protect elderly and low-income families

Weaknesses

Revenue and rate caps restrict local governments

CHAPTER 2

Needs and Challenges

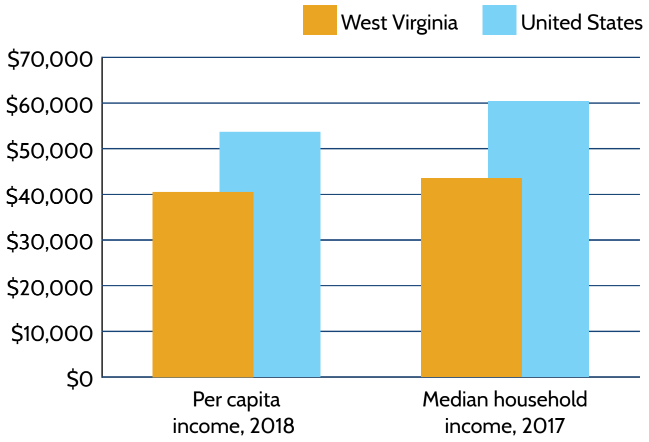
The economic and social well-being of a state is a function of many related and independent factors. While there is no one data point to precisely determine the well-being of a state, there are a number of economic and social indicators that can illustrate how well a state's economy and its people are performing. These indicators can provide useful insights into what can be done to promote greater economic and social well-being and help guide effective tax policies.

LOW INCOME, HIGH POVERTY

West Virginia has historically been one of the poorest states in the country.

One of the simplest measures of the relative wealth of an economy is per capita income. In 2018, **West Virginia's per capita personal income of $40,578 was higher than only one state** (Mississippi) and was $13,134 below the national average. In fact, West Virginia's per capita personal income has never ranked better than 32nd among the 50 states and D.C. since 1929; since 1980 it has not ranked better than 47th.[39]

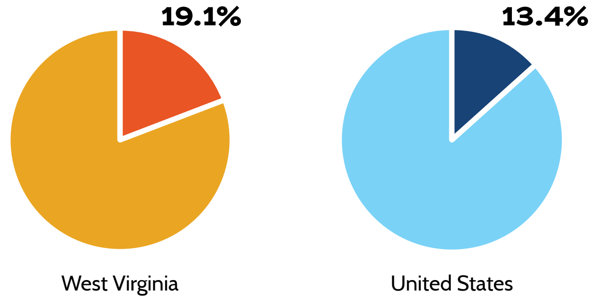
39. Bureau of Economic Analysis



West Virginia's income levels are also low by another measure: median household income, which measures the income of the typical household—or the household in the middle of the income distribution—and serves as a good indicator of how the middle class is faring. In 2017, West Virginia's median household income was an estimated $43,469, **the lowest among the 50 states**.[40]

With low levels of income, it is unsurprising that thousands of West Virginians are struggling to make ends meet. In 2017, the state's poverty rate was 19.1%, the fourth-highest in the country, with **more than 336,000 West Virginians living in poverty**. Poverty is even more prevalent among the state's children, with more than one in four living in poverty. African Americans and women also experienced elevated levels of poverty in 2017, with the poverty rate for African Americans in West Virginia at 31.7% and for women at 20.9%.[41]

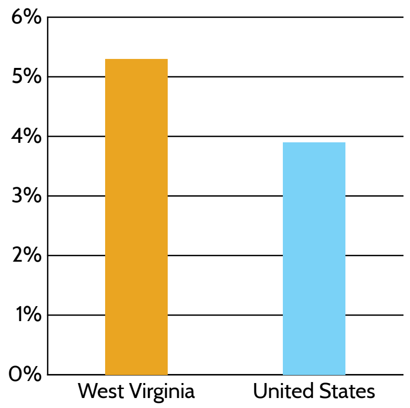
POVERTY RATE, 2017



40. U.S. Census Bureau, 2017 American Community Survey
41. U.S. Census Bureau, 2017 American Community Survey

While West Virginia's unemployment rate has been declining in recent years, fewer West Virginians are working,[42] and those who are work for low wages.

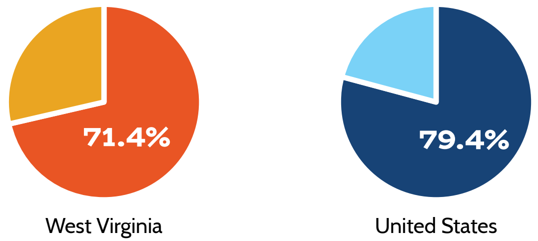
UNEMPLOYMENT RATE, 2018



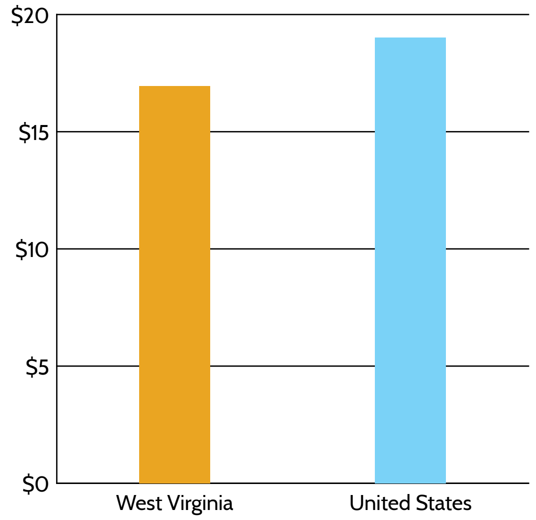
West Virginia's unemployment rate fell to 5.3% in 2018, from a high of 9.0% in 2010. Despite its falling unemployment rate, **West Virginia still had the 2nd-highest unemployment rate in the country in 2018**, with an unemployment rate 1.4 percentage points higher than the national average.[43]

More concerning is West Virginia's prime-age employment-to-population ratio: the measure of people between the ages of 25 to 54 who are working as a share of the adult population. **West Virginia's prime-age employment-to-population ratio in 2018 was 71.4%, the lowest among the 50 states**, and 8.0 percentage points below the national average. The employment-to-population ratio is a key component of long-term economic growth and is a good barometer for how well a state's economy provides employment for those who are able to work. West Virginia has historically had the lowest employment-to-population ratio rate in the country.[44]

EMPLOYMENT-TO-POPULATION



MEDIAN WAGE, 2018



Those who are working in West Virginia are typically working for low wages. The state's median wage in 2017 was $16.94 per hour, $2.08 lower than the national average. West Virginia's median wage was higher than only three other states.[45]

42. Unemployment rates are based on individuals who are looking for work, rather than individuals who are simply out of work. While West Virginia's unemployment rate has fallen, it has fallen in large part to people leaving the labor force, rather than finding employment. Total employment in West Virginia over the past decade has fallen by 35,000. The total size of West Virginia's labor force, the number of people working or looking for work, has shrunk by 29,000 people since 2008.

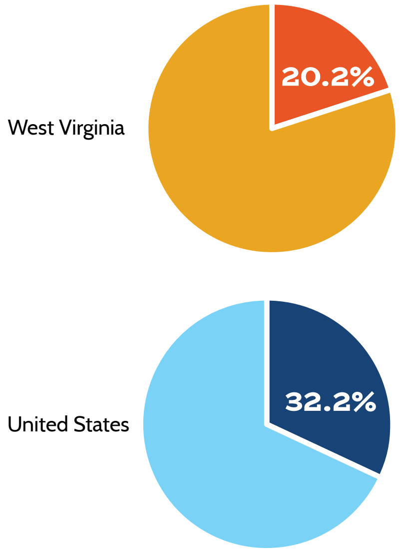
43. Bureau of Labor Statistics
44. EPI analysis of Current Population Survey data
45. Economic Policy Institute analysis of U.S. Census Bureau microdata

Education is arguably one of the most important factors determining long-term economic growth.

The productivity and growth of an economy are directly related to the level of education and training of its workforce.

Unfortunately, **West Virginia has one of the least-educated workforces in the country**, and this low level of educational attainment is a key factor in both its low income and low labor force participation rate. Among the 50 states, West Virginia has the smallest share of adults 25 or older with at least a bachelor's degree, at 20.2%, which is 12 percentage points lower than the national average.[46]

SHARE OF ADULTS 25+ WITH AT LEAST A BACHELOR'S DEGREE, 2017



46. Economic Policy Institute analysis of U.S. Census Bureau microdata

CHAPTER 3

Tax Equity

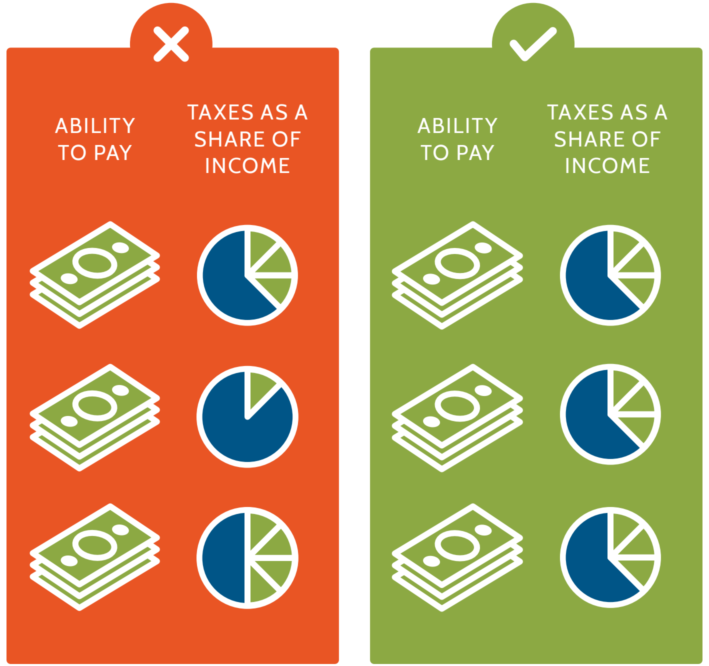
There is general agreement among government leaders, policymakers, and economists that an effective tax system:

- **achieves equality and fairness**
- **produces adequate revenues**
- **provides stability and simplicity**

A fair and equal tax system is one that demonstrates both "vertical" and "horizontal" equity.

Vertical equity means that people with a greater ability to pay should pay more—taxes should not absorb a greater share of income from someone with a low income than someone with a higher income.

Horizontal equity means that people in similar situations with the same ability to pay should pay equally.



A fair and equal tax system is one that does not place a disproportionate burden on the working and middle class.

In a more **balanced tax system**, those with lower incomes pay a smaller portion of their income in taxes than those with higher incomes.

This system most exemplifies the "ability to pay" principle.

In contrast, a **less balanced tax system** requires those with lower incomes to pay a larger portion of their income in taxes.

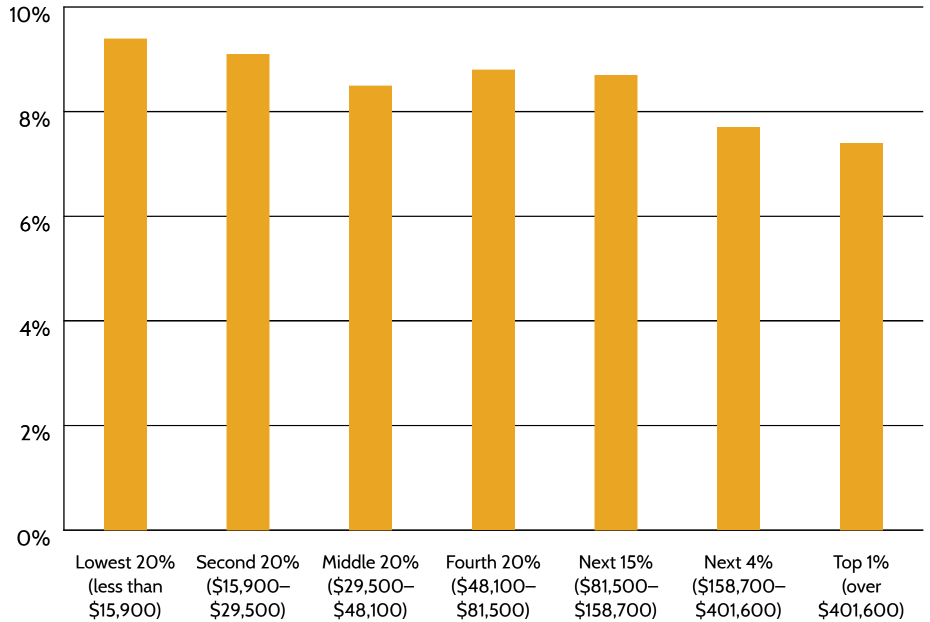
A **proportional tax** (also known as a flat tax) takes the same percentage of income from everyone regardless of his or her ability to pay.

West Virginia's overall tax structure is imbalanced, as low-income families pay more taxes as a share of their income than high-income families.

The three main state and local taxes paid by West Virginia's families are the income, sales and excise, and property taxes. As explained in Chapter 1, West Virginia's personal income tax is the most balanced of the state and local taxes since the tax rate rises along with income earned. However, this is not enough to offset the impact of the sales and excise tax, which constitutes a larger portion of taxes among low- and middle-income families, contributing to overall inequality in the system.

The lowest-income families (the lowest 20%) earn less than $15,900 per year and pay 9.4% of their income in state and local taxes, while those with incomes in the top 1% who make, on average, $702,400, pay only 7.4%.[47]

TOTAL STATE AND LOCAL TAXES AS A SHARE OF FAMILY INCOME



47. Institute on Taxation and Economic Policy

West Virginia's imbalanced tax system adds to income inequality.

When tax systems rely on the lowest-income earners paying a greater portion of their income in state and local taxes than their higher-income counterparts, gaps between the most affluent and the rest of us continue to grow. This is the case in West Virginia. **Incomes are less equal after taxes than before.**

Before taxes, the top 1% earn 78x more than the poorest 20%.

After taxes, the top 1% earn 81x more than the poorest 20%.

This is the predictable result of charging low-income families an effective tax rate of 9.4%, compared to a rate of 7.4% for high-income families.[48]

48. Institute on Taxation and Economic Policy

Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income range	Less than $15,900	$15,900 to $29,500	$29,500 to $48,100	$48,100 to $81,500	$81,500 to $158,700	$158,700 to $401,600	Over $401,600
Average income in group	$8,900	$22,700	$37,000	$61,600	$107,400	$220,500	$702,400
SALES AND EXCISE TAXES	6.6%	5.3%	4.6%	3.6%	2.7%	1.7%	0.9%
General Sales—Individuals	2.8%	2.7%	2.5%	2.0%	1.5%	1.0%	0.6%
Other Sales and Excise—Ind.	2.7%	1.7%	1.3%	0.9%	0.6%	0.4%	0.1%
Sales and Excise on Business	1.0%	0.9%	0.9%	0.7%	0.5%	0.3%	0.2%
PROPERTY TAXES	2.4%	2.0%	1.4%	1.6%	1.5%	1.4%	1.8%
Home, Rent, Car—Individuals	2.3%	1.9%	1.2%	1.5%	1.3%	1.0%	0.5%
Other Property Taxes	0.1%	0.1%	0.2%	0.1%	0.2%	0.4%	1.3%
INCOME TAXES	0.5%	1.9%	2.5%	3.6%	4.6%	4.6%	4.7%
Personal Income Tax	0.4%	1.8%	2.5%	3.6%	4.5%	3.5%	4.6%
Corporate Income Tax	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%
TOTAL TAXES	9.4%	9.1%	8.5%	8.8%	8.7%	7.7%	7.4%

Using taxes that are exportable is one way to raise revenue without contributing to income inequality.

A tax system that features exportability ensures that **individuals and companies based in other states benefiting from our state's public services pay their fair share**. For example, the motor fuel tax is partly exportable since it is paid not only by West Virginians, but also out-of-state travelers and the transportation industry that use West Virginia's highway system.

One of West Virginia's most exportable taxes is the severance tax on coal and natural gas. The severance tax is largely paid for by out-of-state consumers of West Virginia coal and natural gas, and it is therefore beneficial to all West Virginians, regardless of income level.

CHAPTER 4

Taxes and Economic Performance

Strong economic growth is vital to West Virginia's tax system and shared prosperity.

It boosts tax revenues, grows jobs, and can improve living standards for all. A fair and adequate tax system can play a large role in building a strong foundation for businesses to thrive and to enhance the wellbeing of state residents. Cutting taxes for big businesses and those at the top of the economic ladder, however, is not a surefire way to grow a strong economy. In fact, it can be a costly, inefficient, and wasteful strategy that risks harming growth by undermining the state's ability to provide good schools, a world-class college system, and sound infrastructure that businesses and families need to thrive.

Business tax climate rankings should not drive tax policy.

While policymakers sometimes use state business tax rankings to evaluate West Virginia's tax climate for business, **these rankings most often reflect the ideological, political, and policy agenda of the organization that publishes the rankings and have little actual relation to economic growth or the level of taxes paid by businesses.**[49] They are frequently contradictory and fail to take into account certain drivers of economic growth, such as the quality of life in a state.

One of the most popular state tax rankings is the Tax Foundation's annual State Business Tax Climate Index (SBTCI).[50] The SBTCI ranks a state's business tax climate by weighing over 100 features of state tax laws (e.g. income, property, sales, etc.) to determine a grade or ranking for each state. **The rankings are not determined by how much tax businesses have to pay in each state or their effective tax rate**, but by the Tax Foundation's notion of what makes a state and local tax system "good" for (mostly) big business.

West Virginia provides an illustrative example of the flaws in the SBTCI. From 2008 to 2018, West Virginia saw the biggest improvement in its "business tax climate"—moving from 37th to 19th best—because it eliminated its business franchise tax and lowered its corporate net income tax.[51] **Despite this improvement, however, West Virginia experienced no net gain in private sector jobs over the period.**[52]

49. Peter Fisher, "Grading Places: What Do the Business Climate Rankings Tell Us?", *Good Jobs First*, May 2013 (Second Addition). Retrieved from https://www.goodjobsfirst.org/gradingplaces; see also http://www.gradingstates.org/the-tax-foundations-state-business-tax-climate-index/what-others-have-written-about-the-tax-foundations-rankings/

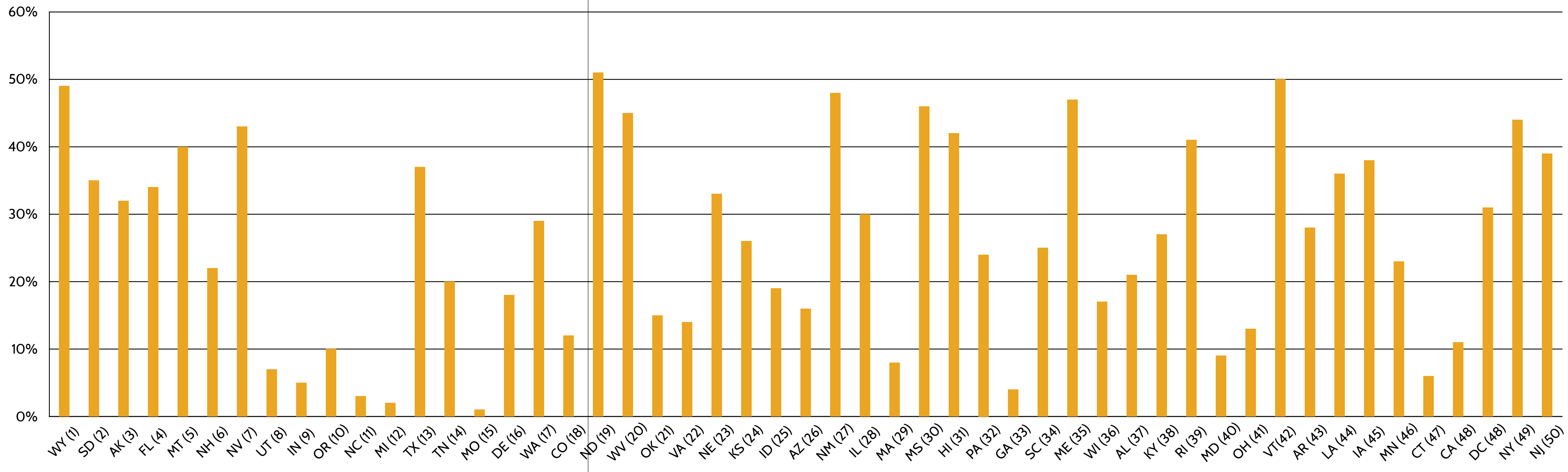
50. Jared Walczak et al, "2019 State Business Tax Climate Index", *Tax Foundation*, September 26, 2018. Retrieved from https://files.taxfoundation.org/20180925174436/2019-State-Business-Tax-Climate-Index.pdf

51. WVCBP analysis of Tax Foundation data

52. U.S. Bureau of Labor Statistics, Quarterly Census on Employment and Wages. West Virginia annual average of private sector covered employment in 2006 was 567,898 compared to 558,602 in 2018.

The graph at right provides data from the Council of State Taxation (COST) on total taxes paid by businesses (FY 2017) as a share of private sector state Gross Domestic Product ranked from highest to lowest—the closest proxy available for effective state business tax rates—along with the SBTCI ranking from the Tax Foundation for 2017.[53] There is little correlation between the two rankings, highlighting that **the Tax Foundation's "tax competitiveness" ranking does not accurately reflect state business tax levels**. For example, only two of the top ten states in the Tax Foundation ranking are among the ten states with the lowest taxes on businesses according to COST. Wyoming is ranked by the Tax Foundation as the state with the best business tax climate despite having the 49th-highest business tax rate in the nation.

TOTAL TAXES PAID BY BUSINESSES AS A SHARE OF PRIVATE SECTOR STATE GROSS DOMESTIC PRODUCT



53. Andrew Phillips et al, "Total state and local business taxes: State-by-state estimates for fiscal year 2017," Ernest & Young and Council on State Taxation (COST), November 2018. Retrieved from https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/FY16-State-And-Local-Business-Tax-Burden-Study.pdf.pdf

5

TAX LEVELS NOT A STRONG PREDICTOR OF ECONOMIC GROWTH

While economic theory predicts that lower taxation should boost economic growth and business investment, this is rarely—if ever—the case.

There are just too many factors at play, and, most often, lower taxes means less investment in what businesses need to thrive, such as a skilled workforce and infrastructure.

Decades of peer-reviewed academic studies examining the effect of state and local tax levels on state economic performance have produced **inconsistent and often contradictory results** that provide no clear conclusions for policymakers.[54] Some studies find that higher levels of income taxes negatively affect state economic growth, while others find the opposite.[55] And several replications of earlier studies that found a negative relationship between higher tax levels and economic growth have found those results disappear by using more sophisticated research techniques or longer time periods of analysis.[56]

54. Michael Mazerov, "State Taxes and State Economic Performance," *Center on Budget and Policy Priorities* (prepared for NCSL Task Force on State and Local Taxation), January 17, 2017. Retrieved from http://www.ncsl.org/documents/taskforces/State_Taxation_and_EconPerformance_JAN2017.pdf
55. William G. Gale et al, "The relationship between taxes and growth at the state level: New evidence," *National Tax Journal*, December 2015, Vol. 68 (4), pp.919-942. Retrieved from https://www.brookings.edu/wp-content/uploads/2016/07/relationshiptaxesgrowthstatelevel_gale_revised-1.pdf
56. Ibid and see Pjesky, Rex J. 2006. "What Do We Know About Taxes and State Economic Development? A Replication and Extension of Five Key Studies." *The Journal of Economics*. 32(1): 25-40 Retrieved from https://econpapers.repec.org/article/mvejournl/v_3a32_3ay_3a2006_3ai_3a1_3ap_3a25-40.htm

> "Sixty years ago, you could put your widget factory anywhere, so taxes were a more significant factor in business-location decisions. But in a service-based economy, companies need to be near customers and close to a wide pool of labor. And there's now strong agreement in the field that **state and local taxes are not typically an important factor in business decisions.**"[57]
>
> — **Therese J. McGuire**
> Professor of Strategy at the Kellogg School of Management at Northwestern University

A comprehensive literature review in 2018 concluded that the "vast majority of the academic studies that examined the relationship between state and local taxes and economic growth found little or no effect."[58] Overall, the majority of research finds that state and local tax levels typically have only a modest impact on a state's economic performance and that **there is no conclusive link between tax levels and economic growth**.

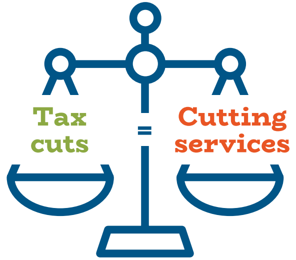
One reason for the weak relationship between state tax cuts and economic growth may be that most are targeted toward high-income people and large businesses. A recent study by Princeton economist Owen Zider found that **tax cuts for the lower 90% of income earners propelled job creation, whereas tax cuts for the top 10% had little to no effect.**[59] Since low- and middle-income people tend to spend most of their money—instead of saving it like higher-income people do—and since their consumption makes up over 80% of our economy, this finding is not surprising.

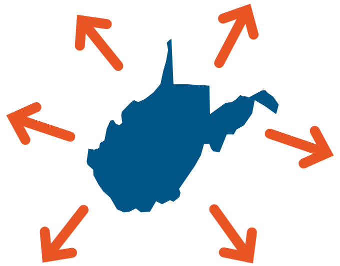
Tax cuts for low- and middle-income people = **More spending** = **More jobs**

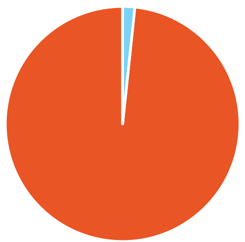
consumption by low- and middle-income people makes up **80%** of our economy

57. David Calvert, "Do High Local Taxes Really Hurt Economic Growth?," *KelloggInsight*, June 26, 2019. Retrieved from https://insight.kellogg.northwestern.edu/article/local-tax-policy-economic-growth
58. Dan S. Rickman and Hongbo,"U.S. State and Local Fiscal Policy and Economic Activity: Do We Know More Now?," *Journal of Economic Surveys*, March 2019. Retrieved from https://mpra.ub.uni-muenchen.de/88422/1/MPRA_paper_88422.pdf
59. Owen Zidar, "Tax Cuts For Whom? Heterogeneous Effects of Income Tax Changes on Growth and Employment," *National Bureau of Economic Research*, March 2015. Retrieved from http://www.nber.org/papers/w2103

There are several reasons why tax cuts aimed at businesses and high-income people fail to significantly grow state economies.







First, it's often a zero-sum game because **states like West Virginia must balance their budgets and pay for tax cuts by raising other taxes or cutting services**—offsetting any potentially expansionary impacts on the economy. Since tax cuts do not pay for themselves, they often result in less investments in schools, roads, universities, and other important public services that provide a foundation for economic growth.

Second, there is no guarantee that corporations or high-income residents will spend their tax savings in-state. In fact, **most corporations—especially multi-state ones—will likely distribute the savings to out-of-state shareholders or owners** in the form of dividends. Meanwhile, nearly all of the revenue loss will happen in-state, resulting in less public sector spending.

Lastly, tax cuts aimed at increasing business expansion ignore the fact that **product or service demand—not tax levels—are the primary driver of hiring** and that relocating is a costly endeavor. State and local taxes on businesses are a small share of business costs—typically around 2%—and are dwarfed by other costs, including labor, capital, support services, energy, transportation, and occupancy.

Other factors also play a larger role in influencing business investment, including climate, skilled labor and the quality of the workforce, state and federal regulations, economic recessions, federal fiscal and monetary policy, quality of life and amenities, consumer demand, public infrastructure, transportation, available sites, proximity to national markets and suppliers, access to raw materials, and much more.

While business tax incentives, such as tax credits and property tax abatements, are better targeted than the across-the-board tax cuts, research shows that they are not very cost effective. A comprehensive 2018 study by economist Tim Bartik found that business tax incentives lead 2% to 25% of firms to favor the location providing the incentive.[60] **This means that such incentives have a failure rate of at least 75%.** In some cases, businesses will receive large tax subsidies and then move after the incentives expire, while investments in infrastructure or human capital do not leave with a company.

Bartik has found that **investments in education, workforce development, and early childhood education have a far greater investment rate of return (ROI) than business tax incentives or general business tax cuts.**[61] Bartik further finds that "in places where incentives are explicitly paid for by cutting K-12 spending, state per capita income drops by more than $4 for each $1 spent on tax incentives." While policymakers are rightfully concerned about creating good-paying jobs, pursuing an approach of tax cuts for high-income or large businesses is not a winning strategy. A far more successful plan would be to focus on ensuring that the state can provide a foundation of investments in physical and human capital which businesses and communities need to thrive.

60. Bartik, Timothy J. 2018. ""But For" Percentages for Economic Development Incentives: What percentage estimates are plausible based on the research literature?" Upjohn Institute Working Paper 18-289. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research. Retrieved from https://doi.org/10.17848/wp18-289

61. Bartik, Timothy J. 2018. "What Works to Help Manufacturing-Intensive Local Economies?" Upjohn Institute Technical Report No.18-035. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research. Retrieved from https://doi.org/10.17848/tr18-035

CHAPTER 5

Tax Policy for a Shared Prosperity

West Virginia's tax system has significant room for improvement. It currently demands more from low- and middle-income families than it does from the wealthy, and it cuts taxes for businesses, detracting from crucial investments in physical and human capital and public services. The following tax policy reforms would make the state's tax system more balanced—delivering a tax cut for the majority of West Virginia families—while also raising revenues to improve the state's fiscal health and to allow for investments in the public goods that help build shared prosperity.

Modernize personal income tax rates and brackets: -$52 million

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%. Adjusting brackets and rates would better reflect modern income levels. This can be accomplished by both lowering the rates on lower brackets and adding new high-income rates and brackets.

These new rates would give West Virginia one of the most balanced income taxes in the country, **providing 95% of West Virginians a tax cut** at an estimated cost of $52.3 million.[62]

Income bracket	Marginal Tax Rate
$0–$20,000	2.0%
$20,000–$35,000	3.0%
$35,000–$55,000	3.5%
$55,000–$85,000	5.5%
$85,000–$150,000	8.5%
$150,000–$350,000	10.5%
$350,000+	12%

62. Institute on Taxation and Economic Policy analysis

Scale back personal exemptions: $19 million

West Virginians are provided a $2,000 personal exemption from their state income tax for each household member. **Unlike the federal government, however, 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 $18.7 million and help make the state's income tax based more on ability to pay.[63]

Reverse corporate income tax cuts: $57 million

West Virginia's cuts to the Corporate Income Tax—decreasing the rate from 9.0% to 6.5%—cost the state millions in lost revenue while failing to create jobs or boost the economy. As this guide has covered, there is little relationship between state and local tax systems and job and economic growth. Reinstating the rate back to 6.5% would increase revenues by an estimated $56.5 million, both allowing the state to make investments that actually promote economic growth and making its tax system more balanced.[64]

63. Institute on Taxation and Economic Policy analysis
64. Institute on Taxation and Economic Policy analysis

Enact worldwide combined reporting: $68 million

West Virginia currently requires businesses to use combined reporting when determining their taxable income under the corporate net income tax, which prevents businesses from avoiding taxes by shifting their income between states. However, most states, including West Virginia, limit the requirement to the "water's edge" of U.S. borders, or they allow corporations to choose whether to report on a worldwide or water's edge basis. This leaves open the possibility for multinational corporations to shift income to other countries to avoid state taxes. **Adopting worldwide combined reporting would prevent that tax-avoidance strategy and increase corporate income tax revenue by an estimated $67.8 million.**[65]

Reinstate the estate tax: $20 million

Changes to federal tax law resulted in the de facto repeal of West Virginia's estate tax. Only the very wealthiest West Virginians paid the estate tax. In fact, **so few West Virginians pay the federal estate tax that the IRS does not disclose how many**. The estate tax raises revenue for public services that contribute to a stronger economy, protects against extreme levels of income inequality, and ensures that the most affluent cannot avoid paying taxes on certain forms of wealth. Re-enacting West Virginia's estate tax for estates over $1 million would raise an estimated $20.0 million, reduce inequality, and close a loophole that allows unrealized capital gains to go untaxed at the state level.[66]

65. Institute on Taxation and Economic Policy analysis
66. Institute on Taxation and Economic Policy analysis

Enact a West Virginia Working Families Tax Credit: -$91 million

26 states and the District of Columbia have enacted Working Families Tax Credits for working people to help them offset the cost of the various state and local taxes they pay. **The Working Families Tax Credit 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 Working Families Tax Credit recipients. A state Working Families Tax Credit at 25% of the federal credit would cost an estimated $91.2 million and help offset the impact of other taxes that hit hardest at low-income levels.[67]

67. Institute on Taxation and Economic Policy analysis

The proposals laid out here would help rebalance West Virginia's imbalanced tax system and provide nearly all West Virginia families with a tax cut.

At the same time, these proposals would actually increase revenue for the state by nearly $20 million.

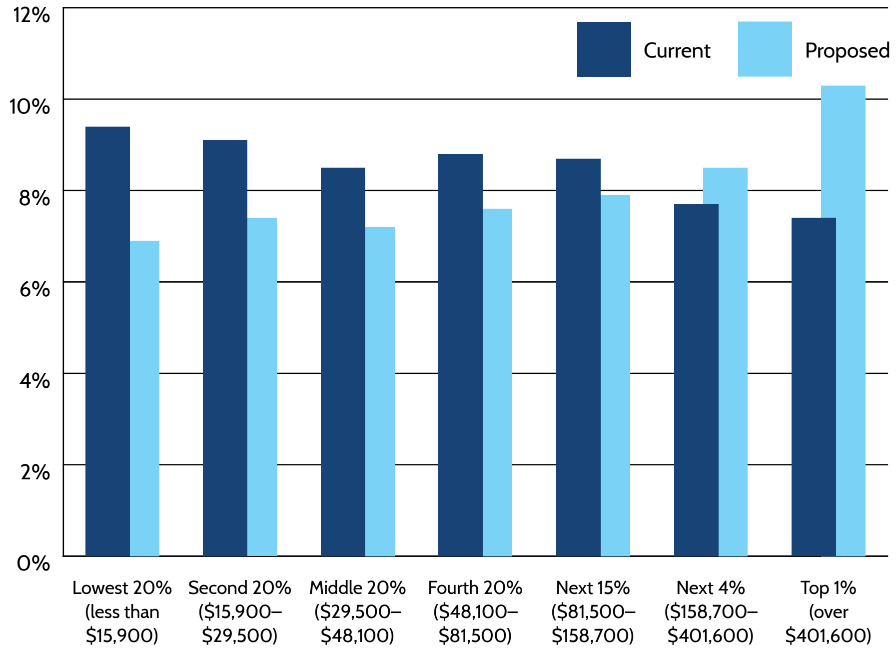
Unlike recent federal and state tax reform efforts, this tax proposal gives the largest tax cuts to low- and middle-income families. The bottom 20% of West Virginia households would see their state and local taxes as a share of income go down by 2.6 percentage points, while the middle 20% would see a 1.4 percentage point reduction. Only the wealthiest 5% of West Virginians would see an overall tax increase.[68]

Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income range	Less than $15,900	$15,900 to $29,500	$29,500 to $48,100	$48,100 to $81,500	$81,500 to $158,700	$158,700 to $401,600	Over $401,600
Average income in group	$8,900	$22,700	$37,000	$61,600	$107,400	$220,500	$702,400
CURRENT EFFECTIVE STATE AND LOCAL TAX RATES	9.4%	9.1%	8.5%	8.8%	8.7%	7.7%	7.4%
Change in effective tax rate with...							
Reformed personal income tax brackets and rates	-0.2%	-0.7%	-0.9%	-1.2%	-0.8%	0.6%	2.5%
Phase out personal exemption	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%
Increase corporate income tax rate to 9.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%
Worldwide combined reporting	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%
Reinstate Estate Tax ($1 million exemption)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%
Enact 25% Earned Income Tax Credit	-2.4%	-1.1%	-0.4%	-0.1%	0.0%	0.0%	0.0%
NEW OVERALL EFFECTIVE TAX RATES	6.9%	7.4%	7.2%	7.6%	7.9%	8.5%	10.3%
CHANGE	-2.6%	-1.8%	-1.4%	-1.3%	-0.8%	0.7%	2.9%
AVERAGE TAX CHANGE	-$143	-$316	-$420	-$679	-$758	$1,711	$20,201

68. Institute on Taxation and Economic Policy analysis

As a result, **West Virginia would no longer have an imbalanced tax system**. Instead of the wealthy paying the smallest share of their income in taxes, they would pay the most, while middle- and lower-income families would pay less, and the state's total revenue would increase.

WEST VIRGINIA STATE AND LOCAL TAXES AS A SHARE OF INCOME BY GROUP



OTHER OPTIONS TO RAISE REVENUE (ANNUAL NUMBERS)

Increase the severance tax on natural gas, oil, and natural gas liquids: $200 million

West Virginia now produces over one 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**. If West Virginia increased its severance tax on natural gas production—as well as oil and natural gas liquids—from 5% to 10%, it would increase revenue by an estimated $200 million, with little evidence that it would affect production, particularly long-term.[69]

Increase the soda tax: $89 million

At its current rate, **West Virginia's soda tax is not significant enough to generate the health benefits associated with higher soda taxes**, while the revenue it does raise is used for one specific purpose. 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, and provide a new source of revenue. A $0.01 per ounce soda tax would raise an estimated $89.0 million.[70]

69. WVCBP analysis of WV State Tax Department Data
70. Institute on Taxation and Economic Policy analysis

Legalize and tax cannabis: $58 million

Over the last two decades, states across the country have modernized their marijuana laws to reflect the growing evidence that doing so will help reduce criminal justice costs, help treat certain medical conditions, and boost tax revenues and their state's economy. As West Virginia continues to struggle with an undiversified economy, fading coal industry, and poor health outcomes, **modernizing the state's marijuana laws could be a step in addressing these problems and help save the state money in the long run**. If marijuana were legalized and taxed in West Virginia at a retail sales tax rate of 37%, the same rate used by the state of Washington, West Virginia would collect an estimated $58.0 million.[71]

Reinstate the business franchise tax: $150 million

Like the corporate net income tax cuts, West Virginia's business franchise tax was phased out between 2007 and 2015, with the promise that doing so would boost the economy and create jobs. And like the corporate net income tax cuts, **eliminating the business franchise tax has had no noticeable impact on the state's economy**. Reinstating the tax would increase revenue by an estimated $150 million.[72]

71. Institute on Taxation and Economic Policy analysis
72. WV State Tax Department

Repeal reduced severance tax rate for thin-seam coal: $41 million

West Virginia's reduced severance tax rate for thin-seam coal produced from underground mines is a costly and ineffective tax practice. Lower severance tax rates are ineffective at encouraging coal production, particularly for metallurgical coal, the price and production of which are largely dictated by international markets. Repealing the reduced severance tax rate for thin-seam coal would increase revenue by an estimated $41 million.[73]

Restore steam coal severance tax rate: $64 million

During the 2019 Legislative Session, the legislature passed a bill reducing the severance tax on steam coal from 5% to 3%. At best, **this tax cut will result in a minimal increase in coal production and jobs, while costing the state millions of dollars**. Restoring the rate to 5% would increase revenue by an estimated $64 million.[74]

73. WV State Budget Office
74. WV State Tax Department

Conclusion

West Virginia’s tax system currently fails to live up to or honor the values of hard-working West Virginians.

The research and analysis presented in this guide show that our state’s tax system is severely imbalanced, with working and middle-class people carrying a far greater share of the tax burden than the wealthy. Our tax system creates additional barriers to success for those have the least—who must work hard every day just to make ends meet—when it should, instead, tear those barriers down.

While our exploration of West Virginia’s tax system has revealed great imbalance, it has also shed light on possible solutions. **The system is broken, but it is not beyond repair.**

We hope that you will give serious consideration to the policy recommendations we have offered in this document, because we believe that concrete changes can be made to help achieve fairness within our economy as well as produce more than adequate revenue for the state. Asking a reasonable amount from hard-working West Virginian families does not have to come at the expense of a stable and healthy budget. We are confident that there are ways to accomplish both, and that building a tax system that more accurately reflects who we are and what we value as West Virginians is possible.

It’s time that West Virginia’s tax system and its values are in alignment.

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8 Capitol Street, 4th Floor
Charleston, WV 25301

Phone: 304-720-8682
Fax: 304-720-9696

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