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Tax Reform Committee Hears Caution Is Prudent in Changing System

When members of the Joint Select Committee on Tax Reform meet again next Monday, they will hear presentations from a few national organizations to give them perspectives on tax reform efforts in other states. Those organizations include: the Tax Foundation, a pro-business think-tank based in Washington, D.C., with ties to some conservative groups; the Council on State Taxation, an organization based in Washington, D.C., representing business taxpayers; and the National Conference of State Legislatures, an organization based in Denver and devoted to improving the quality and effectiveness of state legislatures.

But committee members already have heard warnings about how tax reform that is not planned well can have serious, unintended consequences. The presenters at the committee's first meeting this month all had experience with past efforts to change West Virginia's tax system.

"There is the opportunity for tremendous good," Revenue Secretary Bob Kiss told the committee. But he also warned legislators to make sure the state's tax structure can generate the revenues necessary to support government services.

> ***"Do not divorce the budget from your deliberations on tax reform. If you divorce that from the budgetary considerations, you can sow the seeds for disaster." – Bob Kiss***

"Do not divorce the budget from your deliberations on tax reform," Kiss, a former House speaker and former chairman of the House Finance Committee, said. "If you divorce that from the budgetary considerations, you can sow the seeds for disaster. I would suggest that you don't need to look any further in current times than the state of Kansas, which underwent a significant tax reform effort several years ago." Kansas now has schools closing early because of budgetary cuts and an inability by the legislature to agree on what new taxes or budget cuts are needed to address the problems, he said.

West Virginia also went through a similar self-inflicted disaster almost 30 years ago when Republican Arch Moore was in the last of his three terms as governor, Kiss said. In 1987, the legislature, controlled by Democrats, and the governor either intentionally deluded themselves or were subject to bad estimations and missed the revenue implications of a significant tax reform package by hundreds of millions of dollars, he said.

"We put the state in jeopardy in 1988 and 1989," Kiss said. "We were on the verge of bankruptcy, which required a number of steps and actions, which only now are we starting to emerge from. So be careful as you proceed."

Kiss was among the newly elected legislators called into a special session early in 1989 by new Democratic governor, Gaston Caperton, to approve more than $400 million in tax increases that were only the beginning of the steps the state had to take to fix the problems created a couple of years earlier. Another change made in the mid-1980s put the old workers' compensation system deeply in debt. The state is hoping to get that old debt paid off in the next fiscal year or two.

Another warning Kiss gave the committee members was to be careful about trying to make big changes in the tax system all at once. He said recent changes, such as reductions in business taxes and elimination of the sales tax on food, were phased in over several years.

"I don't think the end result of any study – and certainly the administration does not believe the end result of any study – has to be a comprehensive, 800-page bill, which substantially or fundamentally changes the tax structure immediately," Kiss said.

However, he endorsed the concept that reviewing the tax system from time to time is necessary. Kiss noted that West Virginia was among the earliest states to move away from an inheritance tax and an estate tax. It also has lowered business taxes and eliminated the business franchise tax, he said.

In 2004, Kiss said, West Virginia was ranked 48th or 49th for business taxes by one group, and it now is ranked 21st or 22nd. "We are more mid-stream now certainly than we were just 10 years ago," he said, adding that all the changes leading to the improved ranking were done incrementally. A decade ago, West Virginia's main competitors for business activity all had better rankings, he said, but West Virginia's ranking now exceeds all of the surrounding states. In addition, he said, the state already has done much work to overhaul a property tax system that had very anachronistic procedures.

Although at least one of the Republican leaders of the legislature has suggested holding a special session later this year on tax reform, House Finance Chairman Eric Nelson, R-Kanawha, told the committee, "There is no set agenda with this committee nor is there a set time frame."

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Nelson, who is also co-chairman of the tax reform committee, said the committee's three main goals are to address these questions:

1) Is our tax system fair?
2) Can we simplify it?
3) How can we structure it to best promote economic growth?

West Virginia must be competitive with surrounding states, have a structure that is predictable and have certainty, he said.

"I want to make it clear that our goal is to be open-minded," Nelson said. "We wish to examine our tax structure. It has been nine years [since the last tax reform study]. We all believe it's a prudent step."

West Virginia's tax system already has some advantages.

Mark Muchow, deputy secretary of revenue, told the committee that West Virginia's tax system has distinct differences from those of other states, and it has some problems, but overall the system makes West Virginia competitive with other states. For example, he said, West Virginia's business real property tax burden was ranked 12th lowest in the nation according to a 2006 study by the accounting firm Ernst & Young. That tax burden was 29 percent below the average for all states, he said.

For fiscal year 2014, West Virginia's corporate tax level – including the business franchise tax – as a percent of private-sector gross domestic product was at the national average of 0.3 percent, which was lower than in most of the surrounding states, Muchow said. When the business franchise tax is eliminated in a couple of fiscal years, West Virginia will be closer to Virginia at 0.2 percent, he said.

Severance taxes are more important for West Virginia than they are for many other states. Muchow said West Virginia ranks high in the percentage of severance taxes as a share of total state and local tax collections at 8.9 percent. Only Alaska, North Dakota, Wyoming and New Mexico have higher percentages, he said, explaining that, with severance taxes, the size of the industry and the size of the resident population are important.

> ***"West Virginia is a fairly large state among mineral-producing states in terms of resident population with 1.8 million people." – Mark Muchow***

"West Virginia is a fairly large state among mineral-producing states in terms of resident population with 1.8 million people," Muchow said, and that's almost as much as the total populations of Alaska, North Dakota and Wyoming. Those states have many fewer people and more resources, so the share of severance tax revenue as a share of total collections is high in those states on a per capita basis, he said.

West Virginia's effective tax rate on coal is about 4.25 percent, which is comparable to Kentucky's rate of 4.5 percent, Muchow said. States with broad-based economies and large populations, such as Illinois and Pennsylvania, don't have severance taxes, he said. Instead, they rely on other taxes, such as property and sales taxes to get revenue from mineral resources.

West Virginia ranks ninth highest for gasoline taxes and 11^{th} highest in funding for state roads. "We have some of the lowest fees on motor vehicles and drivers in the country," Muchow said. "We help make it up a bit with the gasoline tax." Northern states tend to have higher gasoline taxes than southern states because they have more freezing and thawing that create potholes, and they need more snow removal, he said.

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Only 25 percent of taxes in West Virginia are imposed by local governments. "That makes us the sixth most centralized state in the country – very little responsibility at the local level, particularly the county level," Muchow said. The state ranks 31^{st} in per capita tax burden, he said. Property tax generates 20 percent of West Virginia's revenue, which helps the state rank 45^{th} in per capita property tax burden.

"If it weren't for personal property taxes, we would be closer to 50^{th} per capita because the average tax burden on a household of \$130,000 of income in West Virginia ranks 50^{th} in the country, only 1.2 percent of income, about one-third of the national average," Muchow said.

In terms of personal income taxes, West Virginia ranks in the middle of the states at 26^{th}. Muchow said the state gets 25 percent of its revenue from personal income taxes. He said the state's income tax is progressive, so for a household with \$130,000 income, the tax is 5.8 percent of income, ranking the state 11^{th} in the nation.

The corporate net income tax ranks West Virginia 34^{th} and accounts for 3 percent of the state's revenue. The sales tax – which does not include motor vehicle sales – makes up 18 percent of the state's revenue and ranks 44^{th}. Lower than average incomes play into that, Muchow said. Also, he said, West Virginians spend a lot as individuals on health care, and health care expenditures generally receive tax preference. A bigger portion of residents' household budgets go to prescription drugs and other health care expenses in West Virginia than in other states, he said.

Muchow complained that some sales tax exemptions need better definition in law. Mark Morton, general counsel for the Tax Division, added that West Virginia's sales tax regulations take up 234 pages.

Overall, Muchow said, West Virginia's taxes have a high level of progressivity. The state is in the top 15 states for higher-income individuals and in the bottom 15 for lower-income individuals, he said. To do a real analysis of the tax system requires looking at both taxes and benefits, he said, and again, West Virginia is relatively progressive in terms of benefits.

Asked about the decline in West Virginia's coal sector, Muchow said it is too soon to call it dead because technology might yet change it the way technology has revived the oil and natural gas sector. But the coal industry has seen better days, he said, while better days seem to be ahead for natural gas. He added that energy in general is a volatile sector.

In terms of the volatility of taxes, Muchow said, the real estate tax is the most stable, excise taxes are very predictable, sales taxes are predictable, and severance taxes are the least stable, but taxes on coal are much more stable than those on natural gas. As someone who must project tax revenue, he lamented the end of the sales tax on food because it was very predictable.

Muchow said there are three major types of taxes: property, income and sales. Nationally, they generate about 77 percent of total state and local revenues, he said, but in West Virginia, it is between 63 percent and 66 percent.

Calling tax the price for government good and services, Muchow noted that the higher the price the lower the demand for services and the lower the price the higher the demand for services. He also noted that all taxes are paid by individuals. Individuals pay business taxes through higher prices, lower compensation and lower returns, he said.

Economic development negotiator says taxes are a minor issue.

Morton explained the tax system from the perspective of someone who has been involved in negotiating economic development packages to lure companies to set up or expand their operations in West Virginia. Sometimes, those negotiations result in having non-taxed public entities hold properties where the companies build their facilities, he said, so payments in lieu of taxes are then negotiated. Those payments can range anywhere from zero to 100 percent of what taxes on those properties would be, he said.

"Often you will see there is a particular concern to cover the school portion of the levy, which is about 78 percent nowadays," Morton said. Payments in lieu of taxes are a significant structural issue in West Virginia, he said.

"I've worked with economic development for a long time, and I'll tell you the truth. I think that probably taxes are far down the list of what a business looks at when thinking about coming to West Virginia." – Mark Morton

"I've worked with economic development for a long time, and I'll tell you the truth," Morton said. "I think that probably taxes are far down the list of what a business looks at when thinking about coming to West Virginia. What they look at first is whether or not there's a market for their product in West Virginia. And boy, we've got some advantages there because West Virginia is within 500 miles of half the population of the United States and within about a third of the population of Canada within 500 miles. We've got interstates that run eastwest. We've got other interstates that run north-south. We've got fine proximity to two of the largest ports, Norfolk and Baltimore, where you can get ships in and out to transport things either as raw material coming in or finished goods going out. So that's one of the things they look at is: Can I get my things to markets? And they sure can in West Virginia."

Morton said the next factor businesses tend to look at is the availability and quality of labor. He said they look for an educated, qualified workforce and work ethic. "West Virginia's got all that in spades," he said. "We got that covered."

The state also does well in training workers, Morton said. For example, he said, West Virginia has many skilled chemical workers.

One of the questions state officials tend to get from companies wanting to put facilities in West Virginia, especially foreign companies, is about the stability of the state's tax system, Morton said. "They don't mind paying a little bit more tax if they know that that doggone tax is not going to change over the next 10 years or five years," he said. "I've heard that over and over again."

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It helps in that regard, Morton said, that West Virginia was one of three states to get through the recession without big budget problems. "That was really impressive to some of those folks, and we actually won factories in West Virginia that were built here because of those discussions," he said. But overall, he said, taxes are marginal considerations for companies.

"I think our tax position is good," Morton said. "I think we've got tax credit programs that'll work, at least for the economic development end of things."

When Sen. Ryan Ferns, R-Ohio, asked how he could guarantee stability, Morton said, "I can't. All I can do is give them the history, and our history has been one of stability in that we've been very good at managing our finances over the last 10 years or so. We've been very good at grandfathering absolutely everybody who was ever entitled to a tax credit for the entire 30 years-plus that I've worked for the state." Most business prospects seem satisfied with that explanation, he said.

Professor explains past tax reform efforts.

The tax reform committee spent much of its meeting hearing from two individuals who had been involved in tax reform studies initiated in the late 1990s by Gov. Cecil Underwood and several years ago by Gov. Joe Manchin. One of them was Calvin Kent, a Marshall University professor who worked on both of those efforts. He said both started by recognizing established principles of taxation, particularly those of 18th century philosopher Adam Smith, who had two basic principles:

- A good tax system is designed on the basis of an appropriate set of rules.
- The system should strike a balance between the interests of the taxpayer and the tax authorities.

Kent also reviewed Smith's Canons of Taxation:

- Canon of Equity
  - Every person should pay depending on the individual's ability to pay.
  - Higher-income individuals should pay more because, without the protection of government, they could not have earned and enjoyed their income.
  - Taxes should be proportionate to income.

- Canon of Certainty
  - The tax a person should pay should not be arbitrary.
  - The taxpayer should know in advance how much is to be paid, when the tax is to be paid and the form in which the tax is to be paid.
  - The government should be certain of the amount it will collect from the tax.

- Canon of Convenience
  - The method and timing of tax payment should be convenient for the taxpayer.
  - If based on income, it should be paid at the time the income is earned.
  - If based on sales, it should be paid at the time the transaction takes place.
  - If based on wealth (gift, inheritance, property), it should be paid at the time of transfer.

- Canon of Economy
  - The cost of collection should be low compared to the revenue collected. "A lot of our nuisance taxes in this state clearly fail that criteria [*sic*]," Kent said. "It's much better to have fewer, broader-based taxes than to have a large plethora of many, many, many taxes that are hard and difficult to collect."
  - Tax collection should be efficient and take no more from the taxpayer than is necessary to defray the cost of providing services.
  - The amount collected should cover the full cost of providing governmental services.

The tax reform commissions that Underwood and Manchin set up agreed on what the principles of taxation should be. Kent said those principles included:

- Efficiency
  - An efficient tax system encourages economic growth and job creation.
  - The tax system should be competitive with those of other states so that it does not encourage resources to flow to other jurisdictions.

  - Taxes should be as neutral as possible, not favoring one business or individual at the expense of another.

- Equality or fairness
  - Similarly situated taxpayers should be taxed similarly.
  - An equitable tax system has minimal effects on low-income taxpayers.
  - The effects on various income groups should be considered for the entire system as a whole (state and local) not on any certain group in isolation.
  - A fair tax system uses a balance of tax sources related to different concepts of ability to pay:
    - Current income basis for an income tax;
    - Wealth basis for property taxes and estate/gift taxes; and
    - Consumption basis for sales and value-added taxes.

- Revenue adequacy
  - The tax system should produce a stable yield in excess of collection costs.
  - The tax system's yield should be sufficient to balance the state budget and meet the needs of the state's highest priorities.
  - The tax system should grow at the same rate as government spending and the growth rate in the state's economy.
  - Administrative costs should be as low as possible with preferences for those taxes with the greatest difference between revenue and collection costs.
  - The tax base should be diversified with taxes collected from a variety of sources to prevent fluctuations in total revenue.

- Simplicity and accountability
  - The easier the tax structure is to understand the higher voluntary compliance and lower enforcement costs are likely to be.
  - Transparency is the key factor in public acceptance.
  - Simple taxes are to be advocated over more complex ones.
  - Changes in taxes should be infrequent as stability is essential for planning both by taxpayers and the government.

One reform effort had many findings but resulted in few changes.

Attorney Michael Caryl, who served as vice chairman of Underwood's tax reform commission, said that commission found that West Virginia's tax system:

1) Was too regressive;
2) Had too many separate and narrowly focused taxes;
3) Had too many exemptions and exceptions;
4) Was not adaptable to an evolving economy;
5) Lacked sufficient revenue-generating capacity for local governments;
6) Lacked fair and equitable review procedures; and
7) Needed a means of school funding that was fair, stable and accountable while providing a competitive property tax structure.

The commission, he said, recognized the need for fairness among taxpayers in general, to all taxpayers as a single class, to the government as the people's institution, and in an overall tax structure that would balance the need for fairness in all three of those relationships.

Caryl said Underwood's commission had six goals:

1) Establishing a simple, broad-based, low-rate tax system with fewer taxes and limited preferences (such as exemptions, credits, etc.);
2) Establishing a less regressive tax system;
3) Establishing a more stable tax system that responds to changes in the evolving nature of the state's economy;
4) Providing local government with more revenue-generating capacity and flexibility;
5) Providing for more independence and objectivity in the procedures for review of state and local tax disputes; and
6) Providing a means of funding public education that would be fairer, more stable and more accountable while also providing a more competitive property tax structure.

As an example of having too many taxes, Caryl cited a short-lived tax on trees to raise money for pay raises for Division of Forestry workers. "It was going to cost more to administer it in Kanawha County than it would yield statewide," he said. "That's an example of what not to do. We did see the light after a few months."

The Underwood commission's work resulted in a proposed constitutional amendment that Caryl said would have:

1) Repealed the property tax on licensed motor vehicles and phased out that tax on all other tangible personal property;
2) Required the legislature to fully fund the regular school levy (to the "thorough and efficient" constitutional standard) while preserving the real property tax base for future local excess levies;
3) Reallocated the entire regular real property tax levy authority to counties and municipalities;
4) Required the legislature to make counties and municipalities whole, if necessary, to avoid a revenue shortfall from the loss of current personal property tax revenue;
5) Preserved the real property tax base for payment of existing bond levies and required the legislature to underwrite any actual shortfall in local bond levy revenues;
6) Repealed, phased out or replaced all existing state taxes except the severance tax, the ad valorem tax on real and utility property, the property transfer tax, the gasoline excise tax, various "sin" taxes and the estate tax;
7) Authorized the legislature to replace the eliminated taxes with a new progressive income tax, a new business activity and profits tax, a new general excise tax, a new electric power generation tax and a new retaliatory-only insurance premiums tax;
8) Authorized the legislature to provide means-tested exemptions from the progressive income tax for low-income elderly and disabled persons;
9) Set up the business activity and profits tax to cover: retained current profits; dividends, interest, rents and royalties paid; the compensation and benefits paid to employees; and

depreciation on new assets minus a deduction in the year of purchase for the full cost of depreciable capitol assets;

10) Required exemptions from the general excise tax only: for isolated sales (such as garage sales); for sales among related businesses; for employee compensation and benefits; for purchases for resale, for direct uses in manufacturing, agriculture and natural resource production, for use by government agencies and for free distribution to the public by charities; for government services and goods not competing with private businesses; and, if allowed by the legislature, for sales of advertising space, time and services, as well as health care services, prescription medicine and appliances;
11) Required that increases (or decreases) in the rate of personal income tax, the general excise tax, the business activity and profits tax or the severance tax would be accompanied by proportional increases (or decreases) in the rates of each of the other taxes;
12) Preserved the remaining economic benefit of any previously earned credits, exemptions, exceptions, discounts or other tax relief provisions (as long as they could be measured finitely) while otherwise repealing all credits, exemptions, exceptions, discounts or other tax relief provisions prospectively and requiring a two-thirds vote of each house of the legislature to reinstate them or enact new ones;
13) Prohibited the imposition of any new government fees measured by a percent or a rate with new fees allowed to be based only on a fixed monetary amount.
14) Permitted the legislature to empower counties and municipalities to impose the same taxes that the legislature would be allowed to impose, including a "piggyback" general excise tax.

Although the proposed constitutional amendment was not adopted, Caryl said, some taxes and credits were repealed or reduced, low-income tax relief was extended and the following were instituted: a West Virginia Office of Tax Appeals for review of state tax disputes, limited reforms in property tax appeals and limited home rule for municipalities (but not for counties).

Caryl said the commission's goals of simplicity, consistency and fairness among taxpayers were undermined by the addition of new special exemptions and credits in recent years. Largely unaddressed have been the goals of a stable and efficient tax system responsive to an evolving economy, a competitive property tax system, broad local government flexibility and neutrality, and greater fairness among and for taxpayers, he said.

"So simplicity is not something we can say we have achieved." – Michael Caryl

To illustrate that West Virginia's tax system has become more complicated rather than simpler over the years, Caryl noted that, in 1991, the state's tax code consisted of one book of 900 pages. Now it takes up two volumes covering 1,629 pages, he said, "So simplicity is not something we can say we have achieved."

The last major tax reform driven by the legislature was the 1985 repeal of the business-and-occupation tax, Caryl said. But he said that reform mainly relabeled the B&O tax on mineral extraction as a severance tax. On paper, that was financed by the adoption of the business franchise tax and the increase in the corporate net income tax, he said.

"It's taken us 30 years to fix that part of that reform," Caryl said. "We've just now brought the corporate net [tax] down and eliminated the business franchise tax."

Caryl called tax credits and payments in lieu of taxes "an indictment of the basic structure" of the tax system. "When we have to do all that, they say that the basic system does not encourage investing," he said. His advice to the tax reform committee was that reform needs to happen, but legislators should go about it carefully.

Kent further warned the committee about the dangers of not being careful about tax reform. "Probably one of the most overlooked laws of economics is the law of unintended consequences," he said. "If you go ahead and make tax changes without knowing what you're doing because it sounds good, you're going wind up with all sorts of problems."

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Suggesting that legislators don't want to repeat West Virginia's experience of the 1980s with tax changes, Kent said, "You have just got to know what the results will be because everything is interconnected. If you change one tax, you're going to wind up with ripples that are going to affect other taxes that may be very negative."

Manchin proposals sought short-term and long-term changes.

Kent said Manchin's Tax Modernization Project came up with two sets of recommendations: one for changes that could be implemented immediately and one for those requiring in-depth analysis and study before implementation.

The project found that West Virginia's personal income tax rates were not out of line with other states, but failure to provide the same deductions and credits as the federal government and other states makes the state's tax system less progressive.

The Manchin project's short-term recommendations for the personal property tax included:

- Establish a family tax credit based on family size and poverty that would phase out as a family's adjusted gross income would increase. The cost would have been $20 million to $24 million.

- Repeal of the Alternative Minimum Tax, which is complex and used by few people. The cost would have been $1 million.
- Increase the personal income tax credit up to $20,000 of assessed value (or $33,000 market value) for senior citizens and disabled people. Local property tax income would not be reduced.
- Increase significantly the compliance by nonresidents on income earned in West Virginia.
- Eliminate the Rehab Residential Building Investment credit because it didn't make sense and few people took advantage of it.

Issues on the personal income tax that Manchin's commission recommended for future study included:

- Reduce the number of tax brackets.
- Reduce or completely eliminate the marriage tax penalty.
- Provide equal treatment for public and private pensions.
- Establish mechanisms to ensure that taxable income received by nonresidents is collected.

On business taxes, the Manchin group's short-term recommendations included:

- Adopt a "throwback" rule to tax profits earned in West Virginia but not taxed in other states.
- Counter tax avoidance among passive investment companies by creation of royalty expenses, intangible licensing and trademark expenses as tax deductions.
- Enhance the ability to tax capital gains resulting from the sale of corporate subsidiaries.
- Require filing of consolidated corporate net income tax returns.

Kent said the Tax Modernization Project made no short-term recommendations for changes in severance taxes on coal, natural gas and timber but did recommend they should be studied. Since 2006, he said, the markets for coal and natural gas have changed dramatically.

"Considering that the combined severance taxes on coal and natural gas are among the highest, if not the highest, in the nation, future investigation of both these taxes is warranted." – Calvin Kent

"Considering that the combined severance taxes on coal and natural gas are among the highest, if not the highest, in the nation, future investigation of both these taxes is warranted," Kent said. Among the 10 biggest mineral-producing states, West Virginia has the highest taxes, considering the severance tax, corporate income tax and local property taxes, he said.

The project did not recommend repeal of the health care provider tax unless an alternative source of revenue could be found, Kent said. That tax is used to match federal funds on almost a three-to-one basis. Half of all states have similar taxes, Kent said.

West Virginia eliminated 13 business tax credits in 2002 and replaced them with three others, he said. However, Kent added, “We found little evidence that most of these are effective.” Manchin’s commission recommended repealing the Capital Company Tax Credit, the Economic Opportunity Tax Credit, the Natural Gas Jobs Industry Retention Tax Credit and the B&O tax on gas storage, he said.

“The repeal of the tax on food that was one of those ideas that sounded great and cost us about 14 percent of our sales tax collections,” Kent said. “It was not recommended by either of these studies nor by any other study, but it happened anyway.”

Manchin’s commission found a need to change the direct-use-in-manufacturing exemption, he said, so it could be used by those who work through contractors rather than allowing it only by those who work directly through manufacturers.

On the issue of taxes on cigarettes and other tobacco products, Kent said, Manchin’s commission recommended raising them because they were lower than those in neighboring states.

In regard to property taxes and local government finances, he said, the commission’s goals were to improve assessment and collection of property taxes and municipal fees and to provide greater flexibility and fiscal capacity for local governments.

“While property taxes on owner-occupied homes are among the lowest, if not the lowest, in the nation…people around here don’t believe it when you tell them that they really do have a good deal.” – Calvin Kent

“While property taxes on owner-occupied homes are among the lowest, if not the lowest, in the nation…people around here don’t believe it when you tell them that they really do have a good deal,” Kent said. “The one thing more than anything else in the property tax area that we needed to do more was to eliminate the tax on inventories or reduce or eliminate the property taxes on machinery, equipment and fixtures because this is where we are out of line with other states.”

What has prevented the state from eliminating such taxes is the difficulty in finding a replacement source of revenue, he said. “One of the problems statewide that we have had in the past is where the state has passed exemptions, deductions and modifications – whatever you want to call them – to the local property tax and then has left the local jurisdictions to pick up the tax bill,” Kent said. “And that has, particularly for counties, put everyone in local governments in a real bind.”

The Manchin commission’s short-term recommendations on property taxes included:

- Allowing sheriffs and city finance officers to have access to property tax information because, unlike in most other states, they don't have such access even though they have to collect tax revenue.
- Permitting the state Tax Division to enter into agreements with local governments to exchange information, including federal employer identification numbers to aid in collection of taxes and fees.
- Allowing costs of collection of tax delinquencies to be shared among all local governments receiving property taxes based on revenue received.
- Allowing municipal liens on property for uncollected fees.
- Clarifying the definition of property exemptions for charitable, educational, religious and other property. "The law is unclear," Kent said. "Court decisions have made it less clear. We found in our studies there is no consistency among the 55 counties as to what is considered charitable, educational and exempt."
- Revisiting the definition of a farm for fair use valuation. The current threshold is $1,000 in income or, if it is less than five acres, $500. That results in holding off the market small tracts bordering cities until they are developed.
- Allowing operators to pay property taxes on behalf of owners of several mineral interests rather than sending the tax tickets to multiple owners, a practice that results in taxes often going unpaid. It also would reduce administrative costs significantly.

The property tax issues the Manchin group wanted to study included:

- Changing the Constitution to allow local governments to pass general obligation bonds with majorities of 50 percent plus one, as school districts now can do.
- Allowing reporting of delinquent taxes and fees to credit reporting agencies.
- Studying taxation of Voice over Internet Protocol (VoIP).
- Allowing counties to levy sales and use taxes.
- Establishing a separate state board for appeal of property valuation of minerals and industrial property valued by the state Tax Department.
- Establishing a recapture provision for taxes when a property's valuation changes from use to market.

"Anytime you are making changes in state and local taxes, this directly impacts state expenditures for local schools," Kent said.

> ***"When you make changes in the property tax, even if they might be minute, that could have larger implications on general fund expenditure that's incumbent on the state to fund the schools." – Kent Sowards***

Kent Sowards, director of research and strategy for Marshall University's Rahall Transportation Institute and the Center for Business and Economic Research, said, "When you make changes in the property tax, even if they might be minute, that could have larger implications on general fund expenditure that's incumbent on the state to fund the schools."

There is a need to find more taxing flexibility for counties and municipalities, he said. "The problem with this is there's also very little base in some counties," Sowards said, and that is one reason why changes at the state level can have large implications for counties and municipalities.

Committee members suggest changes.

After hearing about all the different taxes West Virginia has, one member of the committee, Sen. Ed Gaunch, R-Kanawha, said, "There has to be pots of money all over the place from these revenues. Is that the way we want to run our budget? In other words, if it's worth taxing, why can't we put it all in the same pot and then decide what's worthy of having expenditures?"

"There has to be pots of money all over the place from these revenues. Is that the way we want to run our budget? In other words, if it's worth taxing, why can't we put it all in the same pot and then decide what's worthy of having expenditures?" – Sen. Ed Gaunch

Nelson replied, "It's something we will look at."

Another committee member, Delegate Bob Ashley, R-Roane, wanted to know what would happen if the legislature would give sheriffs and city finance officers access to tax information. Kent said it could improve the collection of tax revenues because those officials currently have no way to check the validity of the information they get. They don't know whether taxpayers are saying one thing about their B&O taxes and telling the state a different story, he said.

Muchow added that about 75 percent of all local taxes nationwide are property taxes. "In West Virginia, we have very low property taxes overall," he said. "As a result, our municipalities – only about 30 percent of their revenue comes from property taxes. More of their revenue comes from other taxes."

Because of the home rule program, Muchow said, municipalities now have the option of imposing sales taxes, but it is not open to counties. However, he said, most neighboring states allow counties to impose sales taxes.

Eliminating certain taxes is appealing to some legislators, so Muchow offered an example of a state that has a much different tax structure.

"New Hampshire is completely opposite of West Virginia," he said. "In New Hampshire, about 58 percent of all revenue is generated by local governments, not the state. In West Virginia, only 25 percent of our revenue is generated by local governments. And in New Hampshire, on a $60,000 home, the property tax bill is around $5,000 a year. In West Virginia, on a $60,000 home, your property tax is somewhere between $300 and $400."

Muchow said New Hampshire has two taxes on business – an 8.5 percent business profits tax and a business enterprise tax on wages, dividend and value-added. "It sort of takes up space that is vacated by the lack of an income tax," he said.

Delegate Rupert Phillips, D-Logan, wanted to know what West Virginia could do to save struggling coal companies, but Muchow offered him little encouragement.

"The economics are totally against the coal industry right now," he said. Global markets have a glut of coal, exports of metallurgical coal are way down, pricing is way down, and it doesn't help that the U.S. dollar has been appreciating against other currencies, he said. On the steam coal side, the closing of coal-fired power plants limits the market, he added.

"Keep in mind that a good 80 percent-plus of our coal traditionally is exported outside of West Virginia, so we were effectively exporting tax liability," Muchow said. Further, he noted that states with huge severance taxes tend to spend more money on government than other states do.

One thing that should help West Virginia's coal industry next year is that a 56 cents-per-ton tax on coal will disappear, he said. That tax has been part of the funding the state has used to pay off the unfunded liability in the old workers' compensation fund.

"In northern West Virginia, we've actually seen an increase in coal production the last two or three years, southern West Virginia a big decrease," Muchow said. "But a significant portion of the coal in southern West Virginia is taxed at 1 percent or 2 percent, not the 4 or 5 percent rate." He said eliminating the tax entirely would have only marginal effects.

Delegate John O'Neal, R-Raleigh, wanted to know how government expenditures in West Virginia compare with those of other states. Muchow said the level of expenditures is related to how centralized the state's government is.

"You're going to have more spending if you have a centralized state government than if you have local government." – Mark Muchow

"You're going to have more spending if you have a centralized state government than if you have local government," he said. "If it's free, everyone wants a four-lane highway. If they have to pay for it, then the number of people that want that four-lane highway start dropping off. We have done a great effort over the years to try to provide as much government services as we can to areas of West Virginia, including the very rural areas of the state."

For example, Muchow said, "In K-12 education on a per-pupil basis, we're 14th highest in the country. Now, some of that's because of the pension liability, but some of it's because we have a lower than average student-teacher ratio. In higher education, we're in around the top 15 or top 16 in the country." Many people come to West Virginia for college because it is cheaper than in their home states, he added.

The level of services provided under Medicaid in West Virginia also is higher than in other states, Muchow said. "There's a lot of support for that," he said.

"The biggest share of property taxes is imposed by voters," Muchow said. "Voters like government services, particularly if it's going to be paid for by the power company down the road."

Overall, he said, West Virginians tend to pay lower taxes, so demands for government services are higher.

Now that members of the Joint Select Committee on Tax Reform have heard from experts on how West Virginia's tax system works and how some people have attempted to change it in the past, they will consider national perspectives at their meeting next Monday. Nelson said another committee meeting is tentatively scheduled for June 9.