IT'S TIME

TO TALK ABOUT

TAX REFORM IN VIRGINIA

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PREFACE

The Commonwealth of Virginia and its local governments have been struggling to maintain a modest level of service delivery for well over a decade. There continue to be important discussions on which level of government should be responsible for delivering and funding the variety of services citizens demand. For example, both the State and local governments fund certain important services, such as K-12 education. There are critical questions on the relative level of commitment by the State and local governments for educational services. But the fact remains that overall, there is not enough revenue to adequately fund K-12 education in Virginia and one way to address this situation is through tax reform.

Some groups and individuals involved in the tax reform conversation argue that tax reform is necessary, but that at the end of the day it should be revenue neutral. That is after all the appropriate changes are made to the Tax Code, the net amount of revenue should be the same. This analysis does not accept that proposition. Tax reform for Virginia at this point should meet two overall needs. The first is to address the inequities and inefficiencies in the current code and the second purpose should be to address the need for additional revenue to fund needed services.

This analysis does not examine in any detail the needed level of additional revenue. Thoughtful groups including the Joint Legislative Audit and Review Commission (JLARC) have studied the issue of needed service revenue shortfalls. This analysis takes those bodies of work and comes up with a figure for additional annual revenue as a target for tax reform to achieve. They include in part, $196.5 million for additional support needed for four-year institutions and community colleges,[1] $400 million to assume full operational costs of mandated social services[2] and $1,650 million for K-12 education.[3] This totals approximately $2,247 million annually and is a target figure for reform. Virginia's FY 2004 Budget is approximately $26 billion.

There needs to be broad public discussion on a subject as important to Virginia's future as tax reform. A number of well-informed commissions have studied this issue over the past decade and produced a substantial body of research that this analysis draws upon and is noted in the Bibliography. The possible changes contained herein do not necessarily constitute the views of the Hampton Roads Planning District Commission (HRPDC). However, the HRPDC believes there should be extensive public dialogue on this important subject that will eventually affect every citizen of the Commonwealth and the services they receive from state and local governments.

It is also important to keep in mind that Virginia and Hampton Roads are in a competitive economic environment with other states and regions. Changes that are made to the Tax Code must be measured against this fact. Virginia is by any indicator a

[1] Joint Subcommittee on Higher Education Funding Policies.
[2] Commission on Virginia's State and Local Tax Structure for the 21st Century.
[3] Joint Legislative Audit and Review Commission.

low tax and increasingly low service state, comparatively speaking. The percent of personal income Virginians spend on state and local taxes ranks Virginia 43rd in the nation. Virginia ranks 34th in spending for K-12 education, 34th in higher education, 33rd in health, 44th in welfare and 39th in environmental spending. Virginia is a growing state as is the region of Hampton Roads.[4,5] The number of children to be educated and the number of vehicles on the road increase every year, but the necessary funds have not kept pace. For example, in the seventeen (17) years since the last increase in Virginia's gas tax, a typical family with two children who received their driver's licenses has increased their family's demand on the highway system by about 100% with no corresponding increase in the tax to pay for the additional demand.

This document makes no specific recommendations for changes in the Virginia Tax Code. Rather it sets out a series of "what if" scenarios for purposes of an informed public discussion. Tax reform is important to all Virginians and the decisions our members of the General Assembly and Governor will be making need informed citizen input. We trust that the information contained herein will be helpful to that public discussion.

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[4] Governing: State and Local Source Book (2002). Congressional Quarterly, Inc.
[5] Governor's Natural Resource Leadership Summit 2003. (April 10-11, 2003.)

PART I

INCOME TAX

REFORMING THE VIRGINIA INCOME TAX

EXECUTIVE SUMMARY

INTRODUCTION

The individual income tax has become the single most important source of general fund revenue for the Commonwealth. Due to the important role that the income tax plays in financing state government, the future of the income tax is of critical importance to the financial health of the Commonwealth.

SELECTED ISSUES

The individual income tax in Virginia has been studied extensively over the years. These investigations have identified a number of concerns that the Commonwealth needs to address as it confronts the issue of tax reform.

The first difficulty with the tax as currently structured is that, while rates are graduated, it functions in many ways like a flat tax since it taxes a great many tax filers of very unequal incomes at similar rates. The flat tax nature of the current state income tax results from both the number and narrow width of its tax brackets as well as its schedule of statutory rates.

Because Virginia has compressed tax brackets, the rate graduation tops out in the poverty range for many families. This leaves a considerable amount of the income of persons living in poverty subject to taxation.

The problem of compressed brackets is compounded by the fact that there is little effective difference in tax rates between taxpayers of different income levels since the tax rates are only slightly graduated. The individual income tax can be made more progressive by increasing the graduation of the tax rates and by widening the tax brackets.

In order to ease the tax burden of low income and poverty level taxpayers, Virginia allows tax filers to utilize personal exemptions and standard deductions to reduce their tax liability. Ignoring the need to increase the exemption and standard deduction over the years has meant that Virginia leaves a very large percentage of poverty level income in the tax base. Virginia can make its individual income tax more progressive by increasing the personal exemption and standard deduction.

The elderly have a special place in the Virginia Tax Code. Virginia grants three age-based preferences to elderly taxpayers even though changes to federal social security have helped to ensure that the elderly are not especially needy. These exclusions from the tax base are very costly to the State and will become more costly as the baby boomers retire and more retirees move to Virginia. Virginia needs to reassess its age-based preferences. Age alone is not a measure of need. Using age as a proxy for ability to pay is imprecise and leads to inequities between taxpayers and shifts the burden of the tax to others who are often less able to pay.

INCOME TAX REFORM

The fundamental approach to taxing income in Virginia has not been changed in many years. HRPDC staff believes that substantive changes to the income tax are needed – both to improve equity and to raise new and badly needed revenues.

REVENUE NEUTRALITY

Studies and statistical comparisons suggest that Virginia is falling behind other states in providing basic public services and making infrastructure investments. While states cannot afford to get far ahead of adjacent states in terms of their tax burden, neither can they afford to fall far behind in the range and quality of public services that they provide. Unfortunately, the State's people, institutions, and economy are now suffering from the under funding of public services and infrastructure. Virginia needs to pursue tax reform aggressively and include in its efforts adjustments to the tax system which will lead to sufficient revenues so that public needs can be met.

An organizing principle behind reform is that the Virginia individual income tax should be changed in such a way as to generate additional revenue. This aspect is in direct contrast to those made by previous tax reform study commissions, which have had revenue neutrality as a centerpiece of their proposals. HRPDC staff believes that the case for additional revenue has been made by the many needs assessments done over the years.

SHARING THE INCOME TAX

Virginia's localities have struggled for some time to meet the public service needs of their residents. In recent years, many have been forced to raise taxes, reduce services, and/or cut staff in an effort to balance their budgets. HRPDC has recommended that the State share a portion of the income tax with its local governments.

INCOME TAX BRACKETS AND RATES

If additional revenue is to be raised to meet the State's many unfunded public needs, tax rates on the individual income tax must be increased (or brackets adjusted to achieve a similar effect). Since the State's low-income tax filers already have limited financial resources from which to meet their basic needs, there is little, if any, opportunity to generate additional revenues from that group of taxpayers. However, since middle and upper income groups are lightly taxed in Virginia as compared to nearby states, there appears to be "room" to increase rates without causing middle and upper income households to flee the State for locations with lower rates.

In recognition of the need to increase the separation in the income tax brackets at the lower end of the income spectrum and the desire to enhance state income tax revenues, the State should consider the adoption of a new income tax structure. This new structure is shown along with the existing tax structure in the table on the following page. The first two tax brackets might be combined so as to do away with the fine distinction between low-income groups currently being made in the present tax code. The rate for the first bracket is set at 2.0 percent and, as such, reduces the rate from 3.0 in the existing structure for tax filers making between $3,000 and $4,999. This new rate would ease the tax burden faced by those in this low-income bracket. The second bracket, from $5,000 to $9,999, is taxed at 3.0 percent. For taxpayers in this bracket, the new proposed tax is less than the 5 percent rate currently in use for this income category and further reflects the desirability of lowering the rate on low-income taxpayers. The third bracket extends from $10,000 to $16,999 and is taxed at 5.0 percent or the same rate in effect today. The last two brackets replace the existing top bracket. The first of these new brackets would raise the levy on those who formerly were making $17,000 or more from 5 percent in the existing bracket to 6 percent. The new 6% bracket would apply to those making between $17,000 and $59,999. The second new bracket is taxed at 6.5% and would apply to those making $60,000 and above. In general, the combination of all the new brackets and rates lowers the tax rate levied on low-income groups and increases the levy on middle and upper income groups.

EXEMPTIONS AND THE STANDARD DEDUCTION

The revenue generated by the income tax as well as the liability faced by the taxpayer is also influenced by the amount of the standard deduction and personal exemption. The State should consider increasing the single and dependent exemptions from $800 to $1,200. This increase will have the effect of reducing the amount of income subject to taxation for both families and low-income taxpayers. In addition, because the increase is modest as compared to an increase that would raise the exemption to the level of adjacent states, the cost to Virginia in lost revenue will not be large.

Unlike the small amount allowed for exemptions, Virginia has been more generous in formulating its standard deduction. As a result, Virginia uses a standard deduction that is equal to or larger than the standard deduction found in any of its adjoining states. It would not make sense to increase Virginia’s standard deductions since the current deductions are at or above the amounts allowed by other states.

As indicated above, Virginia grants age-based preferences to elderly taxpayers. These exclusions from the tax base are very costly to the State. They have the effect of reducing the tax liability of low-income elderly persons but also benefit those elderly whose incomes are far above the poverty level. Using age as a proxy for ability to pay is imprecise and leads to inequities between taxpayers. The State should consider the elimination of the age-based exemptions and deductions, and also consider taxing social security.

In conclusion, the thoughts offered here have been designed to increase the revenue yield from the tax and improve the overall equity between taxpayers.

A COMPARISON OF EXISTING AND POSSIBLE TAX BRACKETS AND RATES

Current Income Tax Brackets and Rates

Tax Brackets	Tax Rates
$0 to $2,999	2.00%
$3,000 to $4,999	3.00%
$5,000 to $16,999	5.00%
$17,000 and Over	5.75%

Possible Income Tax Brackets and Rates

Tax Brackets	Tax Rates
$0 to $4,999	2.00%
$5,000 to $9,999	3.00%
$10,000 to $16,999	5.00%
$17,000 to $59,999	6.00%
$60,000 and Over	6.50%

REFORMING THE VIRGINIA INCOME TAX

BACKGROUND[6]

Virginia enacted an individual income tax in 1843. Numerous changes have been made to the tax since then. Today the individual income tax has become the single most important source of general fund revenue for the Commonwealth. In fiscal year 2000, the Commonwealth collected $6.8 billion in individual income tax revenue representing 63.3 percent of the revenue going to the general fund. In fact, Virginia ranks fourth among all states in the percent of total state tax collections coming from the income tax (Bowman, 2001). Additionally, revenue generated by the individual income tax has grown more rapidly than revenue from any other tax in recent years since it captures the income resulting from real economic growth, population growth, and inflation.[7] Due to the important role that the income tax plays in financing state government, the future of the income tax is of critical importance to the financial health of the Commonwealth.[8]

To make the calculation of the tax easier, the Virginia individual income tax was made to conform to the federal income tax.[9] Because of conformity, the process of computing the tax begins with the federal adjusted gross income (AGI) from which Virginia allows various additions and subtractions. The resulting number is Virginia AGI.

The State allows tax filers to subtract exemptions and deductions from the Virginia AGI. Virginia provides an exemption of $800 for the taxpayer and each dependent. An additional exemption of $800 is provided for each taxpayer 65 and over as well as another $800 if the taxpayer is blind.

In addition, the taxpayer is also permitted to subtract the standard deduction or the itemized deduction from the Virginia AGI. The standard deduction in Virginia is $3,000 for single taxpayers and $5,000 for a married couple. These deductible amounts are not adjusted for inflation but instead are changed on an irregular basis.

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[6]Much of this section comes from Virginia Division of Legislative Services. *A Legislator's Guide to Taxation in Virginia, Volume 1: State Taxes.* June 2001.

[7]Growth in the income tax is being retarded to some degree by the increase in the share of income that is not subject to state taxation. For example, earnings which are taxed are falling as a proportion of personal income. By contrast, there has been an increase in the non-taxable forms of income such as Social Security and employee fringe benefits (National Conference of State Legislatures and National Governors' Association, 1993).

[8]Virginia's heavy dependence upon the income tax has worked to the advantage of its citizens since state income tax payments are tax deductible at the federal level. This deductibility provides a strong argument for using the deductible state income tax as opposed to relying heavily on the nondeductible sales tax. Utilizing the state income tax makes it possible for the residents of a state to export a portion of the income tax to the residents of other states who must make up for the loss in federal revenue that results from the state income tax deduction. As a result, because of the State's heavy reliance on the income tax, Virginians enjoy public services at a lower effective cost than if the State relied on a mix of nondeductible taxes.

[9]While conformity makes it easier to compute the tax, a drawback is that it makes the state individual income tax dependent upon federal law so that changes in federal income tax law can directly affect state revenue collections.

Subtracting exemptions and deductions from AGI reduces taxable income. Finally, before calculating the tax liability, Virginia grants a number of credits that, if used, further reduce the tax owed.

After determining the taxable income, the tax rate is applied to that amount to arrive at the tax owed. In Virginia, taxable income levels and their associated state tax rates are as follows: the first $3,000 of income, 2%; $3001 to $5,000, 3%; $5,001 to $17,000, 5%; greater than $17,000, 5.75%**.**

THE NEW FEDERAL TAX LAW

The federal tax cut, signed by President Bush on May 28, 2003, and referred to as the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), contains fewer provisions that will impact upon states than previous federal tax legislation. The provisions in the new law focus primarily upon individuals but also include provisions for business as well. In general, JGTRRA will accelerate certain previously enacted tax reductions, reduce taxes on capital gains, and provide growth incentives to business (Thorson)[10].

While JGTRRA will impact upon the calculation of federal adjusted gross income (FAGI) which begins the process of computing Virginia adjusted gross income (VAGI), the new legislation will not impact upon the calculation of the Virginia tax liability and will therefore not impact upon the amount of revenue produced by the Virginia individual income tax. The reason that the changes in FAGI caused by JGTRRA will not impact on VAGI is that the Virginia individual income tax "conforms" to the Internal Revenue Code (IRC) as it existed on December 31, 2002. As such, Virginia accepts FAGI calculations based upon IRC as it existed on December 31, 2002 and, as a result, the FAGI amounts computed based upon current IRC provisions (including JGTRRA) will not be used to arrive at VAGI. Furthermore, even if the Virginia General Assembly were to move conformity forward to December 31, 2003, because of the nature of the JGTRRA provisions, the new tax changes would have no effect on Virginia revenues according to the Virginia Department of Taxation (Thorson).

SELECTED ISSUES

The individual income tax in Virginia has been studied extensively over the years. These investigations have identified a number of concerns that the Commonwealth needs to address as it confronts the issue of tax reform. Because the basic elements of the tax have not changed in over 75 years, the tax needs to be modernized so that it reflects the changes that have occurred in the economy over the last several decades.

[10]GTRRA makes all the income tax rate reductions from the 2001 tax law effective in 2003. It reduces the marriage penalty by raising the standard deduction and widening the 15% tax bracket for married couples. It also raises the child tax credit from $600 to $1,000 and lowers the dividend and capital gains tax to 15%. The change in the handling of dividends and capital gains is expected to have a significant impact on taxpayers since 28.7 percent of Virginians have returns with dividend income. The new dividend and capital gains provision will save an average of $539 per return according to the Tax Foundation.

The first difficulty with the tax as currently structured is that, while its rates are graduated, it functions in many ways like a flat tax since it taxes a great many tax filers of very unequal incomes at similar rates. This violates the widely accepted principle of vertical equity that simply asserts that persons with different incomes should have different tax burdens. The flat tax nature of the current state income tax results from both the number and width of its tax brackets as well as its schedule of statutory rates.

Virginia utilizes four income tax brackets. This is one less bracket than the median of all the states that use graduated rates. Among those states with graduated rates, the smallest number of brackets is two (Connecticut) and the largest is ten (Missouri and Montana). Using a limited number of brackets tends to reduce the progressivity of Virginia's income tax (Bowman, 2002).

Further reducing the progressivity of the tax is that the ceiling for the lowest bracket is $3,000. This ceiling is relatively low since the median first bracket ceiling is $3,575 for the thirty-four states that define their own graduated-rate structure while the mean of those states is $6,060. With the ceiling for the next higher bracket only slightly higher than the ceiling for the first, the brackets do not significantly differentiate between the income levels of low-income taxpayers. Furthermore, the floor for Virginia's top bracket is $17,000 as compared to the median of $30,000 and the mean of $44,454 for the states with graduated tax structures (Bowman, 2002). The result of the State's compressed tax brackets is that the rate graduation tops out in the poverty range for many families. Stated differently, a considerable amount of the income of persons living in poverty is subject to taxation. Virginia needs to consider widening its tax brackets so that tax filers with significantly different taxable incomes pay different tax rates. Further, raising the ceiling for the lowest bracket will cause poverty-level taxpayers to pay little or no tax**.**

The problem of compressed brackets is compounded by the fact that there is little effective difference in tax rates between taxpayers of different income levels since the tax rates are only slightly graduated. Furthermore, unlike neighboring states, Virginia's highest marginal tax rate is low. Virginia's top marginal tax rate of 5.75 percent compares to the highest marginal tax rate of 8.7 % in the District of Columbia, 4.75% in Maryland, 8.25% in North Carolina, 7.0% in South Carolina, and 6.5% in West Virginia.[11] The individual income tax can be made more progressive by increasing the graduation of the tax rates and by widening the tax brackets.[12]

[11]The income tax in Tennessee is limited to dividends and interest only.

[12]Over the years, concern has been expressed that higher marginal tax rates can cause high-income taxpayers to flee Virginia for states with lower tax rates. This is not likely to be a problem for Virginia since marginal tax rates are already at low levels. Giving a moderately greater degree of progressivity to the State's income tax rates is not likely to lead to the migration of high-income taxpayers out of state – especially if they perceive that their taxes are being used to provide services of value to them such as for improvements to education and transportation.

In order to ease the tax burden of low income and poverty level taxpayers, Virginia allows tax filers to utilized personal exemptions and standard deductions to reduce their tax liability. Since both exemptions and deductions are subtracted from adjusted gross income to arrive at taxable income, the effect of these subtractions is to assist low-income taxpayers in meeting their basic needs by lowering their tax liability. In 1986 Virginia set its standard deduction at $3,000 for single filers and $5,000 for married couples, which were the amounts allowable under federal law. Unfortunately, while the federal deduction was indexed to inflation, the Virginia deduction was not. As a result, the standard deduction remains at the $3,000/$5,000 levels set in 1986 as compared to $4,550 and $7,600 for the federal tax in 2001. Similarly, in 1986 the personal exemption was set at only $800 in Virginia as compared to $2,000 for the federal tax. The federal amount was indexed to inflation and had risen to $2,900 in 2001 as compared to the state exemption, which has remained at $800. The state exemption was set lower at the beginning and, on a relative basis, has declined when compared to the federal exemption due to the failure of Virginia to index its exemption. Ignoring the need to increase the exemption and standard deduction over the years has been a major reason that Virginia leaves a very large percentage of poverty level income in the tax base (Bowman, 2002).

Virginia can make its individual income tax more progressive by increasing the personal exemption and standard deduction. The Commission on Virginia's State and Local Tax Structure for the 21st Century recommended in 2000 that the standard deductions be raised to $7,000 for married couples filling jointly and $3,500 for single persons and married persons filing either separate or combined returns. This change in the tax code was projected by the Virginia Department of Taxation to reduce state income tax revenues by $65.6 million by 2006 (Virginia Department of Taxation 2002a). The Commission further recommended that the exemption be increased to $2,500. According to the Virginia Department of Taxation, this increase in the personal and dependent exemption would cost the State $469.6 million by 2006 (Virginia Department of Taxation, 2002b). The Commission concluded that these adjustments would be sufficient to accomplish the goal of removing poverty-level income from the tax base for most taxpayers (Commonwealth of Virginia 2000).

The elderly have a special place in the Virginia Tax Code. Virginia grants three age-based preferences to elderly taxpayers even though changes to federal social security have helped to ensure that the elderly are not especially needy. These preferences are (1) an additional $800 personal exemption for persons 65 and over; (2) full exemption of social security income from the state tax base; and (3) a deduction of $6,000 for each person age 62-64 and a deduction of $12,000 for each person age 65 and over.[13] These exclusions from the tax base are very costly to the State and will become more costly as the baby boomers retire and more retirees move to Virginia.

[13]Giving favorable treatment to the elderly is not unique to Virginia. In fact, senior citizens receive more income tax preferences from both federal and state governments than the non-elderly (National Conference of State Legislatures).

These preferences have the effect of reducing the tax liability of low-income elderly persons but also benefit those elderly whose incomes are far above the poverty level. This violates the principle of horizontal equity, which asserts that taxpayers of similar income levels should face similar tax burdens. For example, two couples, one elderly (65 or over) and the other not elderly, of similar incomes would experience quite different individual income liabilities since their total exemptions and deductions differ. The elderly couple that takes the standard deduction can disregard $32,200 of otherwise taxable income as compared to $6,600 for the couple under 62.[14] In other words, the elderly couple has nearly five times the tax-free income as compared to the non-elderly couple. This disparity is even larger than these numbers suggest since the elderly couple could exclude whatever social security income they receive from their state tax liability (Bowman, 2002).

Virginia needs to reassess its age-based preferences. Age alone is not a measure of need. Historically, age was correlated with need but this has not been the case in recent years. Using age as a proxy for ability to pay is imprecise and leads to inequities between taxpayers and shifts the burden of the tax to others who are often less able to pay. Excluding social security from the tax liability of the elderly further shifts the burden of the individual income tax away from the elderly, many of whom have incomes considerably above the poverty level.

INCOME TAX REFORM

The fundamental approach to taxing income in Virginia has not been changed in many years. Substantive changes to the income tax are needed – both to improve equity and to raise new and badly needed revenues. An outline of possible tax reform is contained in Table 1 along with comparisons to recommendations made by previous tax commissions. A sampling of the views of Dr. John H. Bowman of Virginia Commonwealth University is also contained in the table.

REVENUE NEUTRALITY

An organizing principle behind tax reform is that the Virginia individual income tax should be changed in such a way as to generate additional revenue. The suggestion is in direct contrast to those made by previous tax reform study commissions which have had revenue neutrality as a centerpiece of their proposals as can be seen in Table 1.

HRPDC staff believe that the case for additional revenue has been made by the many needs assessments done over the years. One of those studies was done by the Barents Group, which is an operating unit within KPMG Consulting, Inc. Barents conducted a comprehensive review of the fiscal gap facing Virginia if existing tax and spending patterns are not adjusted. They estimated in 1999 that a continuation of

[14] The elderly couple would claim two personal exemptions for $800 each, a standard deduction of $5,000 for couples filing jointly, two elderly deductions for $12,000 each, and two elderly exemptions for $800 each for a total of $32,200. The non-elderly couple would claim only the two personal exemptions and the standard deduction for couples filing jointly.

current trends would produce a funding shortfall of $4.6 billion in FY 2008 (Knapp 2001).

Other studies have focused on the need to support the State's transportation needs at higher levels. In 1998 the Commission on the Future of Transportation projected the need for $74.5 billion in additional highway spending and another $14.2 billion in spending for other transportation needs over a twenty-year period. After allowing for projected revenue, the funding shortfall was projected to be $53.8 billion for highways and $11 billion for other transportation needs. A further needs assessment was performed by VDOT in 2001 as a part of its long-range forecast. VDOT's moderate scenario was projected to cost $82.2 billion. This compares to the $1.7 billion that VDOT expected to spend in FY 2002. Finally, JLARC estimated the cost of completing planned highway projects over the next ten years at $15.6 billion. The unfunded gap was projected to be $7.9 billion (Knapp, 2001).

Studies on the need for additional spending on higher education have reached similar conclusions. In 2000 the Joint Subcommittee on Higher Education Funding Policies estimated that state support for four-year institutions and community colleges would fall short by $187 to $206 million in FY 2002. Similarly, the State Council of Higher Education for Virginia in 2001 projected that enrollment demand in public colleges and universities would outstrip aggregate enrolled capacity by between 9,172 and 14,466 students. Comparable numbers for The Virginia Community College System were 7,827 and 13,189 students (Knapp, 2001).

Needs assessments have also been done for K-12 education in Virginia. In 2001, JLARC released a detailed review of the financing of education in Virginia. The study presented financing options in three tiers. If all three tiers were funded, the State would need to increase its spending on education by a projected $1.5 to $1.8 billion in FY 2002-2004 (Knapp 2001).

There are further indications that Virginia is falling behind other states in providing public services and infrastructure. Most compelling of the statistical indicators is Virginia's rank among the fifty states in public expenditures made by state and local governments expressed as a percent of the State's total personal income.[15] Perhaps most distressing of these comparisons is the State's ranking on educational spending since Virginia ranks 35th in state and local spending on higher education as a percent of total state personal income and just 39th in spending for K-12 education. Virginia also spends comparatively little in other areas since the State ranks 45th in spending for welfare, 32nd in spending on health, 30th in spending for parks and recreation, and 27th in highway spending. Further, Virginia is ranked 50th in the nation in natural resource protection, state parks, and historic preservation spending per capita (Governor's Natural Resource Leadership Summit, 2003). More than half of all states exceed

[15]At best, spending as a percent of income should be regarded as only a broad and general indication of the level of public service being provided to state residents. Shortcomings of this metric are that the statistic fails to allow for geographical differences in the cost of providing services as well as differences in productivity.

Virginia in spending per dollar of personal income in each of these important public service areas (Governing, 2002).

Additional studies and statistical comparisons suggest that Virginia is falling behind other states in providing basic public services and making infrastructure investments. While states cannot afford to get far ahead of adjacent states in terms of their tax burden, neither can they afford to fall far behind in the range and quality of public services that they provide. Unfortunately, the State's people, institutions, and economy are now suffering from the under funding of public services and infrastructure. Virginia needs to pursue tax reform aggressively and include in its efforts adjustments to the tax system which will lead to sufficient revenues so that public needs can be met. Since the State ranks 45th among all states in state and local tax collections as a percent of total personal income, there appears to be ample room to raise new revenues without overburdening taxpayers or making Virginia economically uncompetitive with nearby states. Reforms should be made to ensure the adequacy of funding for public services today.

SHARING THE INCOME TAX

Virginia's localities have struggled for some time to meet the public service needs of their residents. In recent years, many have been forced to raise taxes, reduce services, and/or cut staff in an effort to balance their budgets. While these fiscal stresses have been experienced by nearly all of the communities in the State, they have been most acute in the State's core or central cities.

A study that spoke in some detail to the issue of sharing the income tax with local governments came from the Commission on Virginia's State and Local Tax Structure for the 21st Century. In its report, the Commission recommended that the Commonwealth share at least six percent of its income tax collections with local governments. The Commission estimated that sharing the income tax would generate approximately $500 million in FY 2002 for Virginia's local governments.[16]

While the Commission recommended that the income tax be shared, it did not set forth a mechanism for allocating the shared revenue to local governments. However, in an effort to help the Commission frame its recommendations, the Virginia Municipal League (VML) and the Virginia Association of Counties (VACO) proposed that a 50/40/10 allocation formula be used. This formula would be applied to the revenue to be shared to arrive at each community's payment from the State. As formulated by VML and VACO, the formula would allocate 50 percent of the income tax revenue based upon the place of residence of taxpayers, 40 percent based upon where wages are earned, and 10 percent based upon an equal allocation to all jurisdictions regardless of size. The Commission recommended that while the details of the allocation formula could be worked out later, the basics of a sharing program should be

[16]Sharing the income tax with local governments was also endorsed by the Moss and Gilmore Commissions. The Gilmore Commission recommended that a constitutional amendment require that the State share 20 percent of the income tax with local governments.

put in place as soon as possible. Generally speaking, without a needs element in the 50/40/10 formula, Hampton Roads would be disadvantaged compared to regions with higher incomes and less tax-exempt property.

HRPDC agrees that the State should share a portion of the income tax with its local governments. However, further analytical work needs to be done to ensure that an equitable distribution formula is developed. This formula should take into consideration differences in the communities of the State in terms of their needs and their revenue raising capacity and level of revenue effort. Ultimately, the formula should include such factors as local per capita income, average local wage, the number of persons living in poverty, population size, and revenue effort.[17]

INCOME TAX BRACKETS AND RATES

If additional revenue is to be raised to meet the State's many unfunded public needs, tax rates on the individual income tax must be increased (or brackets adjusted to achieve a similar effect). Since the State's low-income tax filers already have limited financial resources from which to meet their basic needs, there is little if any opportunity to generate additional revenues from that group of taxpayers. However, middle and especially upper income taxpayers are currently being taxed at modest rates as compared to similarly positioned persons in nearby states.

Some comparisons with nearby states may be instructive. For example, in Virginia, middle and upper income tax filers pay a top marginal tax rate of 5.75 percent on income of $17,000 and over. By contrast, in North Carolina, rates for middle and upper income tax filers are much higher with rates of 7.75 percent for incomes from $60,000 to $119,999 and 8.75 percent for incomes of $120,000 and above. Rates are similarly high in the District of Columbia where filers with incomes of $30,000 and higher face a marginal rate of 9.0 percent. In Tennessee, tax filers pay a rate of 6.0 percent regardless of their income. Nearby, in West Virginia, the marginal rate is 6.0 percent for those making more than $40,000 and 6.5 percent for those making more than $60,000. Of Virginia's several contiguous states, only Maryland levies a lower rate than Virginia on middle and upper income taxpayers although the rate is higher for lower income groups since all income above $3,000 is taxed at 4.85 percent. In short, middle and upper income groups are lightly taxed in Virginia as compared to nearby states and there appears to be "room" to increase rates without causing middle and upper income households to flee the State for locations with lower rates. Indeed, moving to an adjoining state (aside from Maryland) would subject middle and upper income taxpayers to higher marginal rates than those found in Virginia.

The tax brackets in Virginia have not been changed in many years and as a result they make distinctions in income levels that have little meaning today. For example, the first bracket covers income from $0 to $2,999 while the second bracket includes income from $3,000 to $4,999 or income levels that, for all practical purposes,

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[17]Revenue effort is estimated each year by Virginia's Commission on Local Government. It compares the revenue a community collects with its theoretical ability to raise revenues.

are nearly identical to the incomes in the first bracket. If brackets are to reflect real differences in the ability to pay, or conversely, differences in the level of financial stress, then there seems little reason to make a distinction between these two income groups.

Virginia's neighboring states do not make fine discriminations between low-income groups when setting brackets and rates. North Carolina, for example, taxes all incomes up to $12,749 at 6%. Similarly, low-income taxpayers are "lumped together" in West Virginia and the District of Columbia where all incomes up to $9,999 are taxed at 3% and 5%, respectively. More extreme still are Tennessee and Pennsylvania where all incomes are taxed at the same rate (Tennessee, 6%; Pennsylvania, 2.8%). In other words, Virginia finds a distinction in the ability to pay of its low income groups while other nearby states do not.[18] A comparison of state tax rates and their associated brackets are shown in Table 2.

In recognition of the need to increase the separation in the income tax brackets at the lower end of the income spectrum and the desire to enhance state income tax revenues, the State should consider the adoption of the income tax structure shown in Table 3. As can be seen from the table, the first two tax brackets have been combined so as to do away with the fine distinction between low-income groups currently being made in the present tax code. The rate for the first bracket is set at 2.0 percent and, as such, reduces the rate from 3.0 in the existing structure for tax filers making between $3,000 and $4,999. This new rate will ease the tax burden faced by those in this low-income bracket. The second bracket, from $5,000 to $9,999, is taxed at 3.0 percent. For taxpayers in this bracket, the new proposed tax is less than the 5 percent rate currently in use for this income category and further reflects the desirability of lowering the rate on low-income taxpayers. The third bracket extends from $10,000 to $16,999 and is taxed at 5.0 percent or the same rate in effect today. The last two brackets replace the existing top bracket. The first of these new brackets raises the levy on those who formerly were making $17,000 or more from 5 percent in the existing bracket to 6 percent. The new 6% bracket applies to those making between $17,000 and $59,999. The second new bracket is taxed at 6.5% and applies to those making $60,000 and above. In general, the combination of all the new brackets and rates lowers the tax rate levied on low-income groups and increases the levy on middle and upper income groups.[19] A comparison of the State nominal income tax rates for various tax brackets is shown in Figure 1.[20]

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[18]Maryland is the only state among those near Virginia that does not follow this pattern. Maryland levies a 2% tax rate against the first $999 of income, a 3% tax rate against the next $1,000 to $1,999 of income, and 4% on the next $2,000 to $2,999 of income. All incomes at or above $3,000 pay at the rate of 4.85%.

[19]This system of brackets and rates is not revenue neutral but will generate significant additional revenues for the Commonwealth. For example, using data from the Virginia Department of Taxation, a simulation done at HRPDC using the existing tax brackets along with 2% and 3% for the first two brackets, and with 6% for the third bracket, and 6.5% for the fourth bracket produced an additional $922 million in income tax revenue for the State.

[20] Where two nominal rates apply to the same income bracket, the weighted rate has been used.

EXEMPTIONS AND THE STANDARD DEDUCTION

The revenue generated by the income tax as well as the liability faced by the taxpayer is also influenced by the amount of the standard deduction and personal exemption. A comparison of the standard deduction and exemptions for Virginia and nearby states is shown in Table 4. As can be seen from the table, at $800, Virginia's personal exemption is the lowest among all its contiguous states since single exemptions are $2,500 in North Carolina, $2,000 in West Virginia, $1,850 in Maryland, $1,370 in the District of Columbia, and $1,250 in Tennessee. Dependent exemptions are similarly high in each of the adjoining states.[21] These numbers suggest that Virginia has a lower single exemption than the amounts exempted in any of its neighboring states. The result of having a low exemption is that Virginia taxes a larger amount of the income of low-income taxpayers than do other states. Virginia should consider increasing the single and dependent exemptions from $800 to $1,200. This increase will have the effect of reducing the amount of income subject to taxation for both families and low-income taxpayers. In addition, because the increase is modest as compared to an increase that would raise the exemption to the level of adjacent states, the cost to Virginia in lost revenue will not be large.

Unlike the small amount allowed for exemptions, Virginia has been more generous in formulating its standard deduction. The standard deduction in Virginia is $3,000 for singles and $5,000 for filers of a joint return. This compares favorably with the amounts allowed in neighboring states. The standard deduction for single filers is $3,000 in North Carolina, $2,000 in both Maryland and the District of Columbia, and $0 in Tennessee and West Virginia. As a result, Virginia uses a standard deduction that is equal to or larger than the standard deduction found in any of its adjoining states. Virginia's standard deduction seems appropriate since the current deductions are at or above the amounts allowed by other states. Additionally, increasing the deduction would be very costly to the State because, while it would be a substantial aid to low-income taxpayers, would also reduce the tax liability of many middle and upper income taxpayers who would, under a new system of brackets and rates, face below average tax rates.

Increasing exemptions and standard deductions can be very costly to the Commonwealth. To explore the impact of increasing exemptions and deductions upon the revenues generated by the income tax, HRPDC conducted several simulations that are summarized in Table 5. As can be seen in the table, increasing the exemption from $800 to $1,000 would reduce the State's revenue by $66.1 million. An increase to $1,200 would reduce the revenue generated by the tax to $132.2 million. Similarly, increasing the standard deduction to $4,000 for single filers and $6,000 for joint filers would result in a revenue loss of $82.5 million. Larger increases to the personal exemption and the standard deduction would produce even larger reductions in the revenue derived from the individual income tax. As the simulations show, increasing exemptions and the standard deduction are a costly and inefficient way to aid low-

[21] Tennessee is the single exception to this pattern since the State has no dependent exemption.

income taxpayers since the increases apply to all taxpayers – not just those within the low-income categories.

As indicated above, Virginia grants age-based preferences to elderly taxpayers. These exclusions from the tax base are very costly to the State. They have the effect of reducing the tax liability of low-income elderly persons but also benefit those elderly whose incomes are far above the poverty level. Historically, age was correlated with need but this has not been the case in recent years. Using age as a proxy for ability to pay is imprecise and leads to inequities between taxpayers. It also has the effect of shifting the burden of the tax to others who are often less able to pay. The Commission on Virginia's State and Local Tax Structure for the 21st Century recommended that the age-based exemptions and deductions be eliminated and that social security be made taxable in Virginia just as it is taxable at the federal level. Eliminating Virginia's age deduction would increase state income tax collections by $338.5 million in 2006 (Virginia Department of Taxation 2002d). In recognition of the several benefits to eliminating the age-based exemptions and deductions and taxing social security, the State should consider endorsing the recommendations made by the Commission on Virginia's State and Local Tax Structure for the 21st Century.

CONCLUSIONS

The income tax is the most important tax levied by the Commonwealth since it supplies much of the revenue going to the General Fund. Keeping this tax "healthy" is vital to the State's ability to finance its future needs. The ideas offered here are designed to do just that. In combination, they will increase the revenue yield from the tax and improve the overall equity between taxpayers.

TABLE 1

A COMPARISON OF INCOME TAX REFORM RECOMMENDATIONS

	Recommendations					
Selected Issues	Moss Commission*	Morris Commission**	Gilmore Commission***	McDonnell/ Hanger Commission****	John H. Bowman***** VCU	Possible HRPDC Recommendations
Should Reforms be Revenue Neutrality?	No Recommendation	Yes	Yes	`	Recommended that Short-Term Revenue Shortfalls Should be Addressed with a Tax Surcharge	No
Should the State Share the Income Tax with Local Governments?	Recommended to the Morris Commission that State Share Revenues with Localities	Recommended that 6% of the Income Tax be Shared with Local Governments	Recommended Ceding 20% of Income Tax to Local Governments	No Recommendation	No Recommendation	Recommended Sharing the Income Tax with Localities
Should Income Tax Brackets and Rates be Changed?	Recommended to the Morris Commission that Brackets be Raised from $0-$3,000 to $0-$4,000 and from $3,000-$5,000 to $4,000-$6,000	Recommended that Two Brackets be Used: 5% on the First $50,000; 5.75% above $50,000	No Recommendation	No Recommendation	Recommended Expanding Brackets to Make the Graduation More Meaningful	Recommended New Brackets and Rates: $0 to $4,999 (2%); $5,000 to $9,999 (3%); $10,000 to $16,999 (5%); $17,000 to $59,999 (6%); $60,000 and Over (6.50%)
Should Standard Deductions be Changed?	No Recommendation	Recommended Standard Deductions of $7,000 for Married Couples and $3,500 for Single Persons	No Recommendation	No Recommendation	Recommended Increasing the Standard Deduction	Recommended No Change in Standard Deduction
Should Exemptions be Changed?	No Recommendation	Recommended Increasing the Exemption to $2,500 and Instituting the Exemption as a $125 Tax Credits	No Recommendation	No Recommendation	Recommended Increasing the Exemption	Recommended Increasing the Personal and Dependent Exemptions to $1,000
Should the Age Deductions Given to the Elderly be Changed?	No Recommendation	Recommended Termination of the Deduction for Individuals 62 to 64 ($6,000) and to those Age 65 and Over ($12,000)	No Recommendation	No Recommendation	Recommended that Age-Based Preferences Be Eliminated	Recommend Termination of the Deduction for Age
Should the Age and Blindness Exemptions be Changed?	No Recommendation	Recommeded Eliminating the Age and Blindness Exemptions While Increasing the Personal Exemption or Credit	No Recommendation	No Recommendation	Recommended that Age-Based Preferences Be Eliminated	Endorsed the Morris Commission's Recommendation on Age and Blindness Exemptions

TABLE 2
STATE INCOME TAXES OF NEAREST COMPETITORS:
BRACKET ANALYSIS
12/31/2002

		Brackets for Single Filers	
	Marginal Rate	Beginning of Bracket	End of Bracket
District of Columbia	5.00%	$0	$9,999
	7.00%	$10,000	$29,999
	9.00%	$30,000	No Limit
Georgia	1.00%	$0	$749
	2.00%	$750	$2,249
	3.00%	$2,250	$3,749
	4.00%	$3,750	$5,249
	5.00%	$5,250	$6,999
	6.00%	$7,000	No Limit
Maryland*	2.00%	$0	$999
	3.00%	$1,000	$1,999
	4.00%	$2,000	$2,999
	4.85%	$3,000	No Limit
North Carolina*	6.00%	$0	$12,749
	7.00%	$12,750	$59,999
	7.75%	$60,000	$119,999
	8.75%	$120,000	No Limit
Pennsylvania	2.80%	$0	No Limit
South Carolina	2.50%	$0	$2,399
	3.00%	$2,400	$4,799
	4.00%	$4,800	$7,199
	5.00%	$7,200	$9,599
	6.00%	$9,600	$11,999
	7.00%	$12,000	No Limit
Tennessee	6.00%	$0	No Limit
Virginia	2.00%	$0	$2,999
	3.00%	$3,000	$4,999
	5.00%	$5,000	$16,999
	5.75%	$17,000	No Limit
West Virginia	3.00%	$0	$9,999
	4.00%	$10,000	$24,999
	4.50%	$25,000	$39,999
	6.00%	$40,000	$59,999
	6.50%	$60,000	No Limit

* Primary Competitors

TABLE 3

A COMPARISON OF EXISTING AND POSSIBLE TAX BRACKETS AND RATES

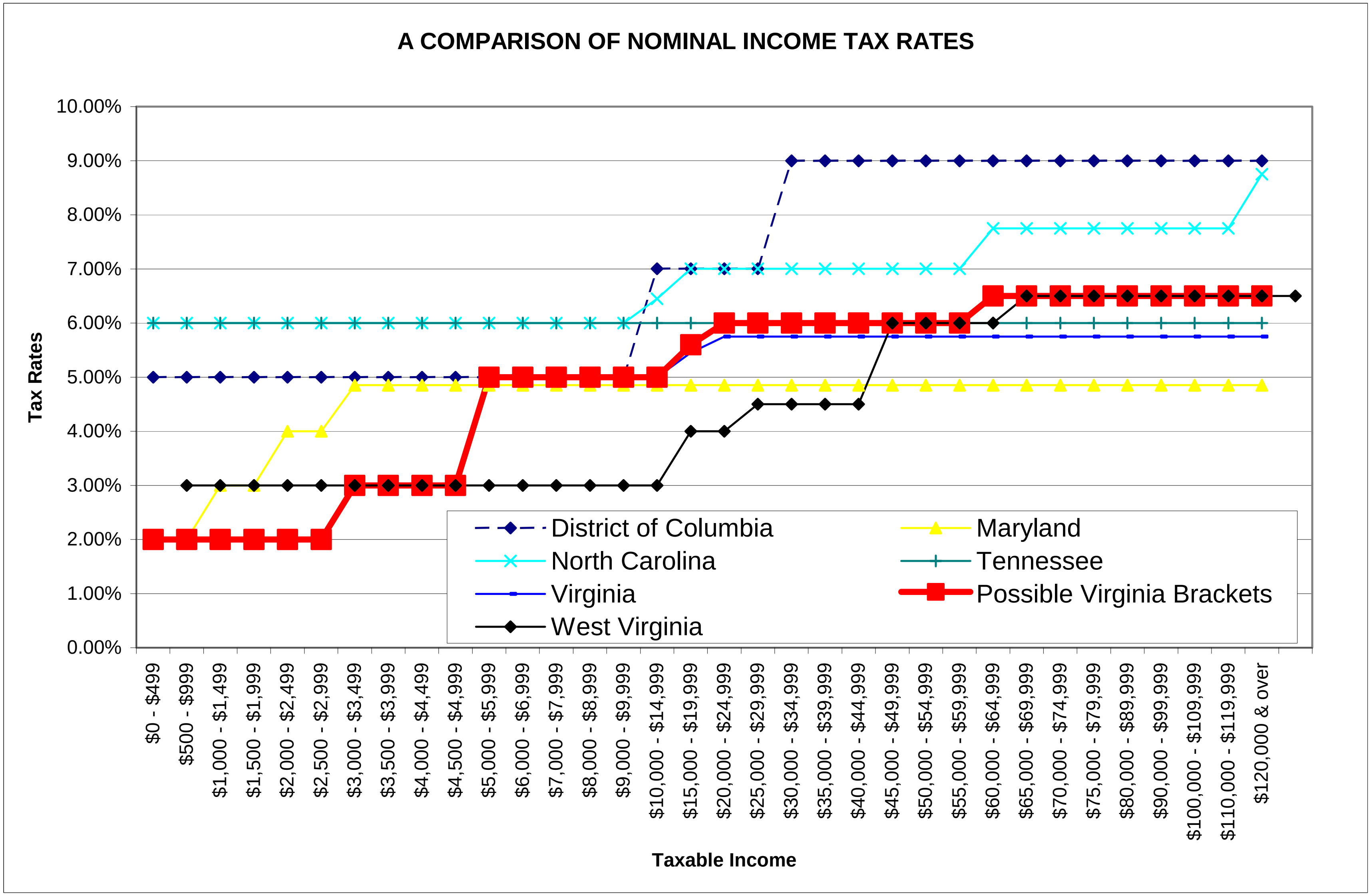
Current Income Tax Brackets and Rates

Tax Brackets	Tax Rates
$0 to $2,999	2.00%
$3,000 to $4,999	3.00%
$5,000 to $16,999	5.00%
$17,000 and Over	5.75%

Possible Income Tax Brackets and Rates

Tax Brackets	Tax Rates
$0 to $4,999	2.00%
$5,000 to $9,999	3.00%
$10,000 to $16,999	5.00%
$17,000 to $59,999	6.00%
$60,000 and Over	6.50%

FIGURE 1



A COMPARISON OF NOMINAL INCOME TAX RATES
10.00%
9.00%
8.00%
7.00%
6.00%
5.00%
4.00%
3.00%
2.00%
1.00%
0.00%
Tax Rates
District of Columbia
Maryland
North Carolina
Tennessee
Virginia
Possible Virginia Brackets
West Virginia
$0 - $499
$500 - $999
$1,000 - $1,499
$1,500 - $1,999
$2,000 - $2,499
$2,500 - $2,999
$3,000 - $3,499
$3,500 - $3,999
$4,000 - $4,499
$4,500 - $4,999
$5,000 - $5,999
$6,000 - $6,999
$7,000 - $7,999
$8,000 - $8,999
$9,000 - $9,999
$10,000 - $14,999
$15,000 - $19,999
$20,000 - $24,999
$25,000 - $29,999
$30,000 - $34,999
$35,000 - $39,999
$40,000 - $44,999
$45,000 - $49,999
$50,000 - $54,999
$55,000 - $59,999
$60,000 - $64,999
$65,000 - $69,999
$70,000 - $74,999
$75,000 - $79,999
$80,000 - $89,999
$90,000 - $99,999
$100,000 - $109,999
$110,000 - $119,999
$120,000 & over
Taxable Income

TABLE 4

STATE INCOME TAXES

December 31, 2002

	Standard Deduction		Personal Exemptions	
	Single	**Joint**	**Single**	**Dependents**
District of Columbia	$2,000	$2,000	$1,370	$1,370
Georgia	$2,300	$3,000	$2,700	$2,700
Maryland*	$2,000	$4,000	$1,850	$1,850
North Carolina*	$3,000	$5,000	$2,500	$2,500
Pennsylvania	$0	$0	$0	$0
South Carolina	$4,550	$7,600	$2,900	$2,900
Tennessee	$0	$0	$1,250	$0
Virginia	$3,000	$5,000	$800	$800
West Virginia	$0	$0	$2,000	$4,000

* Primary Competitors

TABLE 5

VIRGINIA TAXABLE INCOME AND INCOME COMPONENTS

TAXABLE YEAR 2000

Scenarios	Virginia Adjusted Gross Income	Exemptions	Itemized Deductions Claimed	Standard Deductions Claimed	Total Taxable Income (Estimated)	Total Tax Liability (Estimated)*	Change from Current Liability
Current	$156,048,200,899	$5,148,818,613	$19,481,079,628	$5,740,724,416	$125,677,578,242	$6,452,638,764	$0
#1: $1000 Exemptions	$156,048,200,899	$6,436,023,266	$19,481,079,628	$5,740,724,416	$124,390,373,589	$6,386,550,073	-$66,088,691
#2: $1200 Exemptions	$156,048,200,899	$7,723,227,920	$19,481,079,628	$5,740,724,416	$123,103,168,936	$6,320,461,382	-$132,177,382
#3: $1600 Exemptions	$156,048,200,899	$10,297,637,226	$19,481,079,628	$5,740,724,416	$120,528,759,629	$6,188,284,000	-$264,354,764
#4: $2000 Exemptions	$156,048,200,899	$12,872,046,533	$19,481,079,628	$5,740,724,416	$117,954,350,323	$6,056,106,618	-$396,532,146
#5: $4000/$6000 Deductions**	$156,048,200,899	$5,148,818,613	$19,481,079,628	$7,348,127,252	$124,070,175,406	$6,370,110,202	-$82,528,562
#6: $5000/$7000 Deductions**	$156,048,200,899	$5,148,818,613	$19,481,079,628	$8,955,530,089	$122,462,772,569	$6,287,581,639	-$165,057,125
#6: #1 + #5	$156,048,200,899	$6,436,023,266	$19,481,079,628	$7,348,127,252	$122,782,970,752	$6,304,021,511	-$148,617,253
#7: #3 + #6	$156,048,200,899	$12,872,046,533	$19,481,079,628	$8,955,530,089	$114,739,544,650	$5,891,049,493	-$561,589,271

* Estimated using the 5.13428 percent effective tax rate from taxable year 2000.
** Assumes that 40 percent of standard deductions are joint deductions.

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PART II

SALES AND USE TAX

REFORMING THE VIRGINIA SALES AND USE TAX

EXECUTIVE SUMMARY

INTRODUCTION

The sales and use tax was enacted in 1966 and was intended to be a broad-based tax with a limited number of exemptions. Today, it is second to the income tax as a revenue source and accounts for approximately 20 percent of the Commonwealth's general fund revenues. Presently, the tax rate is 4.5 percent, which is levied on the gross price of tangible personal property sold at retail in Virginia.

The State's tax rate of 4.5 percent is relatively low when compared to similar rates in other states. Of those states which utilize the sales tax, only eight have a lower rate than does Virginia. Virginia also has the lowest rate of any of its adjoining states.

Every state that taxes sales also imposes a use tax at the sales tax rate. The use tax is levied upon the use or consumption of tangible personal property or the storage of tangible personal property outside the State for use or consumption in Virginia.

SELECTED ISSUES

The State needs to address two issues concerning the sales and use tax. They are the utilization of exemptions and the taxation of services.

The first of these issues concerns the number of exemptions to the tax and the fiscal impact they generate. All tangible property sold in the State is subject to the sales and use tax unless exempted under Virginia law. These exemptions have proliferated over the years. For example, while there were just 24 exemptions when the tax was enacted in 1966, as of July 1, 2001, there were 453 (Bowen 2002). These exemptions have narrowed the retail base against which the tax can be applied resulting in a reduction in the revenues collected by the State and increasing the cost of government to those persons and institutions that do not benefit from an exemption. In fact, according to an estimate developed by the Virginia Department of Taxation, the revenue lost by Virginia as a result of not taxing transactions exempted from the sales and use tax was $3.6 billion in 1999.

The second issue of concern is whether or not additional services should be taxed in Virginia. At the time that the sales and use tax was introduced, Virginia's economy was based primarily on the production of tangible property, manufacturing and agriculture. Services constituted a relatively small portion of all the State's economic activities. Now that much of the economy is devoted to providing services, Virginia leaves a considerable part of its economic activity untaxed.

Unlike most other states, Virginia taxes relatively few of its services. For example, a nationwide survey done in 1996 by the Federation of Tax Administrators ranked Virginia 44th among the states in the number of services taxed. Only seven states taxed fewer services.

Extending the sales tax to cover a significant number of services has traditionally been difficult. However, if Virginia should be successful in extending the tax to services, the potential to raise revenue or to lower the sales tax rate is considerable. After a review of the issue of taxing services, John L. Knapp of Virginia's Center for Public Service concluded that taxing personal services; admissions/amusements; and fabrication, repair, and installation services offer the most attractive taxing opportunities. His estimate of the tax which would be collected by extending the sales and use tax to personal services, amusements, and repair services was $146 million in calendar 1999.

SALES AND USE TAX

Virginia does not take maximum advantage of its sales and use tax. In an effort to modernize and improve the tax, various commissions and committees have conducted critical reviews and have offered numerous recommendations.

TAXING SERVICES

Virginia taxes a limited number of services. This has the effect of narrowing the tax base and causes an increase in the tax rate and/or a decrease in the tax revenue generated from the tax. Taxing some portion of services not currently being taxed would enable Virginia to increase revenue, lower the tax rate, or both.

Extending the tax to cover services has long been considered difficult since professional groups such as accountants, lawyers, advertisers and doctors as well as business owners and other special interest groups lobby against such changes.

However, several states have successfully extended the tax to cover a wide array of services. Among them is Hawaii, which leads the list of states that are currently taxing services. Close behind Hawaii is New Mexico which also taxes a wide variety of services including the services provided by doctors, dentists, lawyers, engineers, and accountants.

Not only have several states extended the sales tax to cover a wide range of services but other states have been adding services to the range of goods and services being taxed. For example, while more recent information is not available, a survey done by the Federation of Tax Administrators found that in the period from 1990 to 1996, more than thirty states have increased the number of business and personal services that they tax. It is noteworthy that no state was able or found it desirable to extend the tax to cover additional professional services.

Service categories are not taxed equally since the public has been more willing to accept a tax on some services than others. For example, states have been more willing to tax business, personal, and repair services while they have been somewhat less willing to tax utilities, admissions, professional and computer services.

Many Virginians have made the case that the State has many public service needs, which are currently going unmet. Extending the sales tax to encompass a greater variety of services can help to both reduce current and anticipated budget deficits as well as to better meet the State's growing demand for public services. Accordingly, the Commonwealth should consider extending the sales tax to include a greater number and variety of services. Since Virginia taxes such a small percent of its services, there appear to be numerous opportunities to extend the tax into a wide variety of service categories. In fact, even if Virginia were to double the number of services which it taxes, the number of services taxed would not exceed the average number of services taxed in the fifty states and the District of Columbia.

ELIMINATING EXEMPTIONS

In drawing up sales tax legislation, most states have seen the value of exempting certain goods and services from the tax. The benefit derived from these exemptions, in many cases, has exceeded the loss in revenue, which the exemptions generate.

Virginia, like most states, has granted a large number of exemptions to the state sales tax. These exemptions have been written into the Code for a variety of reasons. In general, Virginia has exempted certain products, certain purchasers, certain sellers, as well as most intermediate inputs going into the production process. As of July 1, 2001, 453 exemptions had been granted by the legislature from the sales tax. When granted, each exemption was judged to help to meet an important need. Unfortunately, over time, the weight/cost of these exemptions has increased so that the cumulative cost of these exemptions exceeded $3.6 billion in 1999. In general, each individual exemption has not been costly to the State so that there has been little reluctance to grant the exemption – especially since each proposed exemption is normally considered in isolation from the existing cumulative fiscal impact of all others. However, the combined cost has become unsupportable in recent years. A comprehensive review of each and every exemption is now needed. It is important that this review lead to a reduction in the total number of exemptions granted by the State since Virginia can no longer afford the loss of revenue produced by the several hundred exemptions to its sales tax.

Unfortunately, raising significant new revenues by eliminating exemptions will not be easy. Many of the current exemptions go to local governments/agencies. These exemptions have the desired effect of cutting the cost of providing various public services. Other exemptions have been designed to cut the cost of inputs that go into the production process. This helps to make existing industries in Virginia more competitive and aids in attracting new businesses to the State. Other exemptions have been granted to assist agricultural producers while other exemptions cut the cost of education in Virginia so as to enrich the State's labor supply and to assist Virginia children and young people to acquire the education which they will need to be successful, productive, and responsible citizens. Finally, exemptions have been given to non-profit civic, cultural and community service organizations to enable them to better enhance the quality of community life. Efforts to provide these exemptions have been well intended and most exemptions have produced benefits, which have been of great value to the Commonwealth. Unfortunately, at present, the cumulative fiscal impact of these exemptions is greater than the State can afford. All exemptions need to be examined to ensure that Virginia is continuing to get good value for its "tax expenditures." Further, reviews should be conducted on a periodic basis to ensure that exemptions continue to generate good value for the Commonwealth.

While identifying individual exemptions, which should be cut, is beyond the scope of this analysis (a cost-benefit analysis would be required for each of the nearly five hundred exemptions which existed in July of 2001), it is possible to suggest that Virginia needs to give special attention to those exemptions covering personal services since these exemptions are very costly. In addition, personal exemptions appear to make an unnecessary distinction between services consumed by Virginians as opposed to goods consumed by those same residents.

Taxing exempted personal services has the potential to generate considerable new revenues for the Commonwealth. For example, taxing health professionals was estimated to produce nearly $254 million in new revenue for the Commonwealth according to estimates developed by the Virginia Department of Taxation. Estimates of additional new revenue which could be generated by eliminating other exemptions include the following: funeral services, $9.1 million; laundry and dry cleaning (coin operated), $2.6 million; pet grooming, $0.9 million; barber and beauty shop services, $19.8 million; insurance premiums, $244.2 million; bank service charges, $18.3 million; legal services, $71.3 million; tax return preparation for individuals, $1.8 million; horse boarding, $0.4 million, landscaping and lawn care, $20.3 million; telephone answering services, $1.8 million; armored car and detective services, $12.4 million; and carpet and upholstery cleaning, $1.4 million. These exemptions reduce the cost of each service to Virginians and increase revenue for each service provider but they do little to improve the health of the State's economy and make the Commonwealth more productive and competitive with other states (Bowen).

CONCLUSIONS

Virginia is at a crossroad. It can continue to provide limited public services and run the risk of losing people and businesses to neighboring states with better transportation and educational systems or it can enhance the level of its public services and encourage the growth in resources that will lead to a higher standard of living for all

Virginians. The communities of Hampton Roads believe the choice is clear. State revenues need to be increased so that adequate public services can be provided.

The sales and use tax plays a vital role in the State's revenue collection system. At present, the tax is less equitable than it could be and it fails to produce sufficient revenue to meet the needs of the Commonwealth. Implementing reforms will go a long way toward modernizing the tax and making it better serve the needs of Virginia.

REFORMING THE VIRGINIA SALES AND USE TAX

INTRODUCTION[22]

The sales and use tax was enacted in 1966 and was intended to be a broad-based tax with a limited number of exemptions.[23] Today, it is second to the income tax as a revenue source and accounts for approximately 20 percent of the Commonwealth's general fund revenues. Presently, the sales tax rate is 4.5 percent and is levied on the gross retail price of tangible personal property sold in Virginia. Of the 4.5 percent, two percent goes to the State's general fund, one percent is returned to localities based on the number of school-age children, one percent is distributed to local governments based upon point of sale, and one-half of one percent is distributed to the Transportation Trust Fund.[24]

The State's tax rate of 4.5 percent is relatively low when compared to similar rates in other states as can be seen in Figure 1. Of those states which utilize the sales tax, only eight have a lower rate than does Virginia and all but one of those levies a rate of four percent – only slightly less than the 4.5 percent rate used in Virginia. Furthermore, not only does Virginia have a low rate, but it also has the lowest rate of any of its adjoining states as can be seen in Figure 2.

Every state that taxes sales also imposes a use tax at the sales tax rate (National Conference of State Legislators). The use tax is levied upon the use or consumption of tangible personal property or the storage of tangible personal property outside the State for use or consumption in Virginia. The purpose of the use tax is to ensure that Virginia merchants are not at a competitive disadvantage with retailers from outside the State that are not required to collect the Virginia sales tax. Since out-of-state sellers do not ordinarily collect the use tax, individuals are required to declare the tax, which they owe when they file their state income tax. Since few residents of the State are aware of the existence of the use tax, there is a low level of compliance. In 1999, the use tax generated only $689,920 in revenue from individuals as compared to the total collected from the sales and use tax of $2,410,366,000. In other words, the use tax accounted for less than 0.03 percent of the total collected from the combined

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[22] Much of this section comes from Virginia Division of Legislative Services. *A Legislator's Guide to Taxation in Virginia, Volume 1: State Taxes*. June 2001.

[23] Virginia utilizes several other taxes that resemble the retail sales and use tax. These include separate taxes on the sale and use of automobiles, aircraft, and watercraft. The aircraft sales and use tax (2%) is levied on the sale price of aircraft sold in Virginia or the use of aircraft purchased elsewhere. The watercraft sales and use tax (2%) is levied on the sale price of watercraft sold in Virginia and the use of watercraft not sold in Virginia. Finally, the motor vehicle sales and use tax (3%), commonly known as the titling tax, is imposed on the sale of motor vehicles.

[24] Of the revenue distributed to the Transportation Trust Fund, 4.2 percent goes to the Commonwealth Port Fund, 2.4 percent goes to the Commonwealth Airport Fund, 14.7 percent goes to the Commonwealth Mass Transit Fund, and the remainder is retained in the Transportation Trust Fund.

sales and use tax. By contrast, businesses paid $29 million in use tax to the Commonwealth, still a small proportion of the total collected.

SELECTED ISSUES

The State needs to address two issues concerning the sales and use tax. They are the utilization of exemptions and the taxation of services.

The first issue concerns the number of exemptions to the tax and the fiscal impact which they generate. All tangible property sold in the State is subject to the sales and use tax unless exempted under Virginia law. These exemptions have proliferated over the years. For example, while there were just 24 exemptions when the tax was enacted in 1966, as of July 1, 2001, there were 453 (Bowen 2002). Additionally, the pace at which exemptions have been granted by the General Assembly may have accelerated in recent years since one new exemption was issued in 1999, 80 in 2000, and 79 in 2001. These exemptions have narrowed the retail base against which the tax can be applied resulting in a reduction in the revenues collected by the State and increasing the cost of government to those persons and institutions that do not benefit from an exemption.[25] In fact, according to an estimate developed by the Virginia Department of Taxation, the revenue lost by Virginia as a result of not taxing transactions exempted from the sales and use tax was $3.6 billion in 1999. That revenue loss, organized by category of exemption, is shown in Figure 3.

The large number and rapid growth in the number of exemptions to the sales and use tax was of concern to the Commission on Virginia's State and Local Tax Structure for the 21st Century. After studying this issue for some time, the Commission recommended that a moratorium on the issuance of new exemptions be instituted so that all new and existing exemptions can be critically reviewed. This recommendation has considerable merit. Virginia fails to collect significant revenues each year because of the exemptions and must set its sales and use tax rate higher than would otherwise be necessary had fewer exemptions been awarded. Many have suggested that each exemption needs to be reviewed to determine whether or not the value of the benefit, which Virginia receives from the use of exemptions, exceeds the revenue being lost by the State.

A second issue of concern is whether or not additional services should be taxed in Virginia. At the time that the sales and use tax was introduced in 1966, Virginia's economy was based primarily on the production of tangible property, manufacturing and agriculture. At that time, services constituted a relatively small portion of all the State's economic activities. Now that much of the

[25]The net effect of exemptions in most states is that the state general sales tax applies to only 50 to 60 percent of personal consumption (Fisher).

economy is devoted to providing services, Virginia leaves a considerable part of its economic activity untaxed.[26]

Unlike most other states, Virginia taxes relatively few of its services.[27] For example, a nationwide survey done in 1996 by the Federation of Tax Administrators ranked Virginia 44th among the states in the number of services taxed as can be seen in Figure 4. Only seven states taxed fewer services. Furthermore, the average number of services taxed was 53.5 whereas Virginia taxed just 18 (Bowen 2002). Additionally, Virginia taxes fewer services than all of its adjoining states as can be seen in Figure 5.

Extending the sales tax to cover a significant number of services has traditionally been difficult. Two states, Florida and Massachusetts, have tried to dramatically expand the sales tax to services. Both met with considerable opposition so that the laws extending the tax to services were repealed soon after enactment (National Conference of State Legislatures).

However, if Virginia should be successful in extending the tax to services, the potential to raise revenue or to lower the sales tax rate is considerable. After a review of the issue of taxing services, John L. Knapp of Virginia's Center for Public Service concluded that taxing personal services; admissions/amusements; and fabrication, repair, and installation services offer the most attractive taxing opportunities. For various reasons, he rejected the option of taxing business, computer, and professional services.[28] His estimate of the tax which would be collected by extending the sales and use tax to personal services, amusements, and repair services was $146 million in calendar 1999 or 6.5 percent above actual collections (Bowen 2002).

A further benefit, and one not commonly acknowledged, is that the sales and use tax can be made less regressive by taxing services. Most experts who have studied the sales tax view it as regressive since the tax takes a higher proportion of the income from lower income persons than it does from higher

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[26]When Virginia enacted the sales tax, the idea was to tax the sale or exchange of a tangible item. This involved broadening the concept of the excise tax on specific commodities to commodities more generally. At the time the tax was enacted, services constituted a small fraction of all consumer expenditures – probably about one third – with much of the larger share going to the purchase of goods. Today, those proportions are reversed with services representing some sixty percent of the total and goods only 40 percent (Fisher).

[27]Virginia taxes the following services: services provided in connection with the sale of personal property, meals served in restaurants and hotels, transient accommodations of less than 90 days, the fabrication of tangible personal property for consumers who furnish the materials used in the fabrication process, and the rental of tangible personal property (Bowen 2002).

[28]Business and computer services are frequently inputs into the work of other businesses. Taxing those services would lead to "pyramiding" or piling one tax upon another and would discourage outsourcing. The result would be a high effective tax rate on goods with a large number of inputs as well as several stages of production as compared to a low effective tax rate on goods with few inputs. Professional services have typically been difficult to tax because professional groups have vigorously and successfully fought efforts to extend the sales tax to the services that they provide.

income persons. In fact, the regressivity of the sales and property taxes is the primary reason that state and local taxes combined are generally regarded as mildly regressive while the federal tax on individuals is regarded as mildly progressive. The regressivity of the sales and use tax can be moderated to some extent by taxing services since services tend to be more widely used by higher income persons than by lower income persons. Virginia should consider extending its sales and use tax to cover additional services so as to raise additional revenue and to diminish the regressivity of the tax.

In recognition of the added revenues which might be generated by taxing services, the Commission on Virginia's State and Local Tax Structure for the 21st Century recommended that the State extend the sales and use tax to selected services. More specifically, it recommended that the extension into services should begin with amusements, and personal and repair services. The Commission's proposal has considerable merit since as additional services are taxed, Virginia will have the option of lowering the sales tax rate or leaving the tax rate at its current level and using the enhanced revenue to provide additional public services or both.

RETAIL SALES AND USE

Virginia does not take maximum advantage of its sales and use tax. The Virginia rate is low by comparison to rates used in other states. In addition, Virginia taxes fewer services than do other states and employs a great number of tax exemptions. In an effort to modernize and improve the tax, various commissions and committees have conducted critical reviews and have offered numerous recommendations. Some of those efforts are shown in Table 1 along with reforms suggested for consideration by the HRPDC staff.

TAXING SERVICES

Virginia taxes a limited number of services as can be seen in Figure 6, which compares the average number of services, taxed as compared to the number taxed in Virginia. This has the effect of narrowing the tax base and causes an increase in the tax rate and/or a decrease in the tax revenue generated from the tax. Taxing some portion of services not currently being taxed would enable Virginia to increase revenue, lower the tax rate, or both.

Extending the tax to cover services has long been considered difficult since professional groups such as accountants, lawyers, and doctors as well as business owners and other special interest groups lobby against such changes. Several states, however, have successfully extended the tax to cover a wide array of services. Among them is Hawaii, which leads the list of states that are currently taxing services. Nearly every good and service sold is subject to Hawaii's sales tax including such things as food, utilities, and medical care. Part of Hawaii's success in taxing services has to do with the State's isolated location which insures that the State's residents are unlikely to leave the State to access untaxed services elsewhere.[29] Close behind Hawaii is New Mexico, which also taxes a wide variety of services including the services provided by doctors, dentists, lawyers, engineers, and accountants. The majority of labor and repair services are taxed in New Mexico, as are construction contracts and most personal services including services provided by such businesses as barbershops, laundries, and health clubs.[30] South Dakota has also been successful at extending its sales tax to cover most professional services (Governing, February 2003).

Not only have several states extended the sales tax to cover a wide range of services but other states have been adding services to the range of goods and services being taxed. For example, while more recent information is not available, a survey done by the Federation of Tax Administrators found that in the period from 1990 to 1996, many states systematically added to the number of services already in the tax base. Most of those additions to the sales tax have occurred in the areas of business and personal services. As can be seen in Figure 7, more than thirty states have increased the number of business and personal services that they tax. It is noteworthy that no state was able or found it desirable to extend the tax to cover additional professional services.

Service categories are not taxed equally since the public has been more willing to accept a tax on some services than others. For example, states have been more willing to tax business, personal, and repair services while they have been somewhat less willing to tax utilities, admissions, professional and computer services. The number of services being taxed by states and the District of Columbia is shown in Figure 8.

Many Virginians have made the case that the State has many public service needs, which are currently going unmet. Extending the sales tax to encompass a greater variety of services can help to both reduce current and anticipated budget deficits as well as to better meet the State's growing demand for public services. Accordingly, the Commonwealth should consider extending the sales tax to include a greater number and variety of services. Since Virginia taxes such a small percent of its services, there appear to be numerous opportunities to extend the tax into a wide variety of service categories. In fact, even if Virginia were to double the number of services which it taxes, the number of services taxed would not exceed the average number of services taxed in the fifty states and the District of Columbia. The percent of all service categories that were taxed in Virginia in 1996 according to the Federation of Tax Administrators is shown in Figure 9 (Federation of Tax Administrators).

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[29]The conventional wisdom is that consumers rarely cross state lines to purchase untaxed services in adjoining states – especially if the service is not expensive.

[30]Hawaii and New Mexico each impose derivatives of the sales tax since they impose a tax on businesses for the privilege of doing business in the state – not a tax on specific goods sold (National Conference of State Legislatures).

ELIMINATING EXEMPTIONS

In drawing up sales tax legislation, most states have seen the value of exempting certain goods and services from the tax. The benefit derived from these exemptions, in many cases, has exceeded the loss in revenue, which the exemptions generate.

Virginia, like most states, has granted a large number of exemptions to the State sales tax. These exemptions have been written into the code for a variety of reasons. In general, Virginia has exempted certain products, certain purchasers, certain sellers, as well as most intermediate inputs going into the production process. As of July 1, 2001, 453 exemptions had been granted by the legislature from the sales tax. When granted, each exemption was judged to help meet an important need. Unfortunately, over time, the weight/cost of these exemptions has increased so that the cumulative cost of these exemptions exceeded $3.6 billion in 1999 as can be seen in Figure 3.[31] In general, an individual exemption has not been costly to the State so that there has been little reluctance to grant the exemption – especially since each proposed exemption is normally considered in isolation from the existing cumulative fiscal impact of all others. However, the combined cost has become unsupportable in recent years. A comprehensive review of each and every exemption is now needed. It is important that this review lead to a reduction in the total number of exemptions granted by the State since Virginia can no longer afford the loss of revenue produced by the several hundred exemptions to its sales tax.[32]

Unfortunately, raising significant new revenues by eliminating exemptions will not be easy. Many of the current exemptions go to local governments/agencies. These exemptions have the desired effect of cutting the cost of providing various public services. Other exemptions have been designed to cut the cost of inputs that go into the production process. This helps to make existing industries in Virginia more competitive and aids in attracting new businesses to the State. Other exemptions have been granted to assist agricultural producers while other exemptions cut the cost of education in Virginia so as to enrich the State's labor supply and to assist Virginia's children and young people to acquire the education which they will need to be successful, productive, and responsible citizens. Finally, exemptions have been given to non-profit civic, cultural and community service organizations to enable them to better enhance the quality of community life. Efforts to provide these exemptions have been well intended and most exemptions have produced benefits, which

[31]This estimate was developed by the Virginia Department of Taxation. It includes exemptions to the sales and use tax that have been written into state taxes. It also includes services which were never subject to the sales tax and for which exemptions were never granted. The Department of Taxation included services in its list of exemptions in order to alert members of the General Assembly that an important number of services are not being taxed in Virginia.

[32]It will also be necessary to establish a sunset date for those exemptions which are targeted for elimination.

have been of great value to the Commonwealth. Unfortunately, at present, the cumulative fiscal impact of these exemptions is greater than the State can afford. All exemptions need to be examined to ensure that Virginia is continuing to get good value for its "tax expenditures."[33] Further, reviews should be conducted on a periodic basis of the remaining exemptions to ensure that exemptions continue to generate good value for the Commonwealth.

While selecting individual exemptions for elimination is beyond the scope of this analysis (a cost-benefit analysis would be required for each of the nearly five hundred exemptions which existed in July of 2001), it is possible to recommend that Virginia needs to give special attention to those exemptions covering personal services since these exemptions are very costly. In addition, personal exemptions appear to make an unnecessary distinction between services consumed by Virginians as opposed to goods consumed by those same residents. Furthermore, taxing personal services has the additional benefit of not disadvantaging Virginia producers by increasing their costs as compared to similar producers in other states.

Taxing exempted personal services has the potential to generate considerable new revenues for the Commonwealth. For example, taxing health professionals was estimated to produce nearly $254 million in new revenue for the Commonwealth according to estimates developed by the Virginia Department of Taxation. Estimates of additional new revenue which could be generated by eliminating other exemptions include the following: funeral services, $9.1 million; laundry and dry cleaning (coin operated), $2.6 million; pet grooming, $0.9 million; barber and beauty shop services, $19.8 million; insurance premiums, $244.2 million; bank service charges, $18.3 million; legal services, $71.3 million; tax return preparation for individuals, $1.8 million; horse boarding, $0.4 million, landscaping and lawn care, $20.3 million; telephone answering services, $1.8 million; armored car and detective services, $12.4 million; and carpet and upholstery cleaning, $1.4 million. These exemptions reduce the cost of each service to Virginians and increase revenue for the each service provider but they do little to improve the health of the State's economy and make the Commonwealth more productive and competitive with other states (Bowen).

CONCLUSIONS

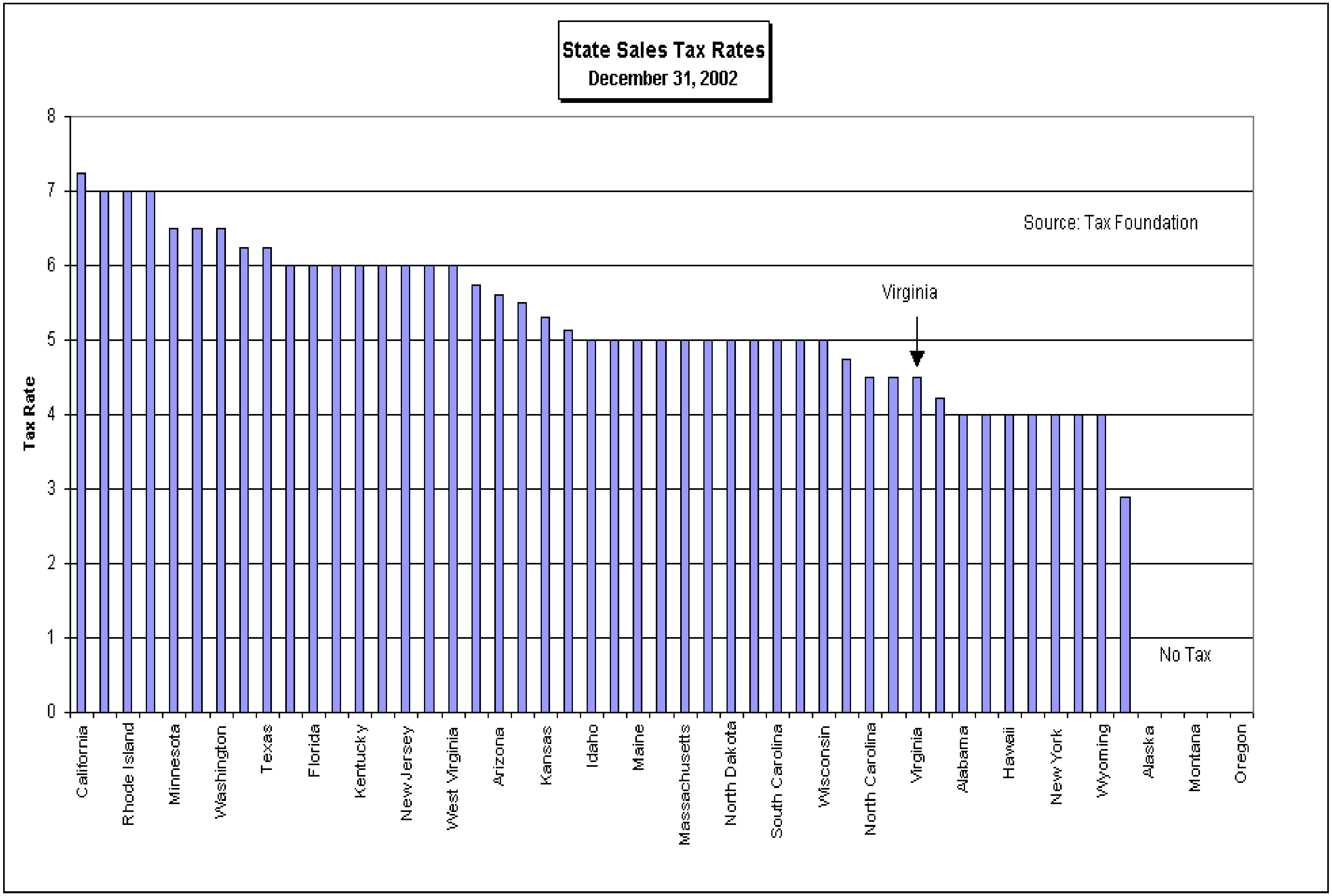
Virginia is at a crossroad. It can continue to provide limited public services and run the risk of losing people and businesses to neighboring states with better transportation and educational systems or it can enhance the level of its public services and encourage the growth in resources that will lead to a higher standard of living for all Virginians. The communities of Hampton Roads believe

[33]Tax expenditures are tax breaks or tax reductions which have the same effect as an expenditure of government revenue to achieve a desired objective. For example, low-income households can be helped by providing them with a reduction in their taxes or by an expenditure of public money to add to their incomes. The result is the same – public money is transferred to low-income households for their benefit.

the choice is clear. State revenues need to be increased so that adequate public services can be provided.

The sales and use tax plays a vital role in the State's revenue collection system. At present, the tax is less equitable than it could be and it fails to produce sufficient revenue to meet the needs of the Commonwealth. Implementing reforms will go a long way toward modernizing the sales tax and making it better serve the needs of Virginia.

Figure 1



State Sales Tax Rates
December 31, 2002
Tax Rate
8
7
6
5
4
3
2
1
0
Source: Tax Foundation
Virginia
No Tax
California
Rhode Island
Minnesota
Washington
Texas
Florida
Kentucky
New Jersey
West Virginia
Arizona
Kansas
Idaho
Maine
Massachusetts
North Dakota
South Carolina
Wisconsin
North Carolina
Virginia
Alabama
Hawaii
New York
Wyoming
Alaska
Montana
Oregon

Figure 2

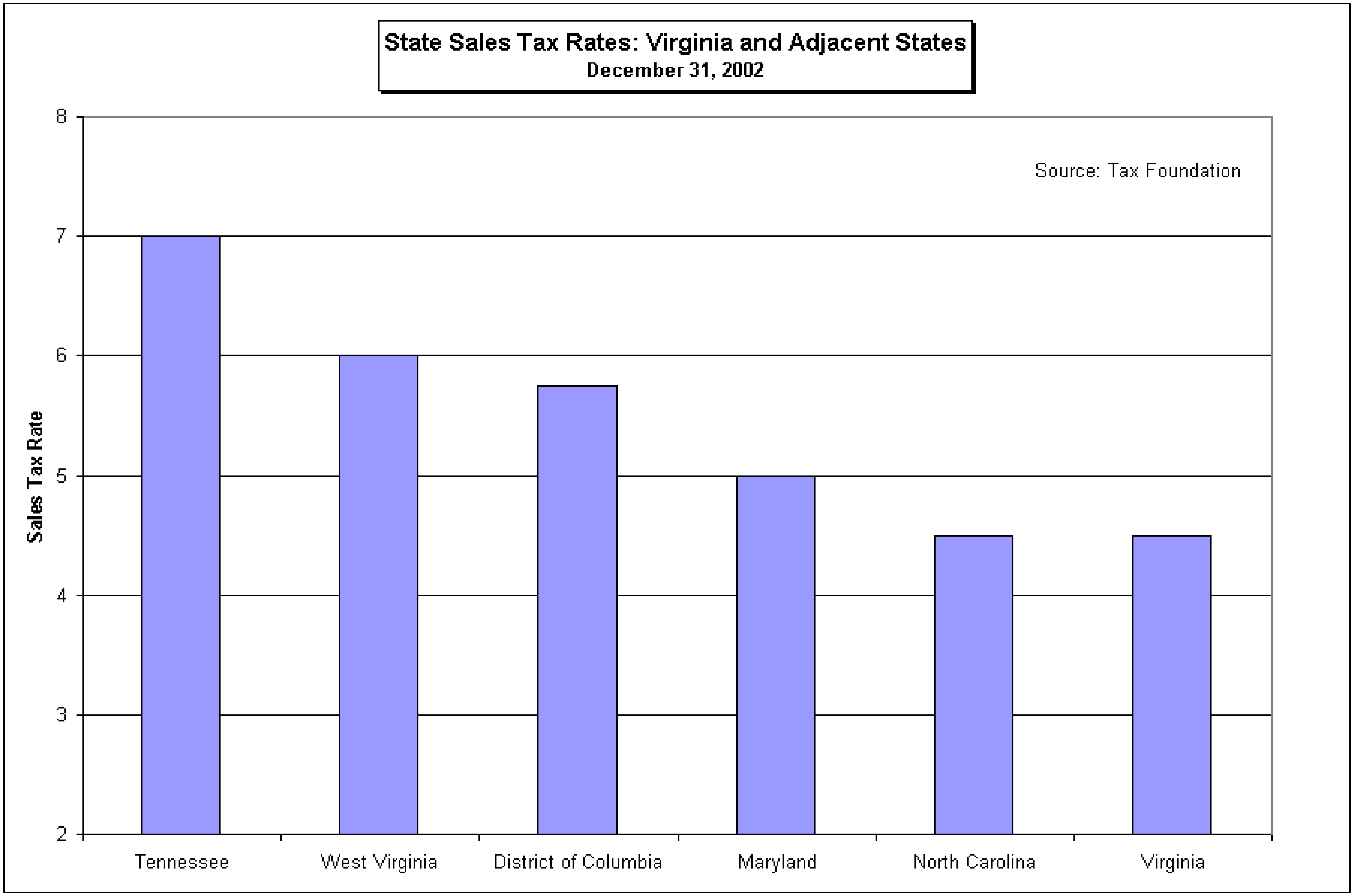

State Sales Tax Rates: Virginia and Adjacent States
December 31, 2002
Source: Tax Foundation
Sales Tax Rate
8
7
6
5
4
3
2
Tennessee
West Virginia
District of Columbia
Maryland
North Carolina
Virginia

Figure 3

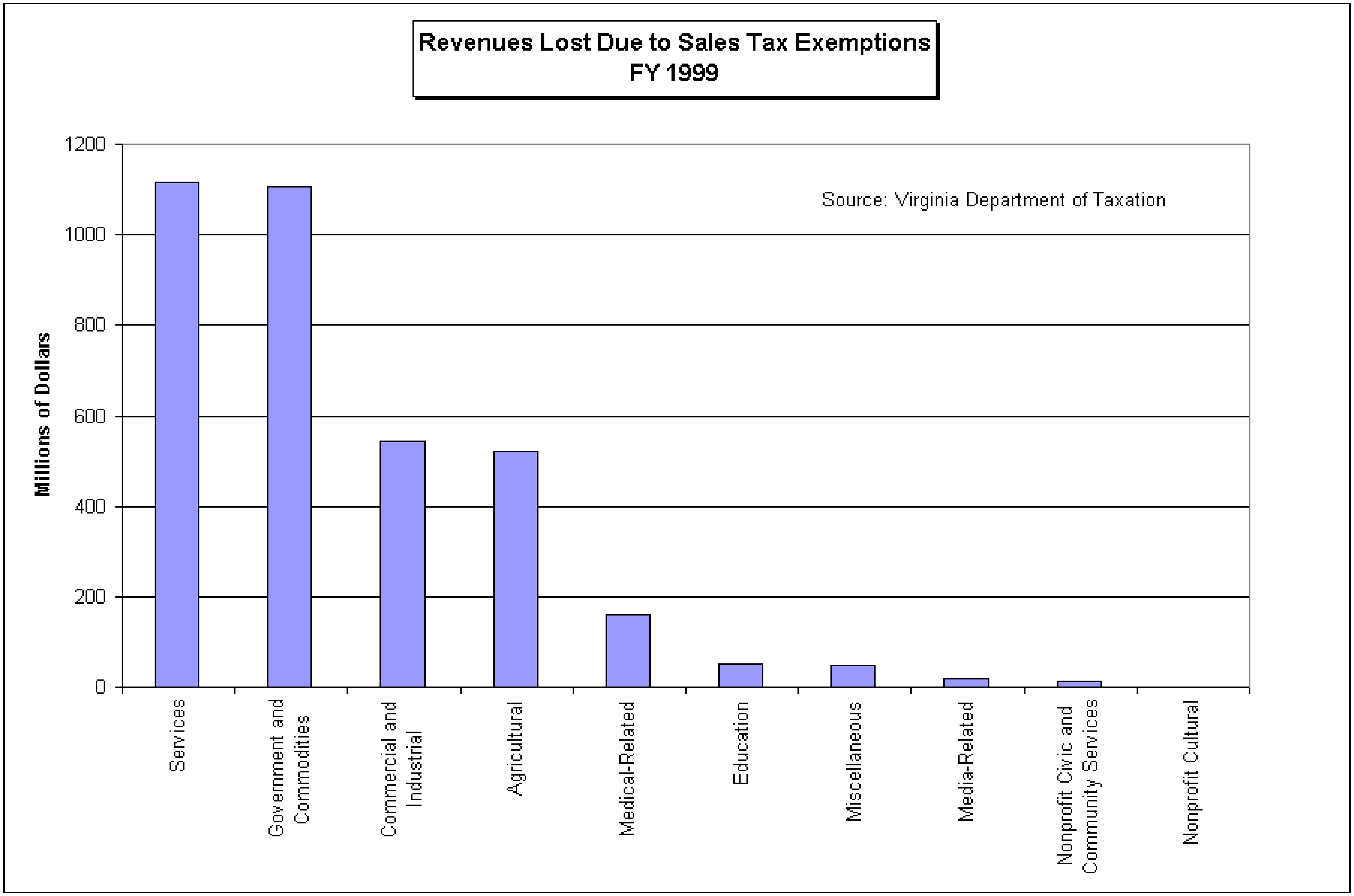

Revenues Lost Due to Sales Tax Exemptions
FY 1999
Source: Virginia Department of Taxation
Millions of Dollars
1200
1000
800
600
400
200
0
Services
Government and Commodities
Commercial and Industrial
Agricultural
Medical-Related
Education
Miscellaneous
Media-Related
Nonprofit Civic and Community Services
Nonprofit Cultural

Figure 4

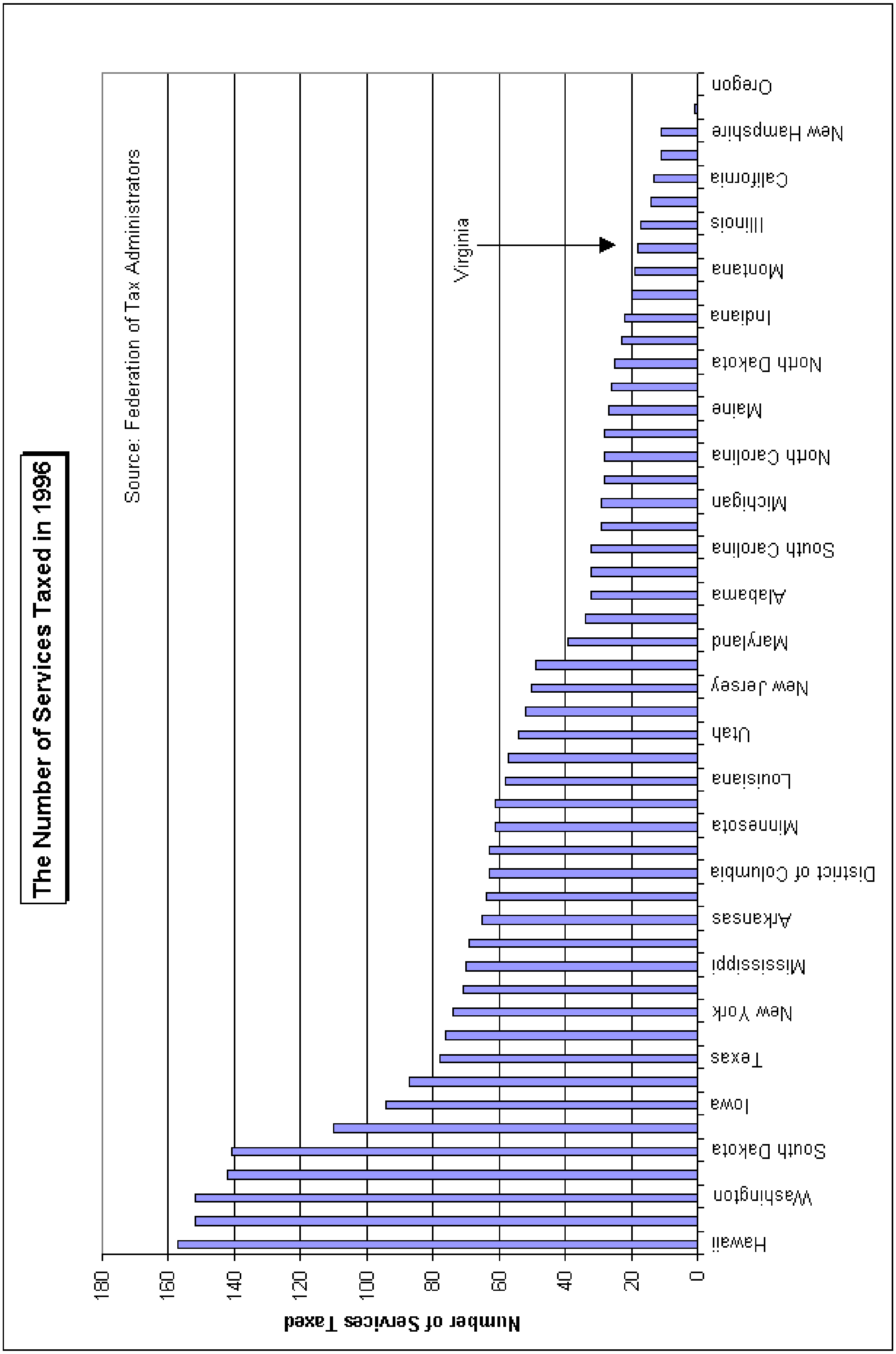

The Number of Services Taxed in 1996
Source: Federation of Tax Administrators
Virginia
Number of Services Taxed
0
20
40
60
80
100
120
140
160
180
Hawaii
Washington
South Dakota
Iowa
Texas
New York
Mississippi
Arkansas
Distict of Columbia
Minnesota
Louisiana
Utah
New Jersey
Maryland
Alabama
South Carolina
Michigan
North Carolina
Maine
North Dakota
Indiana
Montana
Illinois
California
New Hampshire
Oregon

Figure 5

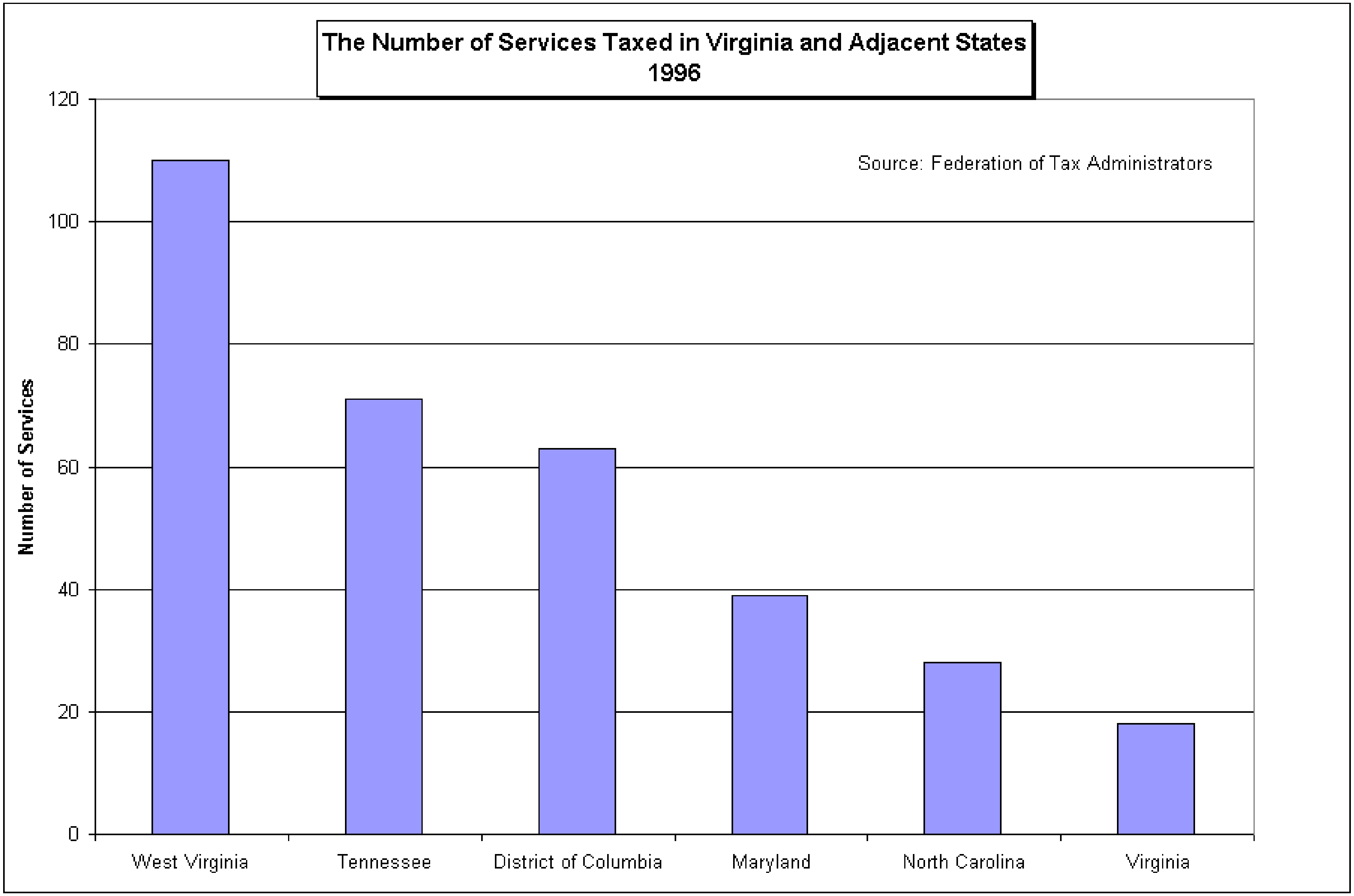

The Number of Services Taxed in Virginia and Adjacent States
1996
Source: Federation of Tax Administrators
Number of Services
120
100
80
60
40
20
0
West Virginia
Tennessee
District of Columbia
Maryland
North Carolina
Virginia

Table 1

A Comparison of Sales Tax Reform

	Recommendations					
Selected Issues	Moss Commission*	Morris Commission**	Gilmore Commission***	McDonnell/ Hanger Commission****	Governor Mark R. Warner Reform Principles	Possible HRPDC Recommendations
Should Additional Services be Taxed?	No Recommendation	Recommended Taxing Additional Services Beginning with Personal Services, Amusements, and Repair Services	No Recommendation	Yes	Need to Look at the Taxation of Services	Yes - Especially Personal Services, Admissions and Amusements, and Repair Services
Should Exemptions be Eliminated from the Sales Tax?	No Recommendation	Recommended that a Moratorium be Placed on the Granting of Additional Exemptions. Recommended that All Exemptions be Critically Evaluated.	No Recommendation	Supported a Moratorium on New Sales and Use Tax Exemptions	No Recommendation	Some Should be Eliminated
Should Internet Sales be Taxed?	No Recommendation	Recommended that Virginia Participate in the Streamlined Sales Tax Project	No Recommendation	Recommended that State Should Maintain a Policy of No Sales Tax on Access to Internet and Digital Downloads. Continue to Work with Streamlined Sales Tax Project.	It's Unfair to Tax Purchases in Stores but not Tax Purchases through Catalogues or the Internet	Yes

* Commission on the Condition and Future of Virginia's Cities
** Commission on Virginia's State and Local Tax Structure for the 21st Century
*** Governor's Commission on Government Finance Reform for the 21st Century
**** Joint Subcommittee to Study and Revise Virginia's State Tax Code

Figure 6

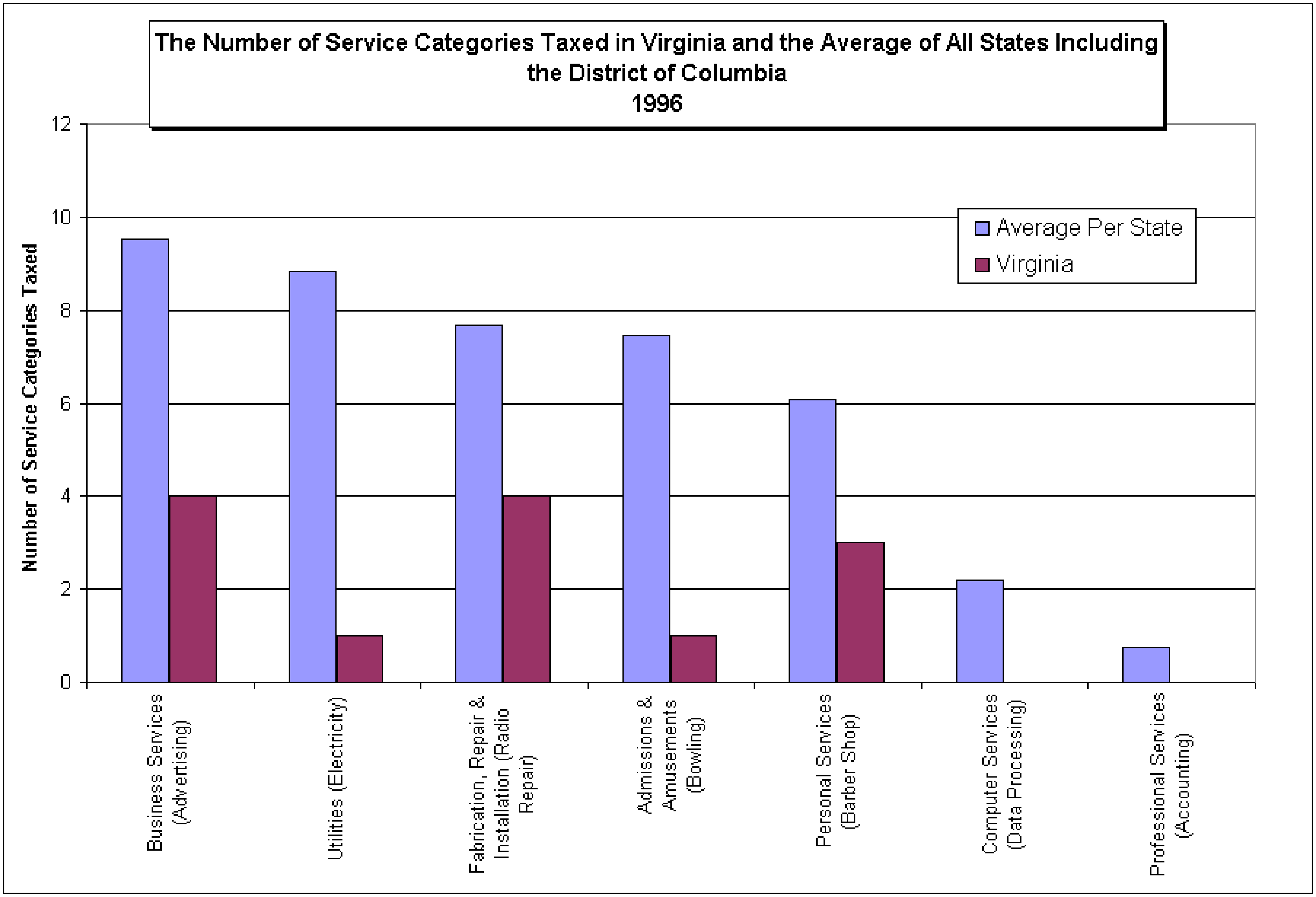
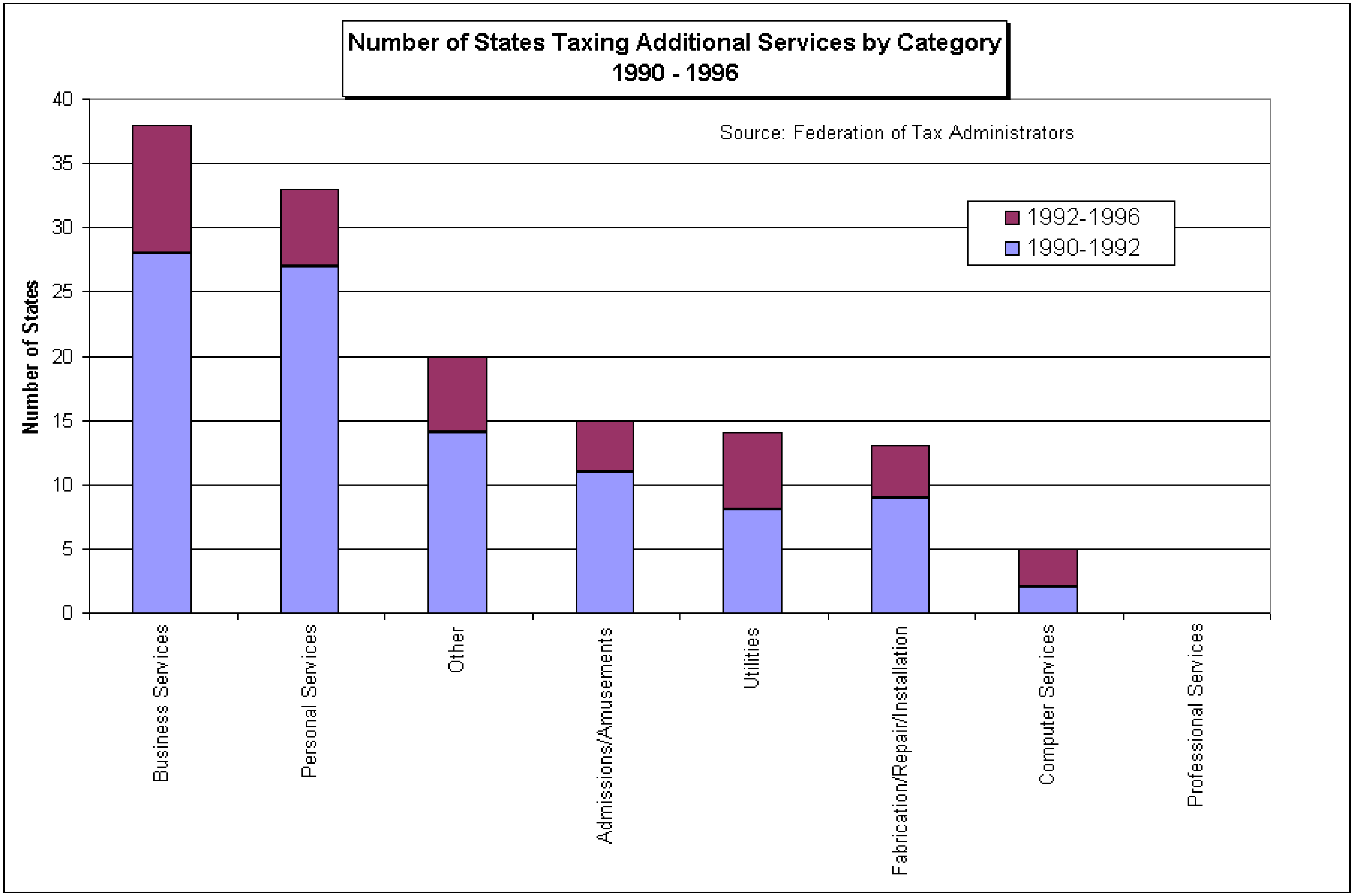
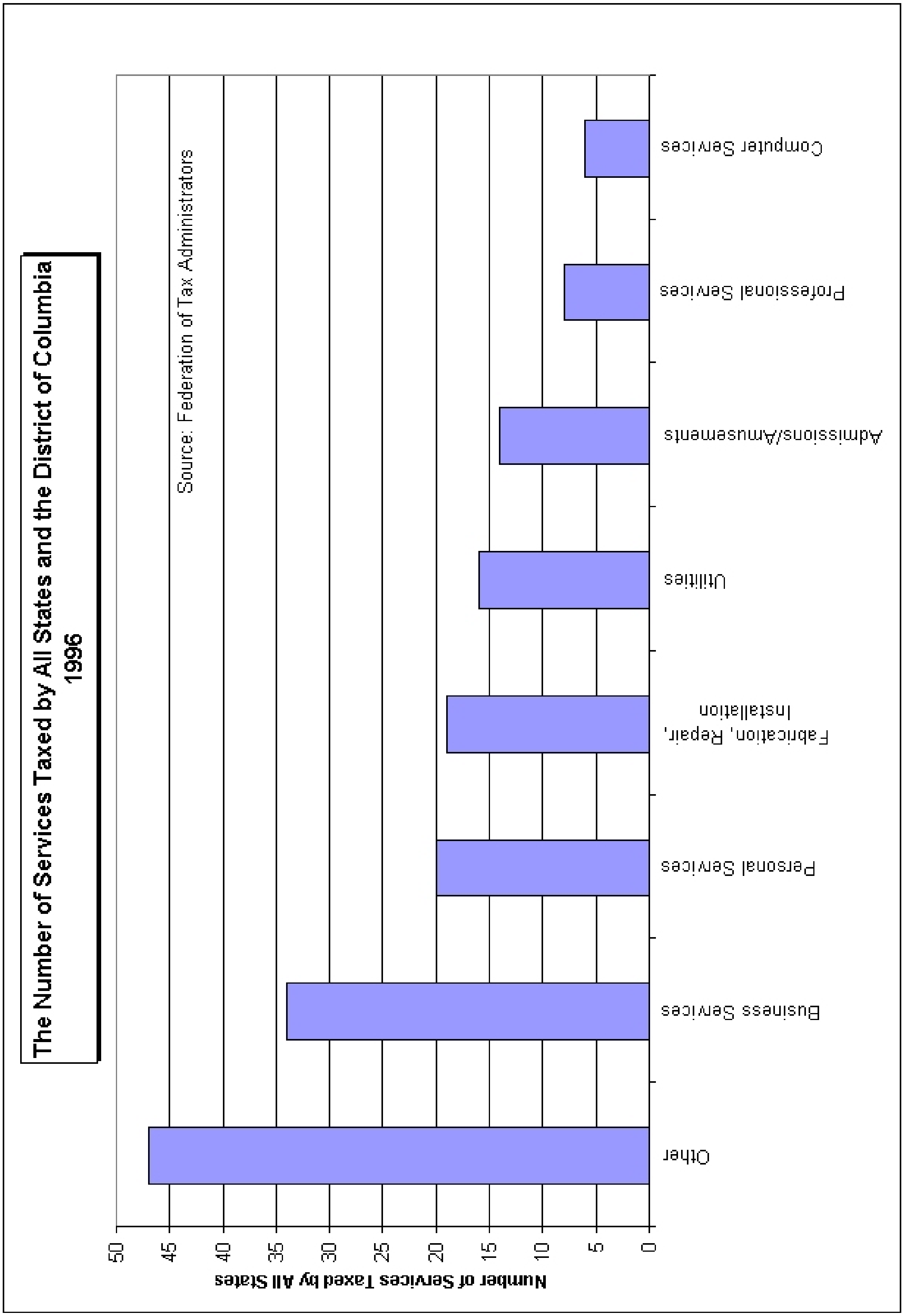

The Number of Service Categories Taxed in Virginia and the Average of All States Including the District of Columbia
1996
Average Per State
Virginia
Number of Service Categories Taxed
0
2
4
6
8
10
12
Business Services (Advertising)
Utilities (Electricity)
Fabrication, Repair & Installation (Radio Repair)
Admissions & Amusements (Bowling)
Personal Services (Barber Shop)
Computer Services (Data Processing)
Professional Services (Accounting)

Figure 7



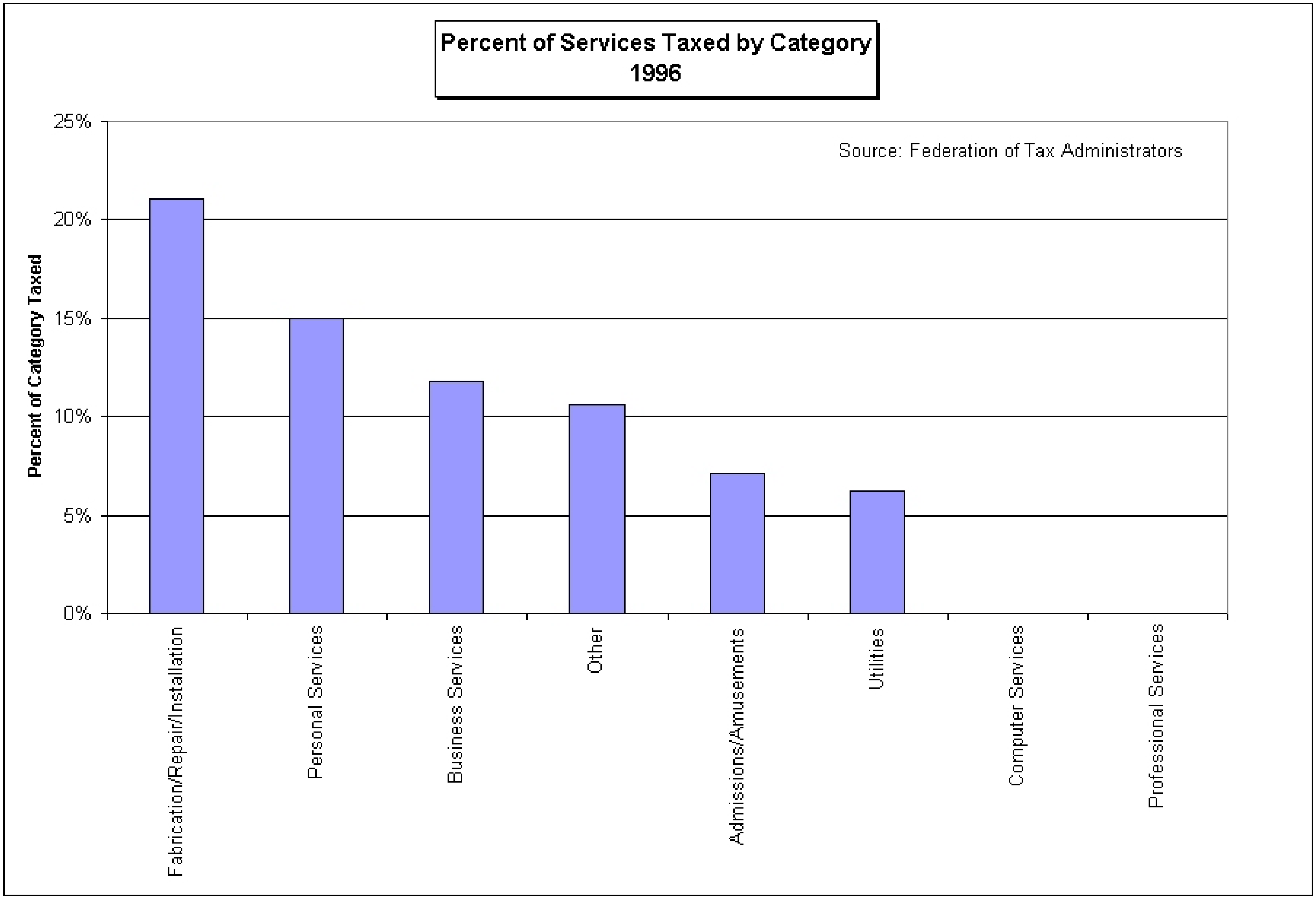
Number of States Taxing Additional Services by Category
1990 - 1996
Source: Federation of Tax Administrators
1992-1996
1990-1992
Number of States
40
35
30
25
20
15
10
5
0
Business Services
Personal Services
Other
Admissions/Amusements
Utilities
Fabrication/Repair/Installation
Computer Services
Professional Services

Figure 8



The Number of Services Taxed by All States and the District of Columbia
1996

Figure 9



Percent of Services Taxed by Category
1996
Source: Federation of Tax Administrators
Percent of Category Taxed
25%
20%
15%
10%
5%
0%
Fabrication/Repair/Installation
Personal Services
Business Services
Other
Admissions/Amusements
Utilities
Computer Services
Professional Services

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______. (June 2002d). *Cost of Virginia's Age Deduction*

APPENDIX 1

REVENUE IMPACT OF REPEALING

CERTAIN SALES TAX EXEMPTIONS

Note on Group 5

Appendix 1 was created by the Virginia Department of Taxation. The items that they have listed in Appendix 1 include two types of exemptions. The first set, Groups 1 to 4 and 6 to 10, includes exemptions to the sales and use tax that have been written into state statutes. The items listed in those groups would be subject to the sales and use tax under Virginia law had not exemptions from the tax been granted by the General Assembly. By contrast, the items listed in Group 5 were never subject to the sales tax and, therefore, were never granted an exemption even though they have been listed as an exemption. The Department of Taxation included services in the list of exemptions so as to alert members of the General Assembly that an important number of services are not being taxed in Virginia.

APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 1 Government and Commodities Exemptions	
Motor Vehicle Fuels	$202.376
Motor Vehicles	$562.082
Gas, Electricity and Water	$246.646
Federal, State and Local Governments	$85.433
Aircraft	$3.329
Motor Fuels for Use in Boats and Ships	$0.042
Sales of Official Flags	minimal
State Board of Elections	minimal
Watercraft	$7.767
Virginia Port Authority	$0.555
Sales of Artwork by Prisoners	minimal
Department of Visually Handicapped	minimal
Virginia Veterans Care Center	$0.001
Community Diversion Programs	unknown
Total	**$1,108.230**

Although a total impact of these sales tax exemptions is reported above, the user should be cautious with this interpretation. An effort has been made to mitigate the effect of overlapping exemptions, but there is still a substantial variance associated with multiple counting of overlapping exemptions. The actual revenue gained by repealing all of these exemptions together is likely to be lower than the estimate reported above, and possibly substantially lower.

APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 3 Commercial and Industrial Exemptions	
Contractor's Temporary Storage	$0.078
Manufacturing	$315.067
Public Service Corporations	$153.467
Ships and Vessels	$8.776
Research and Development	$12.093
Airlines	$39.169
Meals Furnished to Employees	$6.742
Laundry and Linen Processors	$1.712
Pollution Control Equipment	$5.244
Taxicab Parts	$0.533
Electrostatic Duplicators	$0.265
Gas and Oil Production	$0.000
Virginia Commercial Space Flight Authority	$0.359
Expand to Transport Vessels	$0.026
Total	**$543.531**

Although a total impact of these sales tax exemptions is reported above, the user should be cautious with this interpretation. An effort has been made to mitigate the effect of overlapping exemptions, but there is still a substantial variance associated with multiple counting of overlapping exemptions. The actual revenue gained by repealing all of these exemptions together is likely to be lower than the estimate reported above, and possibly substantially lower.

APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 2 Agricultural Exemptions	
Property Used in Agricultural Production	$515.926
Processing of Agricultural Commodities	$0.000
Products Consumed by Farmers	$0.777
Commercial Watermen	$1.110
Feed Making	$0.000
Harvesting of Forest Products	$2.552
Total	**$520.364**

Although a total impact of these sales tax exemptions is reported above, the user should be cautious with this interpretation. An effort has been made to mitigate the effect of overlapping exemptions, but there is still a substantial variance associated with multiple counting of overlapping exemptions. The actual revenue gained by repealing all of these exemptions together is likely to be lower than the estimate reported above, and possibly substantially lower.

APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 4 Educational Exemptions	
School Lunches and Textbooks	$9.632
Institutions of Learning	$31.036
Education for Persons With Mental retardation	$0.050
Face-to-face Educational Programs	$0.268
Reading is Fundamental Programs	unknown
Boarding/Day School for the Handicapped	$0.000
Law Enforcement Educational Programs	minimal
School Fund Raising Activities	$10.916
Specific Day care Centers	$0.032
County Public Libraries and Recreational Centers	minimal
Public Library Associations	$0.007
Free Enterprise Educational Programs	minimal
Art Education Organizations	$0.004
City Public Library "Friends" Organizations	minimal
Organizations Combating Illiteracy	$0.001
Fund Raising Organizations Assisting Public Libraries	minimal
Services for At-Risk Youth	$0.002
Advocacy Organizations for the Hearing Impaired	minimal
Organizations Promoting Highway Safety	$0.032
Organization operating a school for Christian Studies	$0.001
Organization in Tidewater region providing preschool education to children of parents pursuing self-sufficiency	$0.000
Organization to develop pool of data processing professionals, training, and college scholarships	$0.001
An organization that conducts & publishes research for public school improvement	unknown
Telecommunications networks & classrooms in Va. schools	$0.010
Organizations with reading education programs	$0.001
Organizations in the Tenth Planning District with Annual Science Fair and Scientific Investigation	minimal
Organizations that Provide Residential & Educational Services for Abused Children, and Head Start	$0.005
Organizations that Educate About Animal Agriculture	$0.001
Organizations Promoting Vocational-Technical Education in the Public Schools	$0.004

APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 4 Educational Exemptions (Continued)	
Include all Illiteracy Programs	$0.023
Expand to include food purchased for free distribution	$0.483
Consortium of black colleges	$0.002
Total	**$52.510**

Although a total impact of these sales tax exemptions is reported above, the user should be cautious with this interpretation. An effort has been made to mitigate the effect of overlapping exemptions, but there is still a substantial variance associated with multiple counting of overlapping exemptions. The actual revenue gained by repealing all of these exemptions together is likely to be lower than the estimate reported above, and possibly substantially lower.

APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 5 Selected Service Exemptions	
Accountants	$23.600
Engineers	$108.400
Health Professionals	$253.500
Land Surveying	$7.900
Legal	$71.300
Bank Service Charges	$18.300
Nonbank Service Charges	$0.400
Safe Deposit Box Rentals	$0.500
Insurance Premiums	$244.200
Barber/Beauty Shops	$19.800
Carpet and Upholstery Cleaning	$1.400
Funeral Services	$9.100
Laundry and Dry Cleaning	
Coin Operated	$2.600
Non-Coin Operated	$13.200
Horse Boarding	$0.400
Pet Grooming and Training	$0.900
Tax return Preparation (for individuals)	$1.800
Armored Car/Detective Services	$12.400
Collection Services	$2.300
Credit reporting	$2.300
Janitorial and Building Maintenance	$26.200
Landscaping and Lawn Care	$20.300
Parking	$6.900
Pest Control/Disinfecting	$5.200
Security System Services	$4.400
Telephone Answering Services	$1.800
Appliance Repair	$0.000
Automotive Repair	$0.000
Auto Washing	$0.000
Shoe Repair	$0.000
Watch, Clock and Jewelry Repair	$0.000
900 Number Service	$0.800
Cable and Other Pay TV	$25.100

APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 5 Selected Service Exemptions (Continued)	
Cellular Telephone	$7.300
Interstate Calls	$64.900
Intrastate Calls	$71.700
Household Goods Storage	$0.400
Travel Arrangements/Services	$3.100
Cold Storage	$1.600
Amusement Parks	$4.900
Auto Racing Events	$0.500
Movie Theaters	$5.100
Bowling Alleys	$2.600
Labor Charges	minimal
Transportation Charges	$0.647
Alteration Charges	$0.013
Gift Wrapping	minimal
Computer Software Modifications and Custom Programs	$68.889
Transient Accommodations	minimal
Repair & Replacement Parts in Maintenance Contracts	
Total	**$1,116.649**

Although a total impact of these sales tax exemptions is reported above, the user should be cautious with this interpretation. An effort has been made to mitigate the effect of overlapping exemptions, but there is still a substantial variance associated with multiple counting of overlapping exemptions. The actual revenue gained by repealing all of these exemptions together is likely to be lower than the estimate reported above, and possibly substantially lower.

APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 6 Media Related Exemptions	
Motion Picture Film Leasing	$2.201
Broadcast Equipment	$3.108
Publications	$10.618
Catalogs	$3.237
Advertising	minimal
Book publishing facility that distributes books free of charge to educators	$0.107
Delete video dialtone systems, add open video, wireless cable	unknown
Tapes/Production Svcs/AudioVisual	$0.323
Common Carrier Broadcasting Equipment	unknown
Advertising Definition	unknown
Back Copy Sales	minimal
out-of-state business purchases of printed materials	unknown
Total	**$19.595**

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APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 7 Medical Related Exemptions	
Prescription and Controlled Drugs	$77.312
Nonprescription Drugs*	$17.500
Medical Equipment	$5.089
Dialysis Equipment and Supplies	$0.973
Motor Vehicle Equipment for the Disabled	$0.007
Typewriters/Computers for the Disabled	unknown
Hospitals and Nursing Homes	$58.316
Community Health Centers	$0.067
HMOs	$0.091
Free Health Clinics	$0.012
Hospital Cooperatives	$0.117
Ronald McDonald Houses	$0.006
Easter Seal Society	$0.024
Blood Pressure Centers	minimal
Tissue Banks	$0.300
Organization that provides cancer education, screenings	$0.013
Organization to assist primary and secondary victims of Alzheimer's disease	$0.000
Organization to provide breast cancer support and outreach for medically underserved	$0.000
Organization for citizen's research , prevention detection, diagnosis & treatment of kidney disease	$0.004
Organizations Facilitating Health Services to Children in Poverty	$0.003
Organizations Researching Treatment & Prevention of Birth Defects	$0.005
Organizations Promoting Health Care & Health Care Education in Roanoke Valley	$0.001
Organization to Provide Dental Services with the Eighth Planning District	$0.001
Increased health care established at the initiative of the General Assembly & Joint Commission on Health Care	$0.001

APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 7 Medical Related Exemptions (Continued)	
Include Samples of non-prescription drugs & medicines distributed free of charge by the manufacturer	unknown
Faculty Services at Medical Colleges	$0.093
Prescription drug samples	unknown
Medical Airlift	$0.010
Free Medical Clinic	$0.020
Organization for Services to Child Abuse Victims	unknown
Organization for Medical & Psycho-Social treatment in the Fifteenth Planning District	$0.007
Medicaid Recipient Supplies	$0.152
Practitioner/Assistant Prescriptions	$0.000
Volunteer medical services orgs.	$0.011
Leukemia	unknown
Tissue Bank	unknown
Controlled drugs used in corporation physician practice	unknown
Total	**$160.137**

Although a total impact of these sales tax exemptions is reported above, the user should be cautious with this interpretation. An effort has been made to mitigate the effect of overlapping exemptions, but there is still a substantial variance associated with multiple counting of overlapping exemptions. The actual revenue gained by repealing all of these exemptions together is likely to be lower than the estimate reported above, and possibly substantially lower.

APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 8 Nonprofit Civic and Community Service Exemptions	
Churches	$6.790
Volunteer Fire and Rescue Squads	$1.103
REACT Teams	minimal
Nutrition Programs	$0.240
Food Banks	$0.032
Humane Societies	$0.047
Wildlife Federation	minimal
Donated Property	$0.013
Homeless Shelters	$0.106
Christmas Mothers	$0.004
Group Homes for Children	$0.055
Foster Care Associations	$0.068
Head Start Programs	$0.013
Community Action Agencies	$0.658
Homes for Adults	$0.740
Women's Centers	$0.008
Physical Education Programs	$0.006
Youth Programs	minimal
Traveler's Guide Society	minimal
Traveler's Aid	$0.008
Homeless Aid	$0.018
Assistance to the Mentally Retarded	$0.002
Girl and Boy Scout Organizations	$0.429
Heart Organizations	$0.054
Lung Organizations	$0.010
Diabetes Organizations	$0.031
Cancer Organizations	$0.079
Lions Club	$0.114
The Garden Club of Virginia	$0.006
Community Centers	minimal
Kiwanis Clubs	$0.000
Rehabilitation of Adolescent Substance Abusers	$0.011
Conservation of Marine Resources	$0.000
Robotics Education and Technology	$0.000
Therapeutic Horseback Riding	$0.000
Prevention and Treatment of Addictive Diseases	$0.001
Community Service to Children	$0.000
Education of Disabled	minimal
Housing for Low Income Families	$0.001
Training in Christian Character	$0.000

APPENDIX 1
Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 8 Nonprofit Civic and Community Service Exemptions (Continued)	
Charitable Foundation	$0.020
Support for Virginia Rehabilitation Center for the Blind	$0.000
Domestic Violence Task Forces	$0.000
Mental Retardation Organizations	$0.001
Desert Storm Veterans	$0.000
Legal Assistance to Low Income Taxpayers	$0.000
Education on James River Watershed	minimal
Advocacy of Traffic Safety	$0.001
4-H Educational Centers	$0.011
Treatment of Substance Abuse	$0.003
Emergency Assistance to Children	$0.003
Promotion of Downtown Areas	minimal
Missionary Outreach to West Africa	$0.000
Protection of Chesapeake Bay	$0.003
English Speaking Union	$0.000
Care of Low Income Children	$0.001
Improvement of Employment Opportunities for the Blind	$0.009
Promotion of Central Business District	minimal
Baseball Boosters	$0.001
Recreational Opportunities for Youth	$0.003
Chapel Foundation	$0.015
Provision of Low Income Housing	$0.000
Crisis Intervention Hotline	$0.001
Environmental Education	$0.003
Treatment of Substance Abuse	$0.005
Mutual Aid and Service Organizations	$0.000
Military-Related Toy Distribution Organizations	$0.006
Youth Development Programs	$0.003
Half-Way Houses for Non-Violent Offenders	$0.003
Shenandoah River Education and Preservation	$0.001
Eighth District Home Rehabilitation Programs	$0.002
Public Library Support	$0.003
Community Residences	$0.015
Emergency Financial Assistance Organizations	minimal
Community Bible Study	$0.014
State River and National Forest Road Maintenance	$0.001
Residential Youth Substance Abuse Centers	$0.001
Jewish Community and Service Organizations	$0.002
Fund Raisers for Residential Special Needs Centers	minimal
Swamp Wilderness Protection Organizations	minimal

APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 8 Nonprofit Civic and Community Service Exemptions (Continued)	
Support for Families of Autistic Children	minimal
Sixteenth District Mental Retardation Support Organizations	$0.000
Clothing Donation Organizations	$0.000
Amateur Hockey Promotion	$0.000
Providers of Day Care to Low-Income Children	$0.002
Support for Individuals with Physical, Mental or Social Needs	minimal
Providers of Cash Rewards for Crime Tips	minimal
Free Camps for Disadvantaged Children	$0.002
United Jewish Appeal Support Organizations	$0.001
Environmental Promotion and Education Organizations	$0.001
Housing and Support Services for the Low-Income Disabled	$0.001
Organizations Granting Wishes to Ill Children	$0.009
Financial and Social Support Services for the Poor	$0.001
Support Services for Low-Income Families	$0.000
Personal Development Programs for School Age Girls	$0.002
Support Services for the Disabled	$0.001
Providers of Alcohol Education and Al-Anon Support	$0.009
Fundraising for nonprofit member agencies	$0.033
Tenth District Child Care Scholarship Organizations	minimal
Twenty-third District Drug, Alcohol, and Crime Programs	$0.006
Providers of Food in Exchange for Community Service	$0.074
Volunteer Community Improvement Groups	$0.000
Family Service Organizations	$0.020
Athletic Programs for the Mentally Retarded	$0.045
Fifteenth District Youth Athletic Organizations	$0.000
Twenty-third District Technology Access for the Disabled	$0.000
Advocates for Abused and Neglect Children in Court	$0.001
Nineteenth District Assistance Programs for Needy	$0.001
Organizations that Fund Nonprofit Member Organizations	included above
HUD Approved and Financed Meal Programs	$0.017
Mentoring Programs for At-Risk Youth	$0.007
Assistance to Elementary and Secondary Schools	$0.005
Wheelchair Athletic Programs	minimal
Independent Living Services for the Disabled	$0.007
Non-Denominational Religious Outreach Programs	$0.002
Fifth District Youth Softball Leagues	$0.001
Eighteenth District Housing Assistance Programs	$0.002
Eighteenth District Home Repair Assistance Programs	included above
Programs Preparing Students for Agricultural Careers	$0.265

APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 8 Nonprofit Civic and Community Service Exemptions (Continued)	
Fundraising Receptions for Charities	$0.001
Multiple Sclerosis Research and Patient Assistance	$0.012
Organizations Providing Free Meals in Lynchburg	minimal
Third District Independent Living Programs	$0.001
Eleventh District Summer Camps for Mentally Handicapped	$0.005
Environmental Restoration Programs	unknown
Eleventh District Family Counseling Services	$0.001
Eighth District Housing for Low-income, Elderly & Disabled	$0.005
Twenty-third District Employment and Training Programs	$0.009
Twenty-third District Child Care for Lower Income Families	$0.014
Eighth District Community Service Organizations	$0.000
Twenty-first District Counseling and Education Programs	$0.007
Eighth District Housing and Services for the Mentally Ill	$0.004
Organizations Providing Food, Clothing & Shelter	$0.017
Fifteenth District Family Services	$0.046
Expand fire dept., rescue squad, auxiliary	$0.001
All IRC Section 501(c)(4)	$0.000
Total	**$11.414**

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APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 9 Nonprofit Cultural Organization Exemptions	
Historical Society	$0.002
Fine Arts/Science-Technology Museum	$0.045
Public Park and Museum	$0.012
American Indian Heritage Foundation	minimal
Chief Justice Memorial	minimal
Black History Museum	minimal
Live Music Performance Group	minimal
Children's Museum	minimal
Ecological Associations	$0.063
Botanical Garden	$0.022
Roanoke Valley Art Organizations	$0.005
Community Concert Associations	minimal
Fredericksburg Area Museum	$0.002
Arts and Activities Centers	$0.000
City History Museum	$0.000
International Arts Festival	$0.006
Hampton Roads Area Museum	$0.001
Museum Association	$0.003
Virginia Holocaust Museum	minimal
Youth Symphony Orchestras	$0.000
Fine and Performing Arts Promotion Organizations	$0.020
Performing Arts Organizations	$0.008
Historic Building Reconstruction and Preservation	$0.002
Renovation and Operation of Civil War Site and Museum	$0.003
Israeli/U.S. Physician Exchange Program	$0.003

APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 9 Nonprofit Cultural Organization Exemptions (Continued)	
Jewish Community Organizations	$0.017
Commemoration of Virginia's Statute for Religious Freedom	$0.001
Contemporary American and English Theater Production	$0.000
Genealogical and Historical Research Organizations	$0.004
Fourth District Summer Musical Production	$0.001
Organization to Operate and Preserve Mount Vernon	$0.029
Total	**$0.248**

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APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 10 Miscellaneous Exemptions	
Heating Fuels	$17.198
Occasional Sales	unknown
Leasebacks	$3.748
Interstate Commerce/Export Factor	unknown
Boy Scout Jamboree	$0.000
Food Stamps/WIC Vouchers	$25.411
Organization operating a nonprofit swim team	minimal
Organization promoting long-distance running	$0.000
Organization for boys' baseball	$0.000
Organization promoting sportsmanship through soccer	$0.000
Organization to promote region of Civil War activities	minimal
Organization receiving fund from specified government sources, fostering economic development	$0.003
Expand exemption for little-league type baseball/softball and remove exemption for tangible personal property sold by such organizations	$0.140
Promote private sector development of Romania and carry out Support for East European Democracy Act 1989	$0.003
Organization for Social Welfare and Defend Human Rights of Persons Born and Unborn	$0.016
Livestock auction sales proceeds distributed to contestants	$0.002
Little league type baseball & softball in the Second Planning District	unknown
Professional's Provision of original, revised, edited, Reformatted or Copied documents to clients or third parties	unknown
Veterans Associations Providing Scholarships, Life Insurance, and Loans to Coast Guard members who have lost their jobs	$0.000

APPENDIX 1

Revenue Impact of Repealing Certain Sales Tax Exemptions

	Revenue Impact FY 1999 (Millions)
Group 10 Miscellaneous Exemptions (Continued)	
Electronic Securities Information	$0.020
Construction Property	$0.109
Medical Records Copies	unknown
Property for Disaster Victims	unknown
Total	**$46.652**
Total for all Categories	**$3,579.331**

* Nonprescription Drug exemption went into effect July 1, 1998.

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APPENDIX 2

SALES TAXATION OF SERVICES

SALES TAXATION OF SERVICES:

1996 UPDATE

Published by
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Report No. 147 April 1997

Table 1
Number of Services Taxed by Category and State

State	Utilities	Personal Services	Business Services	Computer Services	Admis./ Amus.	Prof. Services	Fabrication, Repair & Installation	Other Services	Total
Alabama	9	2	6	1	10	0	1	3	32
Alaska	0	0	0	0	0	0	0	1	1
Arizona	12	2	5	1	11	0	2	24	57
Arkansas	14	6	11	1	11	0	11	11	65
California	5	2	3	0	0	0	0	3	13
Colorado	4	0	2	1	2	0	3	2	14
Connecticut	10	11	20	6	13	0	14	13	87
Delaware*	9	20	33	6	10	8	19	37	142
District of Columbia**	10	7	11	6	6	0	13	10	63
Florida	7	4	8	2	13	0	16	14	64
Georgia	10	3	3	2	8	0	2	6	34
Hawaii	16	20	34	6	13	8	18	42	157
Idaho	0	3	4	0	11	0	6	5	29
Illinois	12	1	1	1	0	0	1	1	17
Indiana	8	4	2	2	2	0	0	4	22
Iowa	13	15	18	0	13	0	14	21	94
Kansas	10	10	9	2	13	0	16	16	76
Kentucky	10	2	4	0	6	0	3	1	26
Louisiana	12	9	5	3	8	0	13	8	58
Maine	9	1	6	3	2	0	4	2	27
Maryland	5	3	13	1	11	0	4	2	39
Massachusetts	9	1	4	0	1	0	2	3	20
Michigan	12	4	7	1	1	0	2	2	29
Minnesota	15	6	11	2	13	0	4	10	61
Mississippi	8	4	8	3	10	0	14	23	70
Missouri	8	1	2	1	11	0	0	5	28
Montana	12	0	0	0	3	0	0	4	19
Nebraska	14	6	6	3	11	0	5	4	49
Nevada	0	1	4	0	1	0	2	3	11
New Hampshire	8	1	0	0	0	0	0	2	11
New Jersey	6	2	10	0	6	0	14	12	50
New Mexico	16	20	32	6	13	8	18	39	152
New York	9	5	15	4	7	0	16	18	74
North Carolina	10	4	4	1	7	0	1	1	28
North Dakota	6	1	4	0	11	0	1	2	25
Ohio	8	7	14	3	2	0	12	6	52
Oklahoma	8	1	4	2	11	0	0	6	32
Oregon	0	0	0	0	0	0	0	0	0
Pennsylvania	8	6	17	6	1	0	15	8	61
Rhode Island	10	1	6	3	3	0	3	2	28
South Carolina	4	5	6	4	9	0	1	3	32
South Dakota	12	19	28	6	12	4	18	42	141
Tennessee	11	11	6	3	12	0	14	14	71
Texas	12	11	14	6	10	1	11	13	78
Utah	7	8	6	0	9	0	15	9	54
Vermont	3	2	4	1	10	0	2	1	23
Virginia	1	3	4	0	1	0	4	5	18
Washington*	16	20	34	6	10	8	15	43	152
West Virginia	10	17	26	4	13	1	13	26	110
Wisconsin	11	11	6	1	13	0	14	13	69
Wyoming	11	7	6	2	7	0	16	14	63
Number in Category	16	20	34	6	14	8	19	47	164

*Includes the business license tax in Delaware and the business occupation tax in Washington.
**1992 data.
Source: Federation of Tax Administrators, Sales Taxation of Services Survey, 1996.

SERVICE TAXED	NUMBER OF STATES TAXING
Admissions and Amusements:	
Pari-mutuel racing events	28
Amusement park admission and rides	36
Billiard parlors	28
Bowling alleys	28
Cable TV services	24
Circuses and fairs — admission and games	34
Coin-operated video games	19
Admission to school and college sports events	25
Membership fees in private clubs	22
Admission to cultural events	31
Pinball and other mechanical amusements	21
Admission to professional sports events	35
Rental of films and tapes by theaters	8
Rental of video tapes for home viewing	45
Fabrication, Installation and Repair Services:	
Custom fabrication labor	39
Repair material, generally	46
Repair labor, generally	23
Labor charges on repair of aircraft	20
Labor charges - repairs to interstate vessels	13
Labor charges - repairs to intrastate vessels	20
Labor - repairs to commercial fishing vessels	14
Labor charges on repairs to railroad rolling stock	13
Labor charges on repairs to motor vehicles	22
Labor on radio/TV repairs; other electronic equip.	23
Labor charges - repairs other tangible property	23
Labor - repairs or remodeling of real property	13
Service contracts sold at the time of sale of TPP	29
Installation charges by persons selling property	21
Installation charges - other than seller of goods	16
Custom processing (on customer's property)	27
Custom meat slaughtering, cutting and wrapping	12
Taxidermy	29
Welding labor (fabrication and repair)	31
Personal Services:	
Barber shops and beauty parlors	6
Carpet and upholstery cleaning	15
Dating services	10
Debt counseling	7
Diaper service	23
Income from funeral services	15
Fishing and hunting guide services	10
Garment services (altering and repairing)	19
Gift and package wrapping service	18
Health clubs, tanning parlors, reducing salons	20
Laundry and dry cleaning services, coin-operated	8

Laundry and dry cleaning services, non-coin-operated	21
Massage services	10
900 Number services	24
Personal instruction (dance, golf, tennis, etc.)	7
Shoe repair	21
Swimming pool cleaning and maintenance	17
Tax return preparation	6
Tuxedo rental	39
Water softening and conditioning	14
Business Services:	
Billboards	4
Radio and television, national advertising	3
Radio and television, local advertising	4
Newspapers	4
Magazines	4
Advertising agency fees (not ad placement)	11
Armored car services	14
Bail bond fees	4
Check and debt collection	9
Commercial art and graphic design	20
Commercial linen supply	32
Credit information, credit bureaus	14
Employment agencies	10
Interior design and decorating	9
Maintenance and janitorial services	18
Lobbying and consulting	7
Marketing	6
Packing and crating	8
Exterminating (includes termite services)	17
Photocopying services	42
Photo finishing	44
Printing	45
Private investigation (detective) services	13
Process server fees	6
Public relations, management consulting	7
Secretarial and court reporting services	9
Security services	14
Sign construction and installation	23
Telemarketing services on contract	6
Telephone answering service	18
Temporary help agencies	11
Test laboratories (excluding medical)	8
Tire recapping and repairing	25
Window cleaning	17
Computer Services:	
Software - packaged or canned program	45
Software - modifications to canned program	34
Software - custom programs - material	27
Software - custom programs - professional serv.	16

Information services	14
Data processing services	11
Professional Services:	
Accounting and bookkeeping	5
Attorneys	5
Dentists	4
Engineers	5
Land surveying	7
Medical test laboratories	4
Nursing services out-of-hospital	4
Physicians	4
Utility Service	
Intrastate telephone and telegraph - Industrial Use	44
Intrastate telephone and telegraph - Residential Use	42
Interstate telephone and telegraph - Industrial Use	21
Interstate telephone and telegraph - Residential Use	20
Cellular telephone services - Industrial Use	40
Cellular telephone services - Residential Use	40
Electricity - Industrial Use	37
Electricity - Residential Use	24
Water - Industrial Use	19
Water - Residential Use	13
Natural gas - Industrial Use	39
Natural gas - Residential Use	24
Other fuel (including heating oil) - Industrial Use	39
Other fuel (including heating oil) - Residential Use	24
Sewer and refuse, industrial - Industrial Use	13
Sewer and refuse, residential - Residential Use	11
Other Services:	
Soil prep., custom baling, other agricultural services	4
Veterinary services (both large and small animals)	5
Horse boarding and training (not race horses)	7
Pet grooming	16
Landscaping services (including lawn care)	19
Metal, non-metal and coal mining services	6
Seismograph and geophysical services	7
Oil field services	11
Typesetting service; platemaking for the print trade	19
Gross income of construction contractors	11
Carpentry, painting, plumbing and similar trades	13
Construction service (grading, excavating, etc.)	11
Water well drilling	10
Income from intrastate transportation of persons	11
Local transit (intra-city) buses	5
Income from taxi operations	8

Intrastate courier service	6
Interstate air courier (billed in-state)	1
Automotive storage	19
Food storage	10
Fur storage	15
Household goods storage	12
Mini-storage	9
Cold storage	13
Marina Service (docking, storage, cleaning, repair)	21
Marine towing service (incl. tugboats)	7
Travel agent services	3
Packing and crating	9
Service charges of banking institutions	3
Insurance services	6
Investment counseling	6
Loan broker fees	4
Property sales agents (real estate or personal)	5
Real estate management fees (rental agents)	6
Real estate title abstract services	6
Ticker tape reporting (financial reporting)	9
Automotive washing and waxing	21
Automotive road service and towing services	15
Auto service, except repairs, incl. painting & lube	23
Parking lots and garages	20
Automotive rustproofing and undercoating	26
Personal property, short term (generally)	45
Personal property, long term (generally)	45
Short-term automobile rental	45
Aircraft rental	43
Hotels, motels, lodging houses	50
Trailer parks - overnight	28

Fiscal Estimates for a 4% Retail Sales and Use Tax on Most Goods and Services

In February 2002 the Department of Taxation presented a report titled Analysis of Sales and Use Tax Exemptions in Virginia to the House Finance Special Study Committee Studying Sales and Use Tax Exemptions. The report indicated that exemptions from Virginia's retail sales and use tax result in approximately $3.57 billion in potential tax revenue not being collected each year (assuming a 4.5 percent sales and use tax).[1] Several of these "exemptions" from the retail sales and use tax identified by the Department are items subject to other sales or sales-like taxes. For instance, fuels, motor vehicles, aircraft, and watercraft are identified as being exempt from the retail sales and use tax, but motor vehicles are subject to a 3 percent motor vehicle sales and use tax, gasoline is subject to a 17.5 cents per gallon fuels tax and diesel fuel is subject to a 16 cents per gallon fuels tax, aircraft are subject to a 2 percent aircraft sales and use tax, and watercraft are subject to a 2 percent watercraft sales and use tax.

Fuels, motor vehicles, aircraft, watercraft, and purchases by governmental entities are included in the Department's report within a category titled Group 1 Government and Commodities Exemptions. Total Group 1 exemptions were estimated to cost approximately $1.1 billion each year.

The following is an estimate of the annual revenue that would be generated from a 4 percent retail sales and use tax (a half-percent lower than the current rate) on all goods and services with no tax exemptions, with the only exception for items included in the Group 1 Government and Commodities Exemptions:

	Annual Revenue Estimate (4% tax)
Revenue from items currently exempt, except Group 1	$2.2
Revenue from items taxed under current law	3.0
	$5.2 billion[2]

The additional annual revenue estimated to be generated from a 4 percent retail sales and use tax on most goods and services is as follows:

Revenue from a 4 percent sales tax on most goods and services	$5.2
Estimated state and local revenue from the current 4.5 percent tax	- 3.4
Estimated additional annual revenue	$1.8 billion

[1] Although the report was presented in 2002, the Department has stated that many of the estimates included in the report are dated, and new estimates are needed to get a more accurate estimate of the revenue that would be generated from a sales and use tax on goods and services currently exempt from the tax.

[2] Estimate prepared by the Division of Legislative Services.

APPENDIX 3

BPOL

<ins>REVIEW OF BPOL ISSUES</ins>

- The Hanger/McDonnell Commission formed a working group to address issues relating to the BPOL tax.

  - The business community believes the BPOL tax should be repealed. Some objections raised at the working group meetings were: (i) because the tax is imposed on the gross receipts of businesses, the tax does not take into account the taxpayer's ability to pay; (ii) the tax does not favor economic growth; (iii) the tax is not equitable and broad-based due to the numerous exemptions from the tax; and (iv) the tax is difficult to administer.

    As a whole, the business community believes that local governments need to be made whole in terms of lost revenue from any repeal of the BPOL tax.

  - Representatives of Virginia's local governments stated that the BPOL tax generated more than $459 million in local revenue in fiscal year 2001 (BPOL tax revenues for the fiscal year ending June 30, 2002, were $434.4 million).

    These representatives indicated that the BPOL tax accounted for more than 4 percent of all locally generated revenue and that some localities relied on the tax for as much as 25.6 percent of their locally generated revenues (Farmville). All 39 cities, 53 of the 95 counties in the Commonwealth, and 36 towns impose the BPOL tax.

  - Local governments believe that the BPOL revisions passed by the 1996 General Assembly have improved administration of the BPOL tax. Under the 1996 legislation, taxpayers were given a right to appeal BPOL taxes to the Department of Taxation.

- Specific proposals for repealing and replacing the BPOL tax were made during the working group meetings.

  - Several replacement options for the BPOL tax were proposed by various members of the business community. They included replacing the tax with (i) one flat fee charged to all businesses, (ii) a graduated fee determined by gross receipts level, (iii) a sales tax, (iv) a combination of an increase in the corporate income tax with a fee charged to all businesses, and (v) a net income tax on business income (this would include corporations, partnerships, proprietorships, limited liability companies and all other business entities).

Specifically, two proposals provided for a repeal of the tax over 5 years and 10 years, respectively. The proposals provided for a rollback of the BPOL tax rates by an equal amount each year (ultimately down to $0.00) and replacement of loss revenues to local governments through increases in the sales and/or corporate income taxes.

– In lieu of repealing the BPOL tax, the business community proposed an adjustment to the current tax on retailers, which is imposed at a rate of $0.20 per $100 of gross receipts. The business community proposed reducing the rate on retailers to $0.10 per $100 of gross receipts to take into account the smaller profit margins realized by retailers (in comparison to the profit margins realized by contractors and services providers).

- For various reasons, no agreements on BPOL were reached by the business community and local government representatives.

APPENDIX 4

INCOME TAX

RESTRUCTURING THE INDIVIDUAL INCOME TAX (as requested)

Department of Taxation
June 9, 2003

RESTRUCTURING THE INDIVIDUAL INCOME TAX

Under this proposal, all additions, subtractions, and deductions would be eliminated from the computation of Virginia taxable income with the exception of the deduction for social security income. However, Virginia must also allow individuals to subtract income earned on any obligation of the federal government. This is the one subtraction that is not simply a Virginia policy decision. The Supreme Court of the United States has ruled that states are not allowed to tax income earned on an obligation of the United States government. Therefore, under this proposal, an individual's taxable income would be equal to their FAGI minus any social security income and income earned on any obligation of the federal government included in FAGI. This proposal would be effective for taxable year beginning on and after January 1, 2004.

This revision to how Virginia taxable income is computed for individuals would be done in conjunction with a revision to the tax tables and tax rates for the individual income tax. The following shows the revised tables and rates along with the associated impact:

Individual Income Rate Tables

Virginia Taxable Income Level	SINGLE Taxpayer Tax Rate	MARRIED Taxpayer Tax Rate
$0 - $14,999	0%	0%
$15,000 - $24,999	3.5%	0%
$25,000 - $29,999	4%	0%
$30,000 - $49,999	5.5%	5.5%
$49,001 & above	6.25%	6.25%

Revenue Impact

FY 2004	FY 2005	FY 2006
<$241.6 Million>	<$469.1 Million>	<$459.4 Million>

Department of Taxation
June 9, 2003

MEANS TESTING THE AGE DEDUCTION
(as requested)

Department of Taxation
June 9, 2003

MEANS TESTING THE AGE DEDUCTION

- The following estimate shows a potential impact of means testing the age deduction.
- The deduction would be based on the level of federal adjusted gross income for each taxpayer. For joint and separate filers, federal adjusted gross income would be used on a combined basis.
- The following table shows the amount of the deduction as it corresponds with the relative federal adjusted gross income level:

FAGI	Age 62 – 64	Age 65 and Above
$0 - $34,999	$6,000	$12,000
$35,000 - $49,999	$3,000	$6,000
$50,000 and above	$0	$0

- Assuming an effective date of taxable years beginning on and after January 1, 2004, the following table shows the estimated revenue impact of this proposal:

FY 2004	FY 2005	FY 2006
+ $93.7 Million	$190.8 Million	$197.8 Million

MEANS TESTING THE AGE DEDUCTION

Requested by the staff of the Commission on the Revision of Virginia's State Tax Code and the Streamlined Sales Tax Project Agreement SJR 347 (2003)

Department of Taxation
August 4, 2003

MEANS TESTING THE AGE DEDUCTION

Scenario #1

- The following estimate shows a potential impact of means testing the age deduction.

- The deduction would be based on the level of federal adjusted gross income for each taxpayer. For married taxpayers filing either joint or separate returns, the base for the deduction would be their combined federal adjusted gross income (FAGI). Each spouse who qualifies, by age, for a deduction would receive the deduction amount based on the combined FAGI.

- The following table shows the amount of the deduction as it corresponds with the relative federal adjusted gross income level:

FAGI	Age 62 – 64	Age 65 and Above
$0 - $34,999	$6,000	$12,000
$35,000 - $74,999	$4,000	$8,000
$75,000 - $134,999	$2,000	$4,000
$135,000 and above	$0	$0

- Assuming an effective date of taxable years beginning on and after January 1, 2004, the following table shows the estimated revenue impact of this proposal:

FY 2004	FY 2005	FY 2006
$56.1 Million	$114.3 Million	$118.5 Million

MEANS TESTING THE AGE DEDUCTION

Scenario #2

- The following estimate shows a potential impact of means testing the age deduction.

- The deduction would be based on the level of federal adjusted gross income for each taxpayer. For married taxpayers filing either joint or separate returns, the base for the deduction would be their combined federal adjusted gross income (FAGI). Each spouse who qualifies, by age, for a deduction would receive the deduction amount based on the combined FAGI.

- The following table shows the amount of the deduction as it corresponds with the relative federal adjusted gross income level:

FAGI	Age 62 – 64	Age 65 and Above
$0 - $34,999	$6,000	$12,000
$35,000 - $49,999	$4,500	$9,000
$50,000 - $74,999	$3,000	$6,000
$75,000 - $99,999	$1,500	$3,000
$100,000 and above	$0	$0

- Assuming an effective date of taxable years beginning on and after January 1, 2004, the following table shows the estimated revenue impact of this proposal:

FY 2004	FY 2005	FY 2006
$65.9 Million	$134.3 Million	$139.2 Million

Task Force #1
HJR 60 (2002)

State Income Tax Issue

6. Make social security income subject to Virginia income tax.

Currently when calculating their Virginia taxable income, taxpayers are allowed to subtract, to the extent included in federal adjusted gross income, all social security benefits.

The Morris Commission proposed eliminating this subtraction which would then subject taxpayers' social security income to the Virginia income tax.

Attached is an explanation, prepared by the Department of Taxation of the fiscal impact of making social security income subject to Virginia income tax for fiscal years 2003 through 2006.

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ELIMINATING VIRGINIA'S SOCIAL SECURITY SUBTRACTION

Virginia Department of Taxation
May 24, 2002

ELIMINATING THE SUBTRACTION FOR SOCIAL SECURITY BENEFITS

- Federal Adjusted Gross Income (FAGI) includes certain social security benefits.
- For Virginia income tax purposes, taxpayers are allowed to subtract these social security benefits from FAGI.
- Effective for the 2004 taxable year, if this subtraction were eliminated, the following revenue impact would occur:

Fiscal Year			
2004	**2005**	**2006**	**2007**
$50.9 Million	$104.7 Million	$109.4 Million	$116.3 Million

Virginia Department of Taxation
May 24, 2002

Task Force #1
HJR 60 (2002)

State Income Tax Issue

2. Eliminate the age deduction

Currently, taxpayers in Virginia who are 62 years of age or older are allowed a deduction in calculating their Virginia taxable income. Each taxpayer aged 62 through 64, receives a $6,000 deduction annually and those 65 years of age and older receive a $12,000 deduction.

The Morris Commission suggested eliminating this tax preference. One way to achieve this would be to grandfather those taxpayers who currently receive the deduction so they would continue to receive it and to eliminate the deduction beginning in a certain year in the future. For example, any taxpayer who does not turn 62 by January 1, 2005, would not be entitled to the deduction.

Attached is an explanation, prepared by the Department of Taxation of the fiscal impact of the age deduction for fiscal years 2003 through 2006.

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COST OF VIRGINIA'S AGE DEDUCTION

Virginia Department of Taxation
June 4, 2002

COST OF VIRGINIA'S AGE DEDUCTION

- Virginia currently allows an age deduction for taxpayers age 62 or older. The deduction amounts are $6,000 for taxpayers age 62 through 64 and $12,000 for taxpayers age 65 and over. These amounts have remained unchanged since the 1996 taxable year.
- The age deduction was originally enacted by the 1990 General Assembly. The base amounts were $6,000 for taxpayers age 62 through 64 and $12,000 for taxpayers age 65 and over, reduced by the individual's total Social Security or Railroad Tier 1 retirement benefits.
- Beginning in taxable year 1992, the age deduction amounts were indexed annually based on the most recent percentage increase in the Social Security wage base.
- The 1994 Special Session of the General Assembly eliminated the indexation of the age deduction after taxable year 1993 and repealed the requirement for taxpayers to reduce the deduction amounts by Social Security or Railroad Tier 1 retirement benefits beginning in taxable year 1995.
- The projected cost of the age deduction is as follows:

Fiscal Year			
2003	**2004**	**2005**	**2006**
($288.3 million)	($304.2 million)	($320.9 million)	($338.5 million)

Virginia Department of Taxation
June 4, 2002

APPENDIX 5

SELECTED SERVICES SALES TAX

Estimated Revenue from Expanding the Sales and Use Tax Base to Include Selected Services*

by John L. Knapp, Ph.D.

This paper provides an estimate of the additional revenue if the sales and use tax were expanded to include selected services. This is a very rough estimate based on data from the most recent economic census.

The latest survey of state sales taxation of services was conducted by the Federation of Tax Administrators in 1996.[1] The organization s survey covered 164 categories of services aggregated into eight major categories. The results of the survey are summarized below. A more detailed tally is provided in Table 1.

Category	# in Category	Average # Per State	Ratio of Avg. # Per State to # in Category	# in Virginia	Ratio of # in VA to # in Category
Utilities	16	8.8	55%	1	6%
Personal services	20	6.1	31%	3	15%
Business services	34	9.5	28%	4	12%
Computer services	6	2.2	37%	0	0%
Admissions/amusements	14	7.5	54%	1	7%
Professional services	8	0.7	9%	0	0%
Fabrication, repair, & Installation	19	7.7	41%	4	21%
Other services	47	11.0	23%	5	11%
Total	164	53.5	33%	18	11%

The average number of services covered per state was 53.5 (33 percent of the categories). In Virginia only 18 (11 percent of the categories) were taxed. Nationally, the most taxed major categories were utilities and admissions/amusements

Among the major categories of services, personal services, admissions/amusements, and fabrication, repair, and installation services offer the most opportunity for sales taxation in Virginia. Utilities or their customers are subject to significant local utility taxes. Business services is not a good category to tax because many business services are inputs of other firms. This would involved pyramiding of taxes and would discourage firms from outsourcing. A similar argument applies to computer services. Professional services are not fertile ground for sales taxation. John Due and John Mikesell, nationally recognized experts on sales taxation have written:

> The major revenue potential [from taxing services] lies in health, various professional, and business-related services, and there are major obstacles

* Information prepared by John L. Knapp, UVA Cooper Center, at the request of Chairman Thomas R. Morris for the Commission to Study Virginia s State and Local Tax Structure for the Twenty-first Century. November 15, 2001.

[1] Federation of Tax Administrators, *Sales Taxation of Services: 1996 Update.* Research Report No. 147 (April 1997).

to taxation of them, including, in most states, political considerations. Health services expenditures, broadly defined, are probably progressive relative to income, and taxation of them might check their rapid inrease (net of tax). But concern for universal health care, political obstacles to taxing such services, and fear of popular adverse reaction render taxation of them unlikely.[2]

The estimates of expanding the sales tax in Virginia to cover personal services, amusements, and repair services are based on data from the 1997 Economic Census. Since goods sold by these industries are already subject to the sales tax it was necessary to estimate the portion of sales not taxed. For example, televison repair establishments already tax parts with the labor portion of the bill not taxed. To estimate the portion not taxed I used national Internal Revenue Service data on cost of goods sold in relation to business receipts. I assumed that the goods portion of receipts was already taxed. This procedure overstates the untaxed portion of sales since it does not allow for the business mark-up added to the sales price of parts. On the other hand, the Economic Census understates total sales because businesses whose predominant activity falls under another industry category are not included. A prime example is the repair business of auto dealers. Since the sale of vehicles is their predominant business, repair activity is not reported separately in the Economic Census. The estimate does allow for reduced sales of services because of higher prices caused by the added tax nor does it allow for how the added revenue would be used by the Commonwealth.

I estimate that adding personal services, amusements, and repair services would have increased calendar year 1999 state sales and tax revenue by $146 million or 6.5 percent above actual collections of $2.2 billion.

[2] John F. Due and John L. Mikesell, *Sales Taxation, State and Local structure and Administration, Second Edition* (Washington, D.C.: The Urban Institute Press, 1994.

Table 1
Number of Services Taxed, 1996

State	Utilities	Personal Services	Business Services	Computer Services	Admissions/ Amusements	Professional Services	Fabrication, Repair & Installation	Other Services	Total
Number in category	16	20	34	6	14	8	19	47	164
Alabama	9	2	6	1	10	0	1	3	32
Alaska	0	0	0	0	0	0	0	1	1
Arizona	12	2	5	1	11	0	2	24	57
Arkansas	14	6	11	1	11	0	11	11	65
California	5	2	3	0	0	0	0	3	13
Colorado	4	0	2	1	2	0	3	2	14
Connecticut	10	11	20	6	13	0	14	13	87
Delaware	9	20	33	6	10	8	19	37	142
District of Columbia	10	7	11	6	6	0	13	10	63
Florida	7	4	8	2	13	0	16	14	64
Georgia	10	3	3	2	8	0	2	6	34
Hawaii	16	20	34	6	13	8	18	42	157
Idaho	0	3	4	0	11	0	6	5	29
Illinois	12	1	1	1	0	0	1	1	17
Indiana	8	4	2	2	2	0	0	4	22
Iowa	13	15	18	0	13	0	14	21	94
Kansas	10	10	9	2	13	0	16	16	76
Kentucky	10	2	4	0	6	0	3	1	26
Louisiana	12	9	5	3	8	0	13	8	58
Maine	9	1	6	3	2	0	4	2	27
Maryland	5	3	13	1	11	0	4	2	39
Massachusetts	9	1	4	0	1	0	2	3	20
Michigan	12	4	7	1	1	0	2	2	29
Minnesota	15	6	11	2	13	0	4	10	61
Mississippi	8	4	8	3	10	0	14	23	70
Missouri	8	1	2	1	11	0	0	5	28
Montana	12	0	0	0	3	0	0	4	19
Nebraska	14	6	6	3	11	0	5	4	49
Nevada	0	1	4	0	1	0	2	3	11
New Hampshire	8	1	0	0	0	0	0	2	11
New Jersey	6	2	10	0	6	0	14	12	50
New Mexico	16	20	32	6	13	8	18	39	152
New York	9	5	15	4	7	0	16	18	74
North Carolina	10	4	4	1	7	0	1	1	28
North Dakota	6	1	4	0	11	0	1	2	25
Ohio	8	7	14	3	2	0	12	6	52
Oklahoma	8	1	4	2	11	0	0	6	32
Oregon	0	0	0	0	0	0	0	0	0
Pennsylvania	8	6	17	6	1	0	15	8	61
Rhode Island	10	1	6	3	3	0	3	2	28
South Carolina	4	5	6	4	9	0	1	3	32
South Dakota	12	19	28	6	12	4	18	42	141
Tennessee	11	11	6	3	12	0	14	14	71
Texas	12	11	14	6	10	1	11	13	78
Utah	7	8	6	0	9	0	15	9	54
Vermont	3	2	4	1	10	0	2	1	23
Virginia	**1**	**3**	**4**	**0**	**1**	**0**	**4**	**5**	**18**
Washington	16	20	34	6	10	8	15	43	152
West Virginia	10	17	26	4	13	1	13	26	110
Wisconsin	11	11	6	1	13	0	14	13	69
Wyoming	11	7	6	2	7	0	16	14	63
Average	8.8	6.1	9.5	2.2	7.5	0.7	7.7	11.0	53.5
Median	9.0	4.0	6.0	2.0	9.0	0.0	4.0	6.0	49.0

Source: Federation of Tax Administrators, *Sales Taxation of Services, 1996 Update*. Research Report No. 147. (Washington, D.C., April 1997)

Table 2
Estimated Revenue from Adding Selected Services to the State Sales andUse Tax Base, 1999

Item		Business Receipts	(Receipts minus Cost of Goods Sold)/ Receipts*		Business Receipts Not Already Taxed		Tax @ 3.5%
1997							
Personal & laundry services	$	1,551,592,000	0.766	$	1,188,519,472	$	41,598,182
Amusement & rec. services	$	1,397,864,000	0.660	$	922,590,240	$	32,290,658
Repair & maintenance	$	2,845,600,000	0.569	$	1,619,146,400	$	56,670,124
Total	$	2,845,600,000		$	1,619,146,400	$	130,558,964
Current tax						$	1,996,673,036
Selected services % of current tax							6.5%
1999							
Current tax						$	2,242,400,139
Selected services % of current tax							6.5%
Estimated revenue from taxing selected services						$	145,756,009

Source of business receipts data: U.S. Bureau of the Census, 1997 Economic Census: http://www.census.gov/epcd/www/econ97.html

Source of current taxable sales: Virginia Department of Taxation, *Taxable Sales in Virginia Counties & Cities Based on Retail Sales Tax Revenues, Annual Report, 1999* (Richmond, n.d.)

*See Table 3.

Table 3
IRS National Data Used to Estimate Portion of Business Receipts Not Already Subject to Sales Tax

Item	Business Receipts ($000)	Cost of Goods Sold* ($000)	(BR-C)/BR
Nonfarm Individual Proprietorships, 1997			
Personal & laundry services	31,286,346	3,360,618	0.893
Amusement & rec. services	16,011,240	1,424,059	0.911
Repair & maintenance	33,696,184	10,708,321	0.682
Partnerships, 1997			
Personal services	3,586,509	942,198	0.737
Amusement & recreation services	26,677,247	8,675,230	0.675
Auto repair & other services; misc. repair services	7,156,877	2,626,157	0.633
Corporations, 1996			
Personal services.	44,449,184	14,230,528	0.680
Amusement & recreation services	123,675,070	46,452,780	0.624
Auto repair; miscellaneous repair services.	104,495,083	49,329,743	0.528
Aggregate			
Personal services.	79,322,039	18,533,344	0.766
Amusement & recreation services	166,363,557	56,552,069	0.660
Auto repair; miscellaneous repair services.	145,348,144	62,664,221	0.569

Source: IRS Statistics of Income: http://www.irs.ustreas.gov/prod/tax_stats/index.html
*Purchases for nonfarm proprietors

Overview