

**FTA PROVIDENCE
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**VIRGINIA TAX REFORM:
*HOW IN BLAZES DID THAT
HAPPEN?***

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How it all got started

- 2001 Gubernatorial Campaign Promise of now-Governor Mark R. Warner (D)
- Then featured objectives of restoring equity, fairness, restructuring and balancing state/local revenues
- FY 2002 and FY 2003 consumed with discovering and then dealing with revenue shortfall; started developing tax reform package in late April 2003

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What Happened?

- Individual Income Tax
 - Eliminate marriage penalty in standard deduction
 - Increase personal exemption by \$100 to \$900
 - Option of nonrefundable 20% of federal EITC (vs. current \$300 per individual nonrefundable tax credit)
 - Filing threshold up from \$5k/\$8k to \$7k/\$14k
 - Phase out \$6k age deduction (62-64) completely & \$12k age deduction (65+) with means testing \$1 for \$1 over \$50k/\$75 (Va. does not tax social security); remnant of *Davis* case fix

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What Happened? (cont'd)

- Sales and Use Tax
 - Increase state rate from 3.5% to 4.0% (unchanged local rate adds 1%); still low
 - Reduce rate on food from 3.0% to 1.5% in three annual steps of 0.5% each
 - Eliminate exemptions for property purchases and new tpp leases by public service corporations including public utilities, telecommunications companies and motor vehicle common carriers (allows service rate surcharge to pass cost to customers)

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What Happened? (cont'd)

- Corporate Income Tax
 - Requires add-back of IHC payments unless can prove to Commissioner it is not for the purpose of evading taxes
 - Requires all pass-through entities to make an annual information return of owners and distributions to owners
- Recordation Tax
 - Increase rate from \$0.15/\$100 to \$0.25/\$100

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What Happened? (cont'd)

- Tobacco Products
 - Increase cigarette rate from \$0.025/pk to \$0.20/pk and then \$0.30/pk 1 year later
 - New 10% excise tax on wholesale price of other tobacco products
- Reconformed to IRC (with exceptions for bonus depreciation and NOL carryback)
- Bottom Line - \$1.5 billion in new revenue

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Eleven Reasons Why it Should Not Have Happened

- Governor is Democrat
- Legislature is Republican, by comfortable margin
- Governor may challenge Repub. U.S. Senator
- Gov's accomplishments limited by economy
- Governor backed and lost 2 major regional referenda on sales tax increase for transportation
- Governor needed a victory for his legacy
- Most House R's have taken "no tax" pledge

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Eleven Reasons Why it Should Not Have Happened (cont'd)

- Many R's maintained Va. Would grow out of revenue shortfall
- Many R's held up Bush Administration tax cuts as the way to go
- Many R's claimed tax increases would stifle recovery; Alabama, Oregon cited
- Va. Governor only has one term; no momentum; no future; little opportunity for political whipping/retribution

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33 Reasons Why it Did Happen

- Show me the money, if you can
- Growth would not do it
- Already cut \$6 billion; used up one-time fixes
- "Rainy Day" fund depleted
- "Car Tax" growing beyond all bounds
- Structural imbalance out to 2010 because of Medicaid, education, corrections, etc.
- Local Government screaming because of unfunded mandates, pressure on real estate tax

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33 Reasons Why it Did Happen (cont'd)

- Governor proposed a thoroughly researched, thoroughly tested, well-conceived plan
- 65% of the people would pay less in taxes
- Tax Calculator on the Internet
- Va. is a low-tax state and would remain so
- Plan is diverse (taxes & taxpayers)
- Governor held firm to what would be his political legacy, lobbied hard, sold the public, worked the electorate, 46 town hall meetings

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33 Reasons Why it Did Happen (cont'd)

- TAX met with 17 special interest groups in two-hour sessions to introduce the plan
- Full details of the plan on Governor's web page
- TAX worked tirelessly with the business community on business issues (IHC)
- Business community backed the plan
 - Opinion leaders spoke out
 - Va. Chamber of Commerce on board

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33 Reasons Why it Did Happen (cont'd)

- Foundation created to marshal support and market the plan to the public
- AARP backed the senior cut-backs
 - Boomers would break the bank
- Educators backed the plan
- Governor introduced his plan after the November '03 Va. Elections
 - Avoided political football, possible claim of referendum on the plan

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33 Reasons Why it Did Happen (cont'd)

- Senate Finance Committee Chairperson led progressive and moderate Republican senators to embrace a plan substantially greater than the Governor's plan
- House Republicans had no plan; waited too long
 - When House became desperate, grabbed at anything to be a player
 - Had shaky numbers
 - Punished business while they were at it
 - Lost credibility

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33 Reasons Why it Did Happen (cont'd)

- House & Senate were split, at a standstill
 - Senate eager for a major change
 - House remained adamant, no new taxes
- 60 days became 115 days
- One session became two sessions
- Public became fed up with inaction and mounting cost of the process
 - Though House R's did not think so

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33 Reasons Why it Did Happen (cont'd)

- House R's blundered
 - Insisted upon a referendum if taxes were to be increased, then backed off
 - Punished business for support of Governor, then back off
 - Instead of immediately beginning the special session, insisted on a cooling off period to go back to their constituents who, they believed, would support them
 - Public forums called by R's backfired with virtually no support for their intransigence

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33 Reasons Why it Did Happen (cont'd)

- Moody's already put Va. on credit watch for the Commonwealth's Aaa bond rating
 - Inaction would seal the fate of Aaa
- R's lost the governor's mansion because of inaction failing to adopt a budget in 2001
- Seeing another train wreck ahead, 17 moderate House R's broke ranks with the speaker, put forth a solution and passed it with the support of 35 D's

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33 Reasons Why it Did Happen (cont'd)

- Both the Governor and the Senate placed the statutory changes for revenue into the budget making them inseparable
- Governor Mark R. Warner, a businessman, a self-made millionaire, carried a lot of credibility with straight talk
- There were 4 full moons during the 115 days, and 3:1 ratio of "why yes's" to "why not's"

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The Final Bill: Head Scratchers and Jaw Droppers

- No elimination of accelerated sales and use tax payments
- No higher income tax brackets
- No Estate Tax repeal
- No full funding of Car Tax relief; frozen
- No expanded taxing authority for localities
- IHC provisions stronger than expected

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The Final Bill: Head Scratchers and Jaw Droppers (cont'd)

- No real opposition to cigarette tax increase
 - Phillip Morris did not oppose
 - PM got a \$6 million tax credit for exports after locating its headquarters in Va., but the credit was in doubt for a time
 - Raising taxes on public
 - Giving large corporation a big break

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Prospects in Other States

- Dimming as the economy rebounds
- Takes enormous political courage
- Va. politics were extraordinary
- Still, many things untouched
 - Nothing for Transportation
 - No bracket or rate changes for individual income tax
- Saved the Aaa Moody's rating, one of only seven states, longest run, will save millions

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