THE FAIR 55 TAX REFORM PLAN©

FOR WEST VIRGINIA

By

Michael E. Caryl, Esq.

THE FAIR 55 TAX REFORM PLAN ©

TABLE OF CONTENTS

THE FAIR 55 TAX REFORM PLAN©

By Michael E. Caryl, Esq.[1]

INTRODUCTION

By the early 1960s, West Virginia's overall economy had so declined that some commentators described much of the state as an "island of poverty in a sea of US prosperity." There were, doubtless, many causes for these lamentable circumstances, but, certainly, among them were the, at least obsolete and often ill-advised, public policies pursued and imposed by the highly-centralized State government. Chief among such self-defeating policies was the State's tax structure. Prior studies of that structure have unanimously concluded that it is and has been: unfair, designed to punish capital investment, too complex, too reliant on many narrow-based special taxes, burdened by a mushrooming array of special preferences designed to pick winners and losers, unfair to the working poor, too centralized, inflexible and opaque in its operation and uncompetitive in today's global economy.[2]

Thus, comprehensive reform of West Virginia's state and local tax structure must be a major aspect of a multi-faceted effort to revive the State's moribund economy. To that end, it is proposed that major components of that structure, including the taxes on currently earned income and tangible personal property, be replaced by two simple, broad-based consumption taxes which embody <u>all</u> the elements of an ideal tax system. Specifically, the two replacement taxes will not only be broad-based, but they will have low rates and will be: fair, simple in compliance and

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[1] B.S. West Virginia University, 1968; J.D. Yale Law School, 1974; Partner, Bowles Rice LLP 1989-present; WV State Tax Commissioner 1985-1988; adjunct lecturer, West Virginia University College of Law, 1991-1992; Co-Vice-Chairman, Governor's Commission on Fair Taxation (GCFT), 1997-1999; Senior Fellow, Tuscarora Institute for Enterprise Studies & Advancement, LLC (TIESA). The author gratefully acknowledges that many of the foundations of the Fair 55 Tax Reform Plan © were inspired by and directly based on the work of the GCFT. Where appropriate here, those points of inspiration from GCFT will be cited and the rationales for building on them explained.

[2] E.g. "Recommendations to the Governor" by GCFT, December, 1999.

administration, stable as to revenue yield, transparent and predictable in their application to taxpayers, neutral as to economic resource allocation and fully adequate to generate revenues sufficient to fund necessary government programs.

This proposal is being offered in full awareness of, and regard for, the State's current severe budget shortfall challenges. Thus, as was explained to the Legislature's Joint Select Committee on Tax Reform, at its meeting on September 20, 2016, by Jared Walczak, policy analyst of the highly respected Tax Foundation, "[s]ales tax reform is not only possible during a budget shortfall - it can help solve the problem."[3]

Indeed, as a comprehensive restructuring of the State's entire tax structure, The Fair 55 Tax Reform Plan© represents one of the key components of a broader plan, to put its fiscal house in order, which involves more than just the revenue side of the budget equation. Specifically, as explained in Sections B. and J. of The Case for the Plan, etc. *infra*, by establishing a far more accountable, stable and efficient revenue system at all levels, the context is provided through which the State can also meaningfully and responsibly address the concomitant expenditure policy issues.

Further, the Fair 55 Tax Reform Plan© also calls for a broad devolution of taxing authority, spending responsibility and public decision-making, from the State to local elected officials and voters. This second aspect of the proposal is designed to avoid any fiscal dislocation which might, otherwise, accompany such a shift, and, instead, it actively promotes voluntary, local inter-governmental cooperation in, and even consolidation of, programs providing both public services and infrastructure. Thus, certain major taxing and spending

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[3] Ironically, a week after Mr. Walczak's presentation, and on the same day that The Tax Foundation upgraded West Virginia's business tax climate to 18th best in the nation, a second municipal bond rating agency, Fitch's, downgraded the State's bond rating from AA+ to AA, citing, among other things, its narrow-based tax system, specifically, its over- reliance on natural resource production taxes. The Charleston Gazette-Mail, 9/28/2016.

decisions will be returned to the levels of government more responsive to the people, instead of leaving it in the hands of the special interests which naturally prefer the one-stop legislative and administrative lobbying that now just takes place at the State Capitol.[4]

Thus, the proposal also calls for an amendment to West Virginia's Constitution which will not only seek the voters' consent to implement the broad tax structure reforms, but will provide a degree of fiscal discipline previously unknown to any state in this nation.

SUMMARY DESCRIPTION

The Fair 55 Tax Reform Plan© calls for thinking "outside the box," not by taking uninformed leaps of faith into untested waters, but by re-embracing long-standing principles of public revenue excellence. Thus, to the skeptical question, typically confronting any public policy reform proposal, to-wit: "what do the other states do?", the answer here will be, certainly as to our immediately neighboring states, "nothing this good."

Nevertheless, throughout the detailed "Case For the Fair 55 Tax Reform Plan©", starting at page 9 *infra*, examples of successes enjoyed elsewhere, by employing particular aspects of this comprehensive proposal, are cited. Indeed, one of the greatest virtues of this nation's constitutionally-based system of federalism is its encouragement of the states to be "laboratories of democracy."[5] Implicit in that phrase is the intellectually disciplined use of knowledge, experience and scientific methods to achieve valuable innovation. That is precisely why a proposal of this nature promises to enable West Virginia to reverse generations of economic decline and to, in a careful, thoughtful, orderly and fiscally responsible way, enable it to take its place among the most economically competitive and sustainable jurisdictions here and abroad.

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[4] Indeed, the inspiration for the reference to "55" in the name of the Fair 55 Tax Reform Plan© is to evoke the need for greater fairness, not only to the governments of our state's fifty-five counties (and the municipalities within them), but to the particular voters they each specifically serve.

[5] Louis Brandeis, J. in <u>New State Ice Co. v. Liebmann,</u> 285 U.S. 262 (1932).

THE FAIR 55 TAX REFORM PLAN©

The current major taxes the Fair 55 Tax Reform Plan© would eliminate are: the tax on tangible personal property (TPP), the consumers sales and service taxes, the personal income tax (PIT) on the earnings of individuals, all of the corporation net income tax (CNIT) and half of the severance tax.[6] In place of those taxes, two simple, broad-based consumption taxes, being the general consumption tax (GCT) on individual purchases, and the enterprise consumption tax (ECT) on business purchases, would be adopted. In addition, a flat income tax on deferred and passive income (DPIT) would be temporarily imposed at 3%, being the rate now applied in the lowest bracket of the current PIT, but only on taxpayers with adjusted gross income in excess of $25,000, who receive non-Social Security tax-deferred income and/or dividends and interest.

Thus, with a willingness to think (and act) "outside the box," West Virginia can be freed from the "box" of poverty in which too many of its people have been trapped for decades. To learn more, one may simply review the following one-page fiscal score card summary illustration of The Fair 55 Tax Reform Plan© and the two-and-one-half-page, line-by-line explanation of the revenue estimating sources and methodology on which the Scorecard data is based.[7] Beyond that, starting on page 9, *infra.*, is the more detailed Case for the Fair 55 Tax Reform Plan© which explains the reasoning and analysis underlying each aspect of the Plan.

[6] Under the Plan, a few special consumption taxes, to-wit: the business and occupation tax, insurance premiums tax, and certain "sin" taxes on purchases of alcohol and tobacco products, would be retained. See, Section H., page 36, *infra*.

[7] The Fiscal Scorecard illustration [updated here to reflect the budget for the just concluded Fiscal Year 2018 General Fund Budget] does not address any changes in certain excise taxes which are dedicated to special funds separate from the general fund (e.g. the motor fuels taxes). Nor does it attempt to account for special current provisions diverting portions of the current general fund taxes to separate accounts, outside of the general fund budget. Thus, the actual implementation of this proposal, to replace those current general fund taxes would, necessarily, entail adjustments for funding any such special accounts to the extent that good policy so indicates. The proposal also prospectively repeals all existing tax credits, while grandfathering the economic benefit of previously earned credits and of any other objectively demonstrable, good faith and irrevocable reliance on previously granted favorable tax treatment arrangements, e.g. the exemption of municipally-owned or county-owned electric power plants (leased back to for-profit operators) from business and occupation tax. W.Va. Code § 11-13-2o(c)(2).

THE FAIR 55 TAX REFORM PLAN©

FAIR 55 TAX REFORM PLAN FOR WEST VIRGINIA © [TIESA 2017]
FISCAL SCORE CARD ILLUSTRATION

Proposal: (1) Repeal property tax on all vehicles and newly-acquired tangible personal property EXCEPT chattels real (TPP) and centrally assessed public utility (PU) property, and phase-out tax on existing TPP [=$453 million in 2017]; (2) Phase-out income taxes [=$2 billion in FY 2018], keeping only severance (1/2 rate), B&O, property transfer, insurance, beer, liquor profits and tobacco excise taxes, plus two replacement consumption taxes and a temporary, lower rate tax on passive and deferred income of individuals with AGI over $25,000; (3) Convert sales/use taxes to a General Consumption Tax (GCT) with fewer exemptions; (4) As fiscal milestones are met, phase-in new Enterprise Consumption Tax (ECT); (4) Require Legislature to fund, via per/student block grants to local BOEs, 100% K-12 education regular levy/current expenses to its "thorough and efficient" standard; (5) Except for existing excess/bond levies and future BOE excess/bond levies, give counties/municipalities (local govt.) full tax power over the remaining property tax base consisting of real estate (including chattels real) (RE) and public utility (PU) property; (6) If, despite local govt. units' revenue-raising capacity via all regular RE/PU tax, and enhanced home rule, when, needed to make a particular unit whole for loss of its TPP base, the Legislature would have to enhance that capacity as authorized by local referenda; (7) Fully mitigate any regressive or anti-competitive effects of expanding the consumption tax bases and (8) Show revenue neutrality, while expanding the tax base through economic growth.

	Amounts in $1,000s
1. FY 2018 GENERAL FUND BUDGET (net of retained non-tax revenues) ……….	4,080,850
2. Replacement of schools' regular levy property tax base ……………………………	551,286
3. Fair Tax Credit Card (for tax on clothing purchases by low-income taxpayers)……	15,000
4. Rainy Day Fund Cushion ………………………………………………………... +	10,723
5. Total General Fund Tax Revenue Neutral Target …………………………………...	4,657,859

Fair 55 Tax Reform Plan Revenue Elements:

6. General Consumption Tax (GCT) @5.5% on sales of all goods and services EXCEPT: wages, sales of licensed medical services, retail sales of prescription appliances/medicines, sales to/by any govt. unit, sales to/by non-profits not competing with private enterprise, SNAP/WIC purchases, purchases of goods for direct use in agriculture, natural resource production, manufacturing or for resale, isolated sales, sales between related entities and day care/babysitting charges (w/o change to local govt. sales/use taxes and special district excise taxes)…. 1,966,483

7. Enterprise Consumption Tax (ECT) (gradually phased up to) 5.5% on privilege of engaging in free market due to state/local govt. infrastructure, protections, etc., imposed on consumption by for-profit and not-for profit entities (w/annual earned receipts > $100K), by way of: wages, interest, dividends, rents and royalties paid and profits retained, less cost of new capital assets, plus depreciation of the same, minus credit for payments/donations directly reducing state/local govt. burdens, incl. healthcare provider tax (single sales factor apportionment) … 1,954,378

8. Temporary Passive Income Tax (TPIT) @4%-6.5%(until phase-out) on non-social security, non-pension, deferred income & passive investment income of those w/>$25K AGI … 88,298

9. Severance Tax (ST) @ 2.5 % (not including retained 0.35% local ST share) and Other Retained (B&O, RE Transfer, Ins. Prem., Beer, Liquor Tobacco) (same bases/rates).. + 648,700

Total of replacement/retained tax revenues ………………………………………… 4.657,859

THE FAIR 55 TAX REFORM PLAN©

Key to Data Sources for Fair 55 Tax Reform Plan for West Virginia© [TIESA 2017]

Line 1. Source: FY 2018 WV General Fund Budget, (as of 7/1/2017) by WV Budget Office. Non-tax revenue items to be retained, but not included in stated values here, would consist of Departmental Collections, Miscellaneous Receipts, Miscellaneous Transfers, Interest Income, Special Revenue Transfer, HB 102 Lottery Transfers, Liquor License Renewals and Senior Citizen Tax Credit Reimbursements, for a total of $181 million. NOTE: The State's current share of *ad valorem* property tax revenues of $7 million and property transfer tax revenues of $10.2 million are not included in the entered amount for state general revenue target purposes, because the proposal contemplates the reallocation of the former to counties and municipalities and of the latter to counties. See Line 3, below, and Fair 55 Tax Reform Plan © text, pages 14-18, below and Section C. of the Case for the Fair 55 Tax Reform Plan© *infra.* for explanations of how, when combined with the reallocation to them of the entire real and public utility property tax base, such allocations assure no possible revenue loss to counties and municipalities as a result of repeal of tangible personal property tax.

Line 2. Source: 2017 Classified Assessed Valuations/Taxes Levied, by WV State Tax Dept.

Line 3. Source: State Tax Commissioner's Fifty-Second Biennial Report (October, 2017, p. 55), listing 2015 Total Resident Personal Income Tax Returns, broken down by Federal Adjusted Gross Income (FAGI) brackets, and showing the number of exemptions taken on returns in each bracket. The amount of credit entered is the total annual amount of General Consumption Tax (GST) the individuals, represented by the number of exemptions in the FAGI brackets falling between $0 and half of the $20,000 to $40,000 bracket (minor dependents included), would otherwise pay if each of them bought an average of $500 of clothing per year. 50% of the $20,000 to $40,000 bracket is used to reflect the phase-out of the contemplated clothing tax credit between those FAGI levels. See Section D. of the Case for the Fair 55 Tax Reform Plan©, *Infra*, pages 24-25, for a full explanation of the rationale for, and efficacy of, this aspect of the proposal.

Line 4. This is purely a function of the computational interplay of the assumed rates and tax base changes. No policy implication should be drawn from the either the existence, much less the amount, of such surplus beyond the prudence of having a cushion when relying on projections of revenue to fund government expenditures.

Line 5. Tax revenue neutrality was sought and readily demonstrated (i.e. FY 2018 General Fund Tax Revenue Estimate of $4.081 billion + $0.453 billion in Repealed Tangible Personal Property Taxes = $4.534 billion vs. Fair 55 Tax Reform Plan Fiscal Scorecard Total of $4.658 billion) simply to answer the question, inherently raised in tax reform discussions, to-wit: "how are you going to pay for that?" As the text of this proposal explains in greater detail, the ultimate goal is to achieve revenue responsibility through a revenue-generating system that is fair, simple, neutral, competitive, transparent, flexible to evolving needs and circumstances, and, most importantly responsive only to broad democratic process a/k/a popular consent.

Line 6. Source: FY 2018 WV General Fund Budget, (as of 7/1/2017) by WV Budget Office and 2016 Consumers Sales and Use Tax Expenditure Study by WV State Tax Dept. The entered amount is sum of the budgeted FY 2018 Consumers Sales and Use Tax revenues, and the estimated annual value of the various exemptions selected to be eliminated. That sum was then divided by the current 6% rate, and multiplied by the proposed/test rate of 5.5%, to yield the entered amount. Where possible, the inherent overlapping, of certain exemptions to be eliminated, was considered and duplications eliminated. However, because disaggregation of services (taxable) from goods (exempt) purchased for direct use in production activities, and of contracting services for government (exempt) from all other contracting services (taxable), was not possible, a computational assumption was indulged that those items offset each other. Thus, it was assumed that the lost tax revenue, associated with retaining the exemption of contracting services for government, offset the addition of the tax revenue due to the taxation of services for direct use in various private production activities. The details of the GCT are substantively explained on pages 18-27 of Section D. of the The Case for The Fair 55 Tax Reform Plan ©, *infra.*

Line 7. Source: 2015 Statistics of Income, by th IRS, showing the breakdown of sources of FAGI for WV taxpayers; and FY 2018 WV General Fund Budget, WV Budget Office for the Corporation Net Income Tax (CNIT) budgeted revenue. The entered amount is a combination of: (a) employee compensation, (b) Form Schedule C and (c) Schedule E pass-through entity income, all multiplied by the assumed/test rate of 5.5 %, plus budgeted CNIT revenues divided by 6.5% and multiplied by 5.5 %, plus 5.5% on an assumed annual average expenditure per reporting entity of $170,000 for interest, dividends, rents and royalties. The amount for that final group of consumption tax base components had to be assumed due to the absence of direct public data on such expenditures. The amount assumed for those four components is likely to be conservative in light of the fact that, if West Virginia's 35,000 business establishments as of 2012 (See, 2012 Economic Census of the United States, US Census Bureau) just, on average, spent the amount that business firms in the United States (all industry categories and entity forms) averaged spending on rent and interest ALONE, they would have spent more than half the amount assumed here for ALL four of those major items. See, Statistical Abstract of the United States, US Census Bureau. That leaves less than half of the estimated average taxable expenditure amount for not only dividends paid, but, far more importantly, for the disproportionately high amount of royalties paid by West Virginia's dominant natural resource extraction industries. The amount deducted to account for the credit for healthcare provider tax paid was taken from the State Tax Commissioner's 52nd Biennial Report. The exemption for smaller organizations, having less than $100,000 in annual commercial receipts, would not count public or private grants, gifts or donations against that minimum threshold, thus effectively exempting all religious and other donor-supported charitable organizations. NOTE: There are at least two major reasons why the ECT amount entered is likely to be understated: (a) The ECT would be imposed on federal taxable income before the reducing adjustments are taken to determine WV taxable income for CNIT purposes; and (b) certain other elements of the ECT base (i.e. annual depreciation charged, less capital purchases) have not been directly included in the stated amount due to the lack of easy access to such specific data, and, instead, have been either assumed to cancel each out (depreciation and capital purchases) or conservatively extrapolated from broader data (rent, royalties, interest and dividends paid as explained above).

Line 8. Source: 2015 Statistics of Income, by IRS, showing the breakdown of income sources, by FAGI brackets, for WV taxpayers. The entered amount is the result of applying graduated rates of 4%, 5%, 5.5%, 6% and 6.5%, to the combined amounts of the identified deferred and passive income sources (non-social security, non-pension individual retirement benefits, and investment income such as interest and dividends), for taxpayers with FAGI of more than $25,000, $50,000, $75,000, $100,000 and $200,000, respectively.

Line 9. Source: FY 2018 WV General Fund Budget, (as of 7/1/2017) by WV Budget Office. The entered amount for severance tax is the result of dividing the budgeted annual general fund revenues for that tax by 5% and then multiplying the result by 2.5 %. To the extent the general fund budgeted severance tax revenue includes revenues derived from natural resource production which is taxed at less than 5% (e.g. regular state/non-local coal @ 4.65%, the thin seam coal production taxed variously at 2% and 1%), then both the tax base and the entered amount are understated.

THE CASE FOR THE FAIR 55 TAX REFORM PLAN ©

A. PRIMARY RELIANCE ON CONSUMPTION TAXES AND DECENTRALIZED FISCAL POLICY YIELDS THE BEST RESULTS.

The nation's most respected state public finance policy experts unanimously concur that an ideal state tax structure is one that is: characterized by a broad base and low rates, simple to comply with and to administer, stable as to revenue yield, transparent and predictable in its application to taxpayer and administrator alike, neutral as to economic resource allocation, adequate to generate sufficient revenues to fund necessary government operations and fair to all.[8] That latter principle, in turn, embodies fairness among taxpayers (i.e. neutrality, ability to pay), fairness to the taxpayer community as a whole (i.e. simplicity, transparency, predictability) and fairness to the government acting as the people's instrument to provide necessary public goods (e.g. infrastructure, education, community health, physical safety of persons and property) and to have the capacity to achieve a just and orderly society (e.g. the rule of law, social safety net, etc.). This proposal has been designed to fully honor and advance each of those guiding principles.

At the heart of this proposal is the thesis that, overall, because they promote each of the foregoing tenets of an ideal tax structure, consumption taxes, which are broad-based and free of many exemptions, offer what is, easily, the best approach to generation of public revenues. That is, they are simple to administer and with which to comply, highly stable in revenue yield (particularly compared to taxes on profits and income) and neutral in terms of resource allocation. Moreover, due to its automatic inclusion in the total charged price, a consumption tax is not only easier and much cheaper to administer but, as a further practical matter, is likely

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8 See, e.g. "Principles of Sound Tax Policy," The Tax Foundation, Inc.

to encounter far less taxpayer resistance than a tax where a form has to be filled out and accompanied by a check written and mailed to the government (e.g. the income tax).[9]

As challenges, to the desirability of using a broad-based consumption tax, to achieve those policy ends, there are typically three major objections raised. First, it is argued that broad consumption taxes should not be adopted because they have a highly regressive impact when applied to purchases of life necessities (e.g. food, clothing, medicine, healthcare services, utility and transportation services) by low income persons. Of course, in that undeniable social policy drawback of a consumption tax is also found tacit recognition of two of its intrinsic functional advantages: to-wit, as a transactional excise tax collected by the vendor, it is both immediately transparent and inherently self-assessing in its operation. Thus, the customer's decision to purchase is also his or her decision to be taxed.

However, if we can assume full amelioration of the regressive aspects of a consumption tax, as is the case with the Fair 55 Tax Reform Plan© (see, Section D *infra)*, a principled argument can be made that, as a result of such immediate self-assessment, such a tax is a far more efficient and choice-honoring way to measure and implement the ability-to-pay policy objective than is the convoluted, loop-hole riddled income tax, even with its nominally progressive rate structure. That is, as long as a consumption tax does not apply to purchases of life's necessities by low-income individuals, who better to determine the taxpayer's "ability to pay" than the taxpayer in making his or her own decision to purchase goods and services?

Indeed, in his September 20, 2016 presentation to the Legislature's Joint Select Committee on Tax Reform, Tax Foundation policy analyst, Jared Walczak, indicated that a

[9] Though an entirely reasonable respect for the efficiencies of modern technology, no doubt, largely explains the growing insistence of public revenue agencies that taxpayers submit returns and make remittances electronically, at the least, such a relatively less "painful" procedure also serves to somewhat diminish the acuity of taxpayers' reflection on the high cost in time and money of their own tax compliance.

consumption tax with a "[b]road base permits lower rates and shifts [the economic burden] toward higher-income individuals even without exemptions for select goods." That is so because, since higher-income individuals have more disposable income to spend, by taxing the purchase of a broader array of goods and services, such individuals will contribute more to the public treasury. [10]

Of course, if, as anticipated, implementation of the Fair 55 Tax Reform Plan© has a broad economic stimulus effect, that will be the primary reason the Plan ultimately provides West Virginia with a larger, more stable tax base. Specifically, as the economic modeling required to precede final adoption of this plan is expected to show, the overall stimulus of its key elements should readily satisfy the goal of promoting economic growth in <u>all</u> business sectors, regardless of any shifts of relative burdens among them to achieve the neutrality which the current system woefully lacks. [11]

In addition to contentions about being inherently regressive, the second, of the typical major policy challenges to a consumption tax, is the practical economic claim of disadvantage to in-state vendors when their competitors across a state border are not required to charge a tax on the same item of consumption if it has been made taxable when sold here. The manner, by which the Fair 55 Tax Reform Plan © not only addresses, but fully mitigates, the effects of both these two purported reasons, not to adopt a broad-based consumption tax, is fully described in Section D., *infra.* Those measures entail both targeted relief, and a simple border-neutralizing use tax enforcement provision.

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[10] Mr. Walczak's presentation also, somewhat predictably, repeated the mantra that an ideal consumption tax system exempts "business inputs" to avoid tax "pyramiding." However, as discussed below, that point, being always made in the context of overall tax structures also imposing high taxes on income and capital assets, loses much of its practical significance when (as in the Fair 55 Tax Reform Plan©) those other taxes are eliminated, and when the "conduit" nature of all taxes on businesses is fully appreciated. See, Section E. pp. 28-35, *infra.*

[11] See, Section J. pp. 41-47, *infra*., and as found by the GCFT.

Moreover, beyond such remedial provisions, among its other progressive aspects is that adoption of a broad-based consumption tax directly enables the state to eliminate BOTH the highly regressive tax on tangible personal property (TPP) for motor vehicles and the personal income tax on most individuals, all as illustrated on the foregoing Fair 55 Tax Reform Plan's© Fiscal Scorecard and as discussed elsewhere in this paper. At the same time, retention of the current consumption tax exemptions for rent paid for housing, for purchases of professional healthcare services, for retail purchases of prescription medicine, and for consumer purchases of groceries with food stamps and WIC vouchers, all further promote fairness among taxpayers based on ability to pay. Beyond that, the Fair 55 Tax Reform Plan© now contains a unique low-income clothing purchase tax relief plan (the "Fair Tax Credit Card"), which would make it far less regressive in terms of clothing purchases than the current consumers sales tax.

Third, there is the contention, particularly from business interest groups, that the taxation of the consumption of goods and services used by business (often labeled "inputs" by commentators) is, inherently, bad policy. Beyond the fact, that the Fair 55 Tax Reform Plan© does include the retention of many of the current exemptions for purchases of goods for resale, etc., is the larger point that the criticism of the taxation of business inputs is always raised in the context of tax structures which ALSO impose heavy tax burdens on income and property. As discussed in detail in Sections C., D. and E. *infra*, because the Fair 55 Tax Reform Plan© either eliminates those other taxes (e.g. on TPP) or greatly reduces the scope of such taxes, it, thereby, largely negates the policy assumptions of such criticism.

B. THE PLAN'S TAX REVENUE NEUTRALITY ILLUSTRATES ITS CAPACITY TO ACHIEVE ULTIMATE FISCAL RESPONSIBILITY.

Precisely because the concept of "tax reform" often means little else than either lower tax rates and revenues to some, or higher tax revenues to support even more government spending to others, prudence suggests that any serious and objective effort at comprehensive structural tax reform must present its fundamental concepts in a revenue-neutral setting. Thus, this proposal seeks to avoid the distorting influence of the bigger government vs. smaller government philosophical debate. Indeed, it is only once a fair and efficient tax structure is in place that the deck is cleared for a principled discussion about both the proper general level, and the legitimate objects, of government spending. Thus, the final disposition of those issues can then best be implemented through such a reformed tax structure.

For these reasons, this proposal will be illustrated by a revenue neutral model which is designed to disarm at the onset the other skeptical threshold question typically confronting tax reformers, to-wit: "how are you going to pay for that?" See, the Fiscal Scorecard Illustration (the "Fiscal Scorecard") at page 5, *supra.* By use of specific rates to be applied to a restructured base, the revenue-neutral illustration of the capacity, of the restructured general fund tax base, merely demonstrates that it is consistent with what is, at least, the current political determination of the proper level of spending. That is necessary because, to answer the above-quoted question, by calling for a reduction (or increase) in the current level of government spending is to introduce that fundamentally separate and super-heated issue as a disabling distraction to the objective re-design of the substantive tax structure. Thus, by using a revenue-neutral illustration, the analytical focus can rest solely on the substantive terms of the restructured base needed to validate the legitimacy of its policy rationales.

That, the foregoing Fiscal Scorecard of the Fair 55 Tax Reform Plan© even includes a "rainy day fund" cushion, answers the foregoing question about the adequacy of its revenue-generating capacity. Therefore, until the necessary modeling and other testing described in Section J. *infra* is completed, the rates illustrated in the plan are simply adopted to enable the process, of designing the restructured substantive tax base, to proceed, through the first critical step in the overall reform process, unencumbered by the ultimately related but initially separate question about the proper level of government spending.

C. THE PLAN PROVIDES A MORE COMPETITIVE PROPERTY TAX AND RE-ALLOCATED PUBLIC SCHOOL FUNDING AND MANAGEMENT REFORM.

The Fair 55 Tax Reform Plan's© proposed repeal of the property tax on motor vehicles, and the multi-year phase-out of the tax on all other types of tangible personal property (TPP), will greatly improve West Virginia's economic competitiveness by removing its unusually heavy tax burden on job-creating capital investment. At the same time, because local governments (counties particularly) heavily depend on property tax revenues for funding their operations, it is essential that those entities (counties and municipalities) be given the entire regular levying authority over real estate (RE) and public utility (PU) property to make up for the loss of the TPP tax revenues.

Then, to replace taxes on RE and PU property as a source of public schools' regular levy funding of their current expense budgets, the Legislature would be required to appropriate sufficient revenues to, effectively, fund 100% of those budgets to the "thorough and efficient" standard in the Constitution.[12] While this represents a significant sum of money, in relative fiscal budgeting process terms, it simply represents a one-third increase (from 75%) of the present state aid structure supporting public education.

What should also change, however, is that all such state appropriations for public education should take the form of block grants to local schools, thus assuring equal per student funding of programs designed and implemented by local educators, while promoting improved outcomes due to the benefits of local control, choice, competitiion and flexibility. Those

[12] See, Line Item 2 in Fiscal Scorecard , *supra* at p. 5.

involved in that endeavor would ideally include individual school level players such as principals, teachers and students' parents. Indeed, vouchers to students' families would promote school choice and the improved results which such competition has proven to foster. As long as statewide funding is equalized, achievement, though measured by high statewide standards, can be best attained when local educators and students' families have the discretion as to how to use that funding. That conclusion flows from the fact that, based on long experience, detailed mandates, about educational methods from a bloated, top-heavy central bureaucracy in Charleston, do not fit all (or, maybe, any) local educational settings. For the same reasons, Section J, *infra* of the Fair 55 Tax Reform Plan©, also calls for significant reforms to provide greater flexibility and decision-making at the local government and local voter level.

To avoid any potential dislocation of local government funding capacity, resulting from elimination of the tax on TPP, the Legislature should be constitutionally required to underwrite the revenue capacity of any county or municipality in the highly unlikely, but theoretically conceivable, circumstances that the expansion of their levying authority, with respect to both RE and PU property, is not fully sufficient to make them whole. This theoretical possibility could only occur where, in a given county, the taxable value of its tangible personal property is greater than the taxable values of both RE located there and of PU property allocated to that county by the Board of Public Works.

That conclusion is based on the simple logic which would tell us that, due to the current statutory allocation of levying authority among the levying bodies (the Boards of Education having well more than half of it), if the assessed value of TPP in any given county is less than one-half of the total assessed value of <u>all</u> property in that county (i.e. TPP, RE and PU property), then, the proposed elimination of the *ad valorem* tax on TPP for all levying bodies, combined with the reallocation to the County Commissions and Municipal Councils of the Board of Education's/Legislature's large majority regular/current expense levying authority as to RE and PU property, will not result in a net reduction of the base of the former bodies' taxing capacity in terms of assessed values.

However, due to limits of the published data, the portion of the taxes levied on the sub-category of TPP, consisting of "chattels real" (i.e leasehold interests in mineral estates) but arbitrarily classified as TPP for assessment purposes per WV Code §11-3-7a, could not be ascertained and eliminated from the computation. Thus, without eliminating such chattels real, though they are intended to remain fully taxable, the assessed value for FY 2016, of the TPP (including such fully taxable chattels real) in the counties of Brooke, Doddridge, Marshall, Roane, Tyler and Wetzel, does, on the face of it, exceed more than 50% of all assessed values.[13] However, given the extraordinary recent escalation of the value of active mineral leasehold estates in each of those six counties, it is virtually certain that, if the assessed value of TPP in those counties excluded the value of those leaseholds, the value of the remaining TPP, to be exempted in each of those counties (after excluding the still-to-be-taxed leaseholds), would, also, be well below the assumed 50% threshold for triggering such a tax base subsidy. Moreover, the other aspects of the Fair 55 Tax Reform Plan©, reallocating the State's share of the remaining property tax on RE and PU property to the counties and the municipalities, and encumbering the State's share of the property transfer tax, to cover even the theoretical shortfall in those six counties, does so by more than tenfold.[14]

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[13] FY 2016 Classified Assessed Valuations/Taxes Levied, published by the WV State Tax Department.

[14] To quantitatively test the 50% thesis, one would take the excess of twice the assessed value of TPP in each of the six counties over the assessed value of all property (TPP, RE and PU property) for tax year 2015 was (in million dollars): Brooke = \$3.48; Doddridge = \$12.72; Marshall = \$8.0; Ritche: \$0.88; Tyler: \$1.68 and Wetzel = \$14.22, for a total assessed value of \$40.98 million. Assuming an average levy rate of 3%, that represents a theoretical revenue loss of \$1.23 million. (Extrapolated from FY 2016 Classified Assessed Valuations/Taxes Levied, published

Nevertheless, to expect them to responsibly support repeal of the constitutionally-imposed tax on all other TPP (while still taxing the chattels real/mineral leaseholds aforesaid), county and municipal authorities can readily be given a binding legal assurance that their overall tax bases will not decline. That is because their greatly expanded authority to tax RE and PU property, as further underwritten by the mandatory encumbrance of the State's share of the property transfer tax, is fully sufficient to offset the revenue lost due to that repeal. In addition to a mandatory property tax base subsidy to insure against such a loss, other steps, which will not only preclude it but will significantly expand revenue-generating capacity for local governments, are discussed in Section I. *infra*. [15]

Finally, as a part of this major reform, it will be necessary to permanently retain local school boards' current levying authority over RE to the extent it is legally bound to support payment of their existing bond and excess levy commitments. In addition, under the constitutional amendment discussed in Section J. *infra*, all levying bodies' authority, to tax RE in connection with any local voter-approved bond or special levies, would be preserved. Thus, in

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by the WV State Tax Department.) By comparison, the State's budgeted share of the real property transfer tax in FY 2016 is $13.4 million or more than 10 times the collective theoretical shortfall in those six counties. See, 2016 WV General Fund Budget (as of 6/1/2016).

[15] Of course, some might contend that, if such assurances were still not enough to persuade local officials to support the constitutional amendment repealing and replacing all of the tax on TPP, general legislation could be enacted to simply reallocate the authority to tax all of TPP to the local, non-school government bodies, subject, of course, to the constitution's "equal and uniform" principle enforced on a county-wide basis. However, to the extent such bodies actually exercised that authority, both the political support for the other aspects of the constitutional amendment, accruing from exemption of motor vehicles, and the economic stimulus, from the certainty of exemptions for business inventories, machinery and equipment, would be significantly undermined. The first aspect of those negatives could be mitigated by constitutionally mandating the exemption of motor vehicles while still allowing the non-school local bodies the option of taxing the non-vehicle components of TPP. However, in all of this, sight should not be lost of the simple fact that the ubiquitous, but politically critical, West Virginians "in the little white houses" already enjoy what are among the lowest residential property taxes in the U.S. It is for these reasons, that the author of the Fair 55 Tax Reform Plan© does not support such local tax subsidy overkill. Surely, even the traditionally change-resistant local officials advocacy groups will recognize that insisting on such utterly unnecessary protections from such objectively non-existent threats will not be in the best interests of their constituents when it so radically undermines the full stimulus benefit of this aspect of the Fair 55 Tax Reform Plan©.

such circumstances, if still in effect, the current constitutional caps on combined levy rates would be lifted when the local voters agree to impose greater taxes on themselves for such purposes.[16]

D. GENERAL CONSUMPTION TAX (GCT).

It is proposed that West Virginia significantly expand its reliance on consumption taxes by enacting a very broad-based consumer purchase excise tax entitled the General Consumption Tax (GCT). The GCT (illustrated in the Fiscal Scorecard with a 5.5% rate) would replace the current 6% consumers sales and service and use taxes by adopting those taxes' current base and administration, and then by greatly expanding that base through the elimination of the majority of the presently mushrooming array of narrow, special interest exemptions. The long history of broad-based sales taxes in West Virginia is most instructive in considering this proposal.

West Virginia first imposed, temporarily in 1934, and permanently in 1937, what was one of the nation's earliest general consumers sales taxes, and unlike most other states then or now, has, from its inception, imposed it generally on services as well as on the sale of goods. Thus, in a completely opposite fashion compared to other states, in West Virginia all services are taxable unless an express exception or exemption is provided in governing statute. The natural result of such an approach is that, as the service sector has become a larger and larger component of the overall economy, more and more specific exemptions have been enacted once the realization of automatic taxability confronts each new subsector participant of the service industry. This happens particularly if they initially emerge from out-of-state, and, thus, when entering the West Virginia market, are unused to its taxation of services as the general default treatment.

Today, the amount of tax revenue foregone due to those exemptions nearly equals the entire budgeted collections of the sales tax and the complimentary use tax to which they apply.

[16] See, Section I., *infra,* advocating the abolition of the constitutional property tax rate classifications and limits.

More importantly, even with retention of the few categories of exemptions, which implement important fiscal and social policies, the resulting revenue yield of the sales/use taxes could be nearly doubled without any phase-in period for repeal of the rest of the current exemptions selected for elimination.

The exemptions, to be eliminated, and the revenues estimated to be realized by their repeal (stated in millions of dollars based on the illustrated 5.5 % rate) are: food ($153.45); wholesale prescription drugs/appliances ($52.25); computer hardware/software and other digital goods ($15.583); PSC regulated services not including gas, water & electricity ($101.475); sales of gas, steam, water, and electricity ($191.86); personal services (e.g. haircuts and dance lessons) ($23.47); non-medical professional services ($132.92); advertising services ($24.75); electronic data processing services ($4.583); tourism development credit ($2.75); loan broker fees ($2.75); opinion research services ($0.513); travel agency commissions ($0.0275); technical evaluations ($1.375); lodging franchise fees ($3.39); vendor incentives ($1.925); sales by public and private schools ($16.13); exhibitor motion picture rentals ($1.375); aircraft repairs ($3.575); charges for opening burial lots ($0.458); fitness club dues ($1.83); artistic performance fees ($0.385); delivered newspapers ($0.407) and contracting (construction) services ($150.33). Total revenue, to be gained from elimination of the listed exemptions (using the proposed 5.5% rate) is $887,566,167. [17]

[17] <u>2016 Consumers Sales and Use Tax Expenditure Study</u> by WV State Tax Dept. Using the current 6% rate, the amount of revenue presently lost due to such exemptions is nearly one billion dollars ($968,254,000). Note, as to the final, listed exemption item, it was not possible to disaggregate, and eliminate from the tax exemption value total, contracting (construction) services for governmental units, which would remain exempt, or to disaggregate, and add to the total tax exemption value, contract services directly used in various private production enterprises (e.g. manufacturing, mining, etc.), which would become taxable. Therefore, in estimating the revenue gain from eliminating the identified exemptions (net of those exemptions retained), a computational assumption was indulged that those two particular items offset each other.

The choices of exemptions to be retained are based, in part, on the fact that both transparency and sound tax policy recommend the avoidance of buried, double or pyramiding tax on tax, which the proposal recognizes by calling for the retention of the exemptions for those <u>certain</u> business inputs that are directly passed through in taxable sales of <u>goods</u> to ultimate customers (e.g. purchases of goods for resale, or of raw materials and equipment for direct use in manufacturing and certain other "costs of <u>goods</u> sold" etc.). Such exempt purchases would expressly not include services or goods which are merely used and consumed internally by the commercial purchaser in its own operations and which cannot be directly traced on a clear line of tangible possession to ultimate customers (e.g. marketing, general administrative overhead costs, etc.).

Beyond that, the proposed taxability of outside contract services, even for direct use in manufacturing or other production activities (mining, agriculture, etc.), is a significant departure from the current tax structure. In addition to the explanations, provided elsewhere in this proposal, for why the general opposition to taxation of business inputs is at once myopic in its analysis and overstated as to its claimed adverse impact, exemption of non-employee services from the GCT is inappropriate because it would create an incentive for replacing employees with outsourced contract labor. That is the case, because, as explained in Section E. *infra,* the other primary component of the Fair 55 Tax Reform Plan's© replacement tax structure is the Enterprise Consumption Tax (ECT) which will include employees' wages as a major element of the measure of an organization's base for that tax. Correspondingly, to honor the principle of tax neutrality and to avoid distortion in such a fundamental economic resource allocation decision, wages would remain exempt from GCT.

Further, all sales by those who are not selling goods or services to third parties as a formal business endeavor (e.g. yard sales) would remain exempt, and, to avoid pyramiding, so would sales of goods and services among members of controlled groups of business entities. Moreover, to encourage gainful employment in the face of West Virginia's nationally lowest work force participation rate, the current sales tax exemption for day care and babysitting services would be retained in the GCT.

At the same time, because the charges for the great bulk of healthcare services are paid by third parties (including federal and state government), the exemption for such services should be retained to avoid the administrative problems inherent with such indirect transactions, not to mention the lack of transparency and violation of the self-assessment principle otherwise expected with consumption tax like the GCT, as explained in Section A. *supra*. Likewise, to avoid the inefficiency of having state government tax itself or other governments, the exemption for government purchases and sales by governmental units (if not made in direct competition with private commercial entities) should also retain their current exemption. In addition, it would defeat the purpose of the sales tax increment financing (STIF) program to make transactions, already subject to the special district excise taxes, also subject to the GCT.

Further, to more precisely and efficiently address the acknowledged regressive nature of a tax on the consumption of food, purchases of food with food stamps and WIC vouchers, would, by federal statutory mandate, remain exempt. Likewise, all retail purchases of healthcare necessities, such as medical services and retail purchases of medicines, would remain exempt under the GCT. Beyond such specific and direct relief measures, designed to mitigate the inherently regressive nature of consumption taxes applied to purchases of the necessities of life, when it is fully understood, an even broader appreciation of the non-regressive nature of the Fair 55 Tax Reform Plan© emerges.

Thus, it is recognized that, chief among those life necessities are food, medical care, shelter, transportation and utility services and clothing. Of those, purchases of the first three (only by low-income people in the case of home consumed food) will be expressly exempt from the GCT. Although some states, which generally tax purchases of food for home consumption, provide further relief through income tax credits or refund mechanisms,[18] any comparison of the United States Department of Agriculture (USDA) surveys of food purchase patterns, by low-income individuals, with West Virginia's food stamp eligibility and benefit system or SNAP (Supplemental Nutrition Assistance Program), confirms that the exemption of such purchases with food stamps and WIC vouchers is entirely adequate to mitigate the regressive nature of a general tax on food consumption.[19]

The experience of those other states not only confirms that conclusion but also shows how fiscally ill-conceived (though well meaning) was West Virginia's general reduction and ultimate repeal of its sales tax on groceries. Particularly instructive is the history of food tax relief in South Dakota. There, faced with the prospect of completely exempting the sale of food from sales tax, a full two-thirds of the voters prudently <u>rejected</u> such a fiscally irresponsible proposal in a state-wide referendum. Then, as a presumably better targeted alternative, the

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[18] Hawaii (refundable income tax credit of a flat amount per exemption which declines as income rises up to $30 K AGI); Idaho (flat $100/person refund regardless of income); Kansas (income tax credit for low income taxpayers, replacing a sales tax paid rebate program for low income taxpayers); Oklahoma (flat $40/person credit against income tax for low income persons) and South Dakota (now repealed an inflation-adjusted quarterly refund amount based on family size for incomes up to 150% of federal poverty level).

[19] In a recently published study of the matter, using data from Alabama and Louisiana, its authors concluded that "[u]sing SNAP participation rates from studies commissioned by the [USDA], we recalculate the effective incidence of the sales tax (using both income and consumption as bases) to highlight the effect of the nontaxability of benefits. Because SNAP effectively reaches a high percentage of the poor, we find that the sales tax is substantially less regressive once that feature of SNAP is considered." "Rethinking the Sales Tax Food Exclusion with SNAP Benefits." by Anna L. Johnson and Steven M. Sheffrin, <u>Special Report in State Tax Notes,</u> January 11, 2016.

legislature enacted a direct food tax relief program for low income taxpayers. However, almost certainly because virtually all of the eligible taxpayers also received automatically exempt food stamps and, thus did not qualify, the separate relief program remained almost entirely unused.[20]

This real world example well confirms the foregoing conclusion that the automatic exemption of food stamp purchases fully addresses the regressive effect of a general consumption tax on grocery purchases. In doing so, it also confirms the fiscal irresponsibility of providing a blanket exemption for such purchases. Thus, the Fair 55 Tax Reform Plan© will not repeat that mistake, and, will, as result, enable the state to give more than $150 million in truly meaningful tax relief where it will help the most (e.g. toward repeal of the income tax on most individuals and of the regressive and non-competitive tax on TPP).

Though, as explained above, the exemption from GCT for medical services and medicine is primarily based on a separate rationale of administrative necessity and applies to patients of all income levels, it also serves the goal of eliminating another potentially regressive aspect of a broadly applied consumption tax. Finally, since the payment of rent is, by far, the most prevalent way by which low income families secure their personal shelter, retention of the existing exemption for rentals of RE avoids any regressive impact in terms of that life necessity.[21] In addition, the existing reduced rate for purchases of mobile homes would also continue to reduce the otherwise potential regressive nature of GCT as a broad tax on consumption.

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[20] Only $100,000 of benefits claimed against an annual appropriation of $5 million. http://articles.aberdeennews.com/2011-02-05/news/27102932

[21] One of the most regressive aspects of West Virginia's current tax structure is the constitutionally embedded property tax rate differential between owner-occupied homes and rental housing whereby those who can afford to own their own homes pay one-half the rate of property tax that those who, cannot afford to buy a home, have to pay (through their rent). An even more-sweeping reform of our tax structure would amend the constitution to do away with both the nationally unique property tax rate differentials and the rate caps altogether. See, Section J. *infra.*

In terms of transportation costs, in a rural state like West Virginia, the exemption of the TPP tax on motor vehicles goes a long way to reduce the regressive impact of the current overall tax structure, despite this proposal's retention of the existing consumption tax on vehicle purchases.[22] In addition, to the extent public transportation is directly provided by governmental units, that necessity of life would also remain free of the GCT. Likewise, though the current sales tax exemption, for services rendered by for-profit transportation and other public utility companies subject to Public Service Commission regulation, would not be retained for GCT purposes, the special credit in WV Code §11-13-3f, against certain utilities' pre-credit Business and Occupation Tax liability for lowering utility rates for low-income customers, would remain. Moreover, with appropriate structuring, that credit represents a model which could be expanded to use the same customer eligibility system to identify those low-income individuals who would be entitled to a narrowly targeted GCT exemption on their consumption of certain utility services.

Nevertheless, to make the GCT even less regressive than the current sales and use tax, when it comes to purchasing the life necessity of clothing by low income people, a special Fair Tax Credit Card would be authorized and issued to essentially exempt up to $500 of annual clothing purchases for each person in households with Federal Adjusted Gross Income (AGI) below $30,000, with the exemption fully phased out at the $40,000 AGI level.[23] The estimated

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[22] Example: If a taxpayer buys a $20,000 vehicle, is credited with $2,000 trade-in and keeps it for 5 years, his/her savings from repeal of the TPP tax will fully offset the 5% excise tax paid on the purchase. ($20,000 - $2,000 = $18,000 X .05 = $900 vs. $20,000 X 60% assessment ratio X 50% average depreciation X 3% tax rate X 5 years = $900.)

[23] To avoid essentially arbitrary abrupt loss of all benefit eligibility, conceivably due to receiving a single additional dollar of AGI, better tax policy favors phase-outs of benefits over a range of AGI levels. E.g. the Oklahoma Policy Institute's 2008 call for a phase-out of that state's food tax relief benefit as a part of proposed reforms. ("Giving Credit Where Credit is Due: Boosting the Grocery Tax Credit Would Provide Targeted Help for Struggling Families," October 2008.)

$20 million cost of this tax fairness measure is expressly provided for as Item 3 in the Fiscal Scorecard illustrating the revenue neutrality of the Fair 55 Tax Reform Plan©.

Specifically, the Fair Tax Credit Card program would require applicants to annually submit a copy of their federal income tax returns to establish/confirm both eligibility and the number of individuals in their household, and would employ the same electronic benefit transfer system technology that is presently used for West Virginia's SNAP.

Portions of the proposal may also be reflexively met with opposition based on state border competition from jurisdictions whose sales/use tax regimes do not have nearly as broad a base as we have now, much less, as we would have with the GCT. This opposition, to greater reliance on a consumption tax, was particularly acute in the context of the debate over West Virginia's tax on groceries. Specifically, it was said, in support of a broad exemption of groceries (even for the overwhelming number of us who do not need a coupon-less 6% discount on our food purchases), West Virginia residents would drive into a neighboring state just to buy their food exempt of tax, and, thus, it was argued, our grocery stores would lose business.

Lost in such a debate is the completely unrecognized policy implications of this State's long experience with a far broader sales tax base than any of its neighboring states. Thus, as explained above, from its inception (and long before its current, extended economic decline began), West Virginia was imposing its consumption tax on the bulk of all services while few, if any, other states tax them at all. Yet, if anyone really believes that fundamental tax policy difference explains why West Virginia, <u>decades later,</u> became chronically uncompetitive for the last half century, they have not ever been heard to say so, let alone, objectively demonstrate the merit of such a conclusion. Indeed, given the utter absence of even claims, much less offers of proof, of such an effect, it is apparent that it is more than "OK" to be different when it comes to well-conceived tax policy. Thus, if well-designed, different policy can lead to improved competitiveness.

Indeed, by recognizing the actual nature of the purported “border competition” threat, the Fair 55 Tax Reform Plan© includes a creative provision which promises to virtually eliminate the problem. First, since businesses will continue to be subject to regular audits of their purchases for consumption tax compliance under the GCT, it must be recognized that the border competition threat is strictly a retail customer level issue. Moreover, in light of the specific provisions included, either in the form of overt exemptions or those which tie GCT relief for low income taxpayers to in-state programs (e.g. food stamps, the Fair Tax Credit Card), it should be clear that the only real source of the threat of border competition in our tax law on retail purchases, lies in our state’s less than competitive rates of tax on retail purchases of tobacco and fuel, not on anything introduced by the Fair 55 Tax Reform Plan©.[24]

Nevertheless, to help mitigate that existing retail border competition threat, the Fair 55 Tax Reform Plan© would also include a provision imposing a creditable (but not refundable) GCT use tax on individuals, whose income is <u>above</u> the level of those eligible for food stamps or for the Fair Tax Credit Card for clothing purchases. The amount of creditable use tax, applicable to all non-exempt purchases, would be based on twenty percent (20%) of the amounts in the state-specific sales tax tables, now used for itemized federal income tax deductions, for the 41% of West Virginia income taxpayers with reported AGI over $40,000.

Thus, on simple GCT use tax returns, after entering the appropriate AGI, number of federal income tax exemptions and the resulting tentative 20% creditable use tax, those

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[24] Though they certainly could use much scrutiny and a parallel effort at major reforms, the Fair 55 Tax Reform Plan© does not address the various special revenue taxes dedicated to any use other than the State’s General Fund (e.g. the excise taxes on gasoline, etc. flowing into the Highway Fund, or the broad-based healthcare provider tax imposed on institutional healthcare providers to yield revenues to attract matching federal Medicare funding).

reporting taxpayers could then offset the tax dollar-for-dollar, up the full amount of its pre-credit liability, by simply providing documented proof of having paid that amount of sales or use tax to any jurisdiction during the preceding tax year. Whether taxable purchases, for which use tax credit is claimed, have been made with cash or credit cards, by simply retaining and submitting the automatically generated paper sales receipts showing the tax payment, the process will be seen as a far simpler tax return compliance obligation for most taxpayers in the middle and upper income brackets than is the current (but to-be-repealed by the Fair 55 Tax Reform Plan©) personal income tax return process with W-2s, various credit schedules, etc.

For those, to whom it is still too much trouble to provide enough sales receipts, the maximum annual liability for the GCT use tax for a family of four in the $40,000 AGI bracket, without any credit for GCT actually paid, would still be less than $130. However, if the Legislature, in its wisdom, decided that using an even smaller portion of the federal table amounts (i.e. < 20%) was sufficient to overcome the currently existing border competition threat (already caused by our uncompetitively high retail gasoline and tobacco taxes), the cost of not reporting and claiming taxable sales for credit would be even less. Nevertheless, because of the ease of compliance with the tax paid credit claim process under its creditable GCT use tax provision, no revenue "windfall," from non-compliance with the credit claim procedure is included in the Fair 55 Tax Reform Plan's© Fiscal Scorecard accompanying this proposal, *supra*, page 5.

Finally, unlike the gradual repeal of the tax on non-vehicle TPP, and the gradual replacement of the personal and corporate income taxes with the ECT, described in the next section, the positive revenue flow from the broader consumption tax in the form of the GCT can be achieved as soon after its enactment as the administrative mechanics can be implemented.

E. ENTERPRISE CONSUMPTION TAX (ECT).

In what, to some, may be the boldest aspect of the Fair 55 Tax Reform Plan©, it is proposed that, in an orderly and fiscally responsible manner, both the current Personal Income Tax (PIT) on individuals' currently earned income, and the Corporation Net Income Tax (CNIT) on C corporations' profits, would be repealed and replaced by the addition-method Enterprise Consumption Tax (ECT), imposed at the illustrated rate of 5.5%.[25] The proposal does provide for the temporary imposition of a limited Deferred and Passive Income Tax (DPIT), to be applied only to non-social security/non-public employee retirement benefits such as deferred income, interest and dividends, received by higher-income individuals, but at the flat rate of 3%, which is the rate for the lowest bracket of the current state personal income tax. See, Section F., *infra* at page 35.

This new consumption tax, on private for-profit and not-for-profit organizations engaged in economic activity would, in effect, function as a user fee for participation in the free enterprise system. Specifically, the substantive policy foundation of the ECT is that all private, non-government organizations with commercial receipts in excess of $100,000 (including larger non-profits), which use and enjoy the benefits of the free enterprise system, should contribute, through a simple and principled tax structure, the funds to help defray the government's burden of providing the public goods and services on which the efficacy of that system fundamentally

[25] Though inspired by the Single Business Tax, recommended by the GCFT to be imposed at a 2% rate in order to replace a large number of narrow-based, high rate business taxes and the tax on TPP, the ECT builds on (rather than simply emulates) the intrinsic merits of such a business consumption tax and would, thus, be imposed at a 5.5% rate to enable extension of the reach of such reforms by helping to achieve FULL REPEAL of the income tax on the current earnings of individuals, which was to remain under the GCFT proposal (though at lower and flatter rates than the current PIT).

depends. Those public goods and services are public infrastructure, safety, education, health and the rule of law.

Reflecting the measure of the extent of an organization's use of, and benefit from, the system, the base of the ECT would be the value of the labor and capital resources the organization devotes to that use, to-wit: compensation to employees, rents, royalties, interest and dividends paid, and profits retained.[26] In addition, the annual use of capital assets (i.e. depreciation) would be included in the tax base, after allowing a deduction for the amount of their purchase in the year of acquisition (i.e. the reverse of the current income tax concept of periodically recovering, through annual tax base deductions for depreciation, the investment in such assets as they are used).

Because the underlying rationale of the tax is to defray the burdens of government expenditures, any direct donations (cash or in kind) or other expenditures, which are duly certified as directly relieving those burdens, would be credited, dollar-for-dollar against the donor organization's pre-credit ECT liability. Those creditable expenditures would include payments of the healthcare provider tax, which is proposed to be retained due to the necessity of using it as a source of revenue to attract federal matching funds for the state's Medicaid program.[27]

Further, regular operational expenditures by an organization, which are certified as directly providing, in a manner subject to free market, private-sector discipline and efficiency, any particular public good, would be deductible by that organization from its ECT base. To

[26] As was the case of the SBT proposed by the GCFT, when they are acting as financial intermediaries, interest paid by banks, etc. on deposits, would not be part of their ECT base.

[27] Though this tax has been narrowed over time to just apply to institutional providers, its retention, with its current scope, is a point of departure of the Fair 55 Tax Reform Plan© from the GCFT's proposal, the latter of which would have phased the entire tax out over 5 years.

illustrate the breadth of such a deduction, consider all the payroll of a private (profit or non-profit) accredited, degree-granting institution of higher education. To the full extent such an entity is providing one of the fundamental public goods, to-wit: higher education, it would be allowed to deduct all of the compensation paid its employees, and the other elements of its ECT directly employed for that purpose, thus, making it effectively exempt from the tax by having a zero tax base The same would be true of a hospital (for profit or not-for-profit) to the extent it directly renders in-kind charity healthcare.

In addition, the proposal will encourage expanded use of "public-private partnerships" whereby an organization, subject to the ECT, will apply for State government certification of a proposed infrastructure project as being "in the public interest." An example would be a public access road to a new industrial site. If the project is so certified, the organization would then receive a credit against its ECT for a stated large percentage of its expenditures which are within the proposed cost of the project as certified. At the same time, by not giving a full dollar-for-dollar (100%) credit, the private benefit to the organization from the project is accounted for while the economic efficiencies and free market discipline will be leveraged to achieve important public infrastructure improvements. In other words, a far greater scale of useful infrastructure can be realized if the improvements are directly funded with private dollars and not with tax revenues, the value of the latter of which, due to bureaucratic inefficiency and the inherent "handling" cost of spending "someone else's money," is thus heavily discounted before the remainder of those funds are actually applied to the desired improvement.

When viewed as a revenue-generating replacement for much of the present income taxes on most individuals and C corporations, the ECT's most extraordinary feature is that, due to the deductibility of ECT tax paid by any employer entity subject to federal income taxes, the net cost to the employer of the ECT (after the benefit of the employer's federal income tax deduction) is such that, even if the employer took the truly unprecedented (and, ideally, illegal) step of shifting to its employees, by a wage reduction, the economic incidence of the net cost of the ECT on wages, the employees would still be economically better off due to their no longer having to pay the PIT on their compensation pursuant to its repeal under the Plan.

That is because, as long as the employee's current effective state income tax rate is more than 3.575% (e.g. any married couple with taxable income over $25,000 or single person with taxable income over $12,500), the net, after-federal-tax cost of the ECT to the employer will (assuming the 5.5 % ECT rate in the accompanying Fair 55 Tax Reform Plan© Fiscal Scorecard) always be less than the current income tax otherwise payable by the employee.[28] Moreover, if we can impose a minimum wage, regardless of its level, we can design effective prohibitions against any such pass-through of the ECT on wages to employees, particularly for the very low income wage earners in the bottom 3% bracket of our current income tax structure.

To be certain, this uniquely beneficial consequence, of the interplay of the proposed ECT with federal income tax deductibility, will not help entities (or, indirectly, protect their employees) which have no federal income tax exposure due either to the absence of taxable profits or to exempt status. Admittedly, there is no <u>tax</u> disincentive for a non-income tax paying entity to not lower one otherwise deductible expenditure (wages) due to the added cost of another otherwise income tax deductible expenditure (the ECT on wages). However, the overall economic stimulus, expected to be demonstrated by the dynamic modeling necessarily preceding implementation of the Fair 55 Tax Reform Plan©, should go far to reduce the incidence of non-

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[28] Assumed federal corporate income tax rate of 35% and ECT rate of 5.5% = effective, after-tax cost of ECT = 3.575% (1 - .35 X .055 = .03575.)

profitability in the for-profit organization community.[29] Moreover, the significant credits and deductions for ECT purposes, available to the non-profit community for directly relieving the burdens of government, including, particularly for non-profit institutional healthcare providers, their payment of the healthcare provider tax, all should greatly mitigate the actual economic impact of the ECT on such entities.

Further, a small organization exemption from the ECT is proposed for independent entities with less than $100,000 of annual commercial receipts. By not counting any public or private grants, gifts or donations toward that taxable threshold, all religious and other primarily donor-supported charitable organizations will also avoid exposure to the ECT. Typical related-party rules, found in other business tax schemes, will then become necessary to prevent abuse of the small organization exemption by groups of related and commonly controlled economic interests.

Although, as explained in Section D. *supra*, in terms of avoiding taxation of many business inputs, the GCT would contain many of the typical exemption provisions (sale for resale, direct use in manufacturing, etc.), the same contentions about the folly of taxing those inputs can be expected to be raised against the ECT. However, just as with the taxation of contract labor under the GCT, the taxation of employee labor under the ECT still comports with well-known public finance principles. Thus, it cannot be disputed that, when it comes to the taxation of a business organization, it operates purely as a conduit to shift the ultimate economic incidence of the tax burden to one, two or each of three constituencies, to-wit: its customers, its employees or its equity owners. Thus, when the certain truth of that principle is recognized, the typical lamentations about taxing business inputs succumb to their own superficiality.

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[29] See, Section J. *infra*.

To be certain, a "pass-through" of the tax burden to customers is the essence of the design of broad-based consumption taxes like the current consumers sales tax or the proposed GCT. At the same time, it must be acknowledged that, when taxes are buried in higher prices to customers, lowered wages to employees or lower profits for owners, the aspirational goal of maximum transparency of taxation is compromised. Of course, either voluntary disclosure or a legal mandate requiring the listing of otherwise buried taxes would be one remedy.[30] However, a far more meaningful way to honor the principle of transparency in taxation is to have the people, at its onset, to actually vote on the fairness of a simple, consumption tax system which expressly states how the immediate incidence of its burden is allocated. Then, any shifting to consumers will be apparent to each of them in each purchase they make. That is precisely what is contemplated for the Fair 55 Tax Reform Plan© as described in Section J. *infra.*

Finally, in the case of multi-state organizations, to more precisely align their liability for the ECT, with the extent of their actual exploitation of the West Virginia market, and to stop penalizing such entities based on the extent of their employment and property investment in West Virginia, the proposal calls for a change of the method for apportionment of the base of the ECT from the present three-factor method (property, payroll and sales) to a single sales factor method.

To address the typical question, raised in response to any policy proposal, to-wit: "what do the other states do?" the ECT would be modeled in its structure, to an extent, on New

[30] Presumably, such disclosure of effectively absorbed tax burdens by a business already occurs in the case of financial reports given its owners. Less obvious to the naïve, but well-intended advocates of labor price fixing (a/k/a minimum wage laws) is that such laws operate to effectively impose a tax that impairs employment opportunities (again, via the employer conduit) by arbitrarily raising the cost of labor above its productive value.

Hampshire's Business Enterprise Tax.[31] However, unlike the Fair 55 Tax Reform Plan©, that state still also imposes, on a parallel track, a Business Profits Tax which is similar in structure to West Virginia's present CNIT, the latter of which would be repealed here.

Despite its obvious merits, there will be those who reflexively oppose the ECT on the grounds that it would be labeled, by tax policy wonks, as being an addition-method value-added tax (VAT). A traditional VAT uses a subtraction-method impost whereby each party in the chain of commerce charges the tax to his or her customer measured by the sold merchandise's selling price, less its cost to the selling merchant, and, thus, on the "value added" by the selling merchant via his or her mark-up over the cost of the resold item to him or her.[32] .

Nevertheless, "VAT" is the tax category to which its opponents will readily relegate the ECT, because of (not, as you would assume, in spite of) the fact that traditional VATs are, by far, the most prevalent primary tax employed throughout the global economy. Before we go down that road of economic xenophobia, however, it should be remembered that nineteen (19) years after Michigan adopted its SBT (an addition-method VAT), and twenty-five (25) years before New Hampshire adopted its BET, West Virginia's Legislature, in 1970, enacted its own VAT,

[31] Before it was repealed in 2008, Michigan had a similar addition-method business consumption tax, also designated the Single Business Tax. However, over its half century of operation, that tax's simplicity was undermined by virtually unending legislative tinkering in the form of special provisions, etc. Michigan's SBT was ironically replaced with the MBT (Michigan Business Tax), but, as a practical matter, the "M" really stood for "Multiple" Business Tax, because that latter impost involved not only a net income tax AND a gross receipts tax BUT ALSO a surtax levied on the total of the first two. Understandably, in 2012, the MBT was, itself, replaced with a new, simple, flat rate (6%) tax on corporate income. The ECT, under the Fair 55 Tax Reform Plan© would avoid such undoing of its simple design by virtue of expressly embedding its base and limited exemptions in the State's constitution. See Section J, *infra.*

[32] For that reason, the very concept of an addition-method VAT, whereby various business inputs (wages, profits retained, dividends, interest, rents, royalties, etc.) are added together to measure the tax's base, might seem, , when compared to the subtraction of costs of goods sold in a traditional (subtraction-method) VAT, at least somewhat of a semantical contradiction.

based on what was then referred to as the "Papke Plan" developed by James Papke, an economist from Purdue University who the Legislature had hired for that purpose.[33]

However, due to doubts about whether the new tax would have the same revenue-generating capacity as the business and occupation tax it was to replace, then-Governor Arch Moore vetoed the bill too late in the 1970 session for the Legislature to override his action. Today, however, nearly half a century later, as explained in Section J. *infra,* we have and will employ far superior economic modeling tools and time-tested methods, than those available to the Legislature and Governor Moore in 1970. As a result, we will be able to confidently predict (and cautiously phase in) the revenue-generating capacity of the ECT and of the entire Fair 55 Tax Reform Plan© until they can be fully implemented. Indeed, that was also true of the SBT and the rest of the 1999 tax reform proposal of the GCFT.

F. TEMPORARY DEFERRED AND PASSIVE INCOME TAX (DPIT).

Largely to assure revenue neutrality, by initially using the least objectionable, narrow aspect of a general individual income tax, it is proposed that a low-rate (3%) flat rate tax be temporarily imposed on income that was deferred (and not taxed) before repeal of the current PIT and on interest and dividends. Thus, the deferred income, to be taxed (for the first and only time), would only consist of distributions from tax-deferred private qualified plans such as IRAs 401Ks, etc. The tax would not apply to an individual's receipt of social security retirement benefits or public (federal, state or local) retirement plan benefits. Moreover, a provision would be included which required this tax to phase out as certain fiscal milestones are reached and, in all events, as the funds in each individual's pre-reform private deferred income plan account are fully withdrawn.

[33] Robin C. Capehart, Real Tax Reform for West Virginia, Public Policy Foundation of West Virginia, 2009.

G. REDUCED RELIANCE ON DECLINING AND UNCOMPETITIVE SEVERANCE TAX.

Both to reduce fiscal reliance on the declining market for coal, and to extend much-needed relief to the nation's most heavily-taxed extractive industries, it is proposed that the severance tax rate for coal, oil and gas, be reduced by half from 5% to 2.5%, which would include and retain, in the case of coal, the 0.35% portion of the tax rate dedicated to local governments. It is further proposed that the recently reinstated severance tax on timber production be permanently and immediately repealed as it represents a major outlier in the taxation of timber in the mid-Atlantic region which, in turn, causes West Virginia's timber industry to be uniquely uncompetitive in that commodity market.

H. RETAINED SPECIAL CONSUMPTION TAXES: B&O, INSURANCE PREMIUMS AND CERTAIN "SIN" EXCISE TAXES (E.G. ON ALCOHOL AND TOBACCO).

It is proposed that certain of the existing special consumption taxes, paid by purchasers and collected by vendors, be retained for their efficiency and capacity to shift the incidence of tax to the beneficiaries of the service or product using them. For example, because the economic incidence of the business and occupation tax on electric power generation falls, in large part, on out-of-state utility customers, that is an arrangement which, good policy dictates, ought to be retained. However, the infamous "pop tax" on purchases of soft drinks should be eliminated.

I. ENHANCED FISCAL FLEXIBILITY AND VOTER CONTROL THROUGH EXPANDED LOCAL GOVERNMENT REVENUE-GENERATING POWER AND SPENDING RESPONSIBILITIES.

To achieve optimum efficiency and transparency in the use of tax revenues, a major decentralization of state government fiscal control and a restructuring of local government, including the long-term possibility of significant consolidation, will be necessary. However much that a full treatment of that endeavor remains well beyond the scope of this proposal, there are reforms of the state and local tax structure which can play a major role in facilitating achievement of those even broader reforms.

As explained in section C. *supra*, one important reform would be the use of block grants whereby the Legislature funds all public schools, on an equal per student basis to satisfy the constitutional "thorough and efficient" standard, but leaves specific school expenditure and management decisions to local educators, and parents, guided primarily by the need to achieve objectively measured educational attainment outcomes. Beyond that, there are other steps that should be taken in the direction of expanding local governments' revenue-generating options and capacity. These would include the reallocation of the entire regular levy tax authority over RE and PU property, and encumbrance of the State's current share of the property transfer tax, to or for the benefit of counties and municipalities.

Under the Fair 55 Tax Reform Plan©, even greater flexibility in local taxing and expenditure decision-making would be the result of a ballot initiative repealing both the property tax rate limits and rate classifications now embedded in the State's Constitution.[34] This would yield many progressive government reforms which include: (a) enabling local levying bodies (including school boards seeking voters' consent for excess levies on RE) to actually coordinate tax rates with spending plans; (b) imposing the extraordinary fiscal discipline resulting from linking the relative level of tax rates on all taxpayer groups as described in detail in Section J. *infra* and (c) removing the highly regressive effect of the double tax rate paid (via their landlords' rent) by typically lower income occupants of rental residential property when compared to the rate paid by the relatively more affluent owners of their own residences. At the

[34] Optimally, such a reform would be part of the constitutional amendment described in Section J. *infra*.

same time, the more targeted relief intended by the Constitutional requirement, that farm land be valued based on its use as such (and not on its highest and best use), would be retained, along with the long-term, income-method, currently used to set taxable values of managed timberland, and adopted pursuant to the Constitution's separate Forestry Amendment.[35]

Then, with a reformed structure in place, to address the fundamental political question of the proper levels of taxation and spending, the corollary regime, for reviewing disputes as to the measurement of the base of the property tax (i.e. determining taxable value), must also be reformed. The current system, whereby such disputes are decided by elected officials (assessors and county commissioners) whose primary public duty it is to assure the availability of adequate tax revenues, whose personal political interests lie with favoring voting residents to the extreme prejudice of non-voting business entities and non-residents and whose raises in their personal compensation are statutorily tied to increased taxable values, has been sarcastically referred to as "… perhaps not a scheme whose design would prompt nomination for the Nobel Prize …"[36]

Indeed, because of the previously criticized constitutional tax rate limitations, when combined with the growing need for revenue, the actual rates, imposed by most levying units, are often at or near the maximum levels, making the other side of the tax liability equation, to-wit: the taxable value of property, the only place to which revenue-starved local officials have to turn for fiscal relief. At the same time, the county assessors cannot explain often enough (with both

[35] WV Const., Art. VI, Sec. 53.

[36] Neely, Richard J.'s Dissent in Rawl Sales & Processing Co. v. County Commission, 443 S.E.2d 595 (W.Va. 1994). See, also, Caryl, "The Illusion of Due Process in West Virginia's Property Tax Appeals System: Making the Constitution's Promise a Realty," 98 W. Va. L. Rev. 301 (1995) and Broadwater, "The Illusion of Due Process in West Virginia's Property Tax Appeals System: What Illusion?" 113 W.Va. L. Rev. 791 (2011).

straight faces but only superficial accuracy) that they just set values and do not determine tax burdens.[37]

Toward the end of a more straightforward, transparent and accountable system for determining levels of taxation, it would be a significant improvement in terms of fairness and independence, if we simply returned to the arrangements in place in this State between 1909 and 1933, whereby taxable value matters were reviewed by independent officials who had property valuation knowledge and who were appointed by the state-level Board of Public Works.[38] Further, to minimize the volume of disputes by improving objectivity and accuracy of proposed values in the first instance, a property valuation system modeled on Maryland's approach is recommended. Specifically, in that neighboring state, trained professionals, who are entirely independent of elected local taxing bodies, do both the work of initial valuation and of reviews.[39]

Beyond reforming the administration of the property tax, in addition to the authority to impose a piggy-back GCT, both counties and municipalities should also have the same power with respect to ECT, and certain of the other consumption taxes, such as the various sin taxes (e.g. on sales of alcohol and tobacco). In that manner, depending on their location, they can balance their specific concerns about retail border competition with revenue-generating and expenditure objectives.

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[37] Perversely, this county assessors' mantra is only exceeded in its frequency of repetition by the one disclaiming any true responsibility for the values they place on commercial property when they say "the Tax Department in Charleston requires us to do it that way." Indeed, this, in turn, exposes the dark side of the purportedly superior accountability of elected (vs. appointed) local government officials. See, Note 40, *infra.*

[38] Id., Caryl at 331-332.

[39] See, Maryland Department of Assessments and Taxation @ www.dat.state.md.gov.us Should such a reform be adopted, and it remains desirable to retain the office of county assessor (elected or appointed), it could take over the current property tax collection duties of the county sheriff who (again, whether elected or appointed) could then be freed up to concentrate on local law enforcement in coordination with both the State Police and the law enforcement agencies of municipalities within their counties (absent consolidation of such local law enforcement services.)

Further, it is proposed that, instead of forcing municipalities to eschew their local business and occupation tax as a trade-off if they want to adopt a piggy-back GCT, they should be given greater options to tailor their tax system to local circumstances by eliminating not only that mandatory trade-off, as imposed under the current tepid version of “Home Rule” now allowed, but by repealing the obsolete rate limits, and by eliminating the industry-specific rate differentials, in the former tax as well. Moreover, extending business and occupation tax authority to counties, allowing them, to impose it on business activities outside municipal limits, would not only immediately expand their revenue-generating capacity, but would eliminate the inherent revenue leakage otherwise suffered by the municipalities due to the “tax free” zone that the surrounding unincorporated parts of the county now represent.

Finally, in time, such more balanced taxing authority, between municipalities and counties, should foster greater interest in coordinated fiscal policies, and government service expenditure programs, between and among contiguous jurisdictions. This, in turn, could be an important first step promoting voluntary cooperative public service agreements, and, ultimately, could encourage mutually agreed (not forced) consolidation based on local referendum votes. That is, the State should not (and, politically, probably cannot) try to mandate any such consolidation, but it should act not only to remove any and all barriers to enabling local governments, and local voters, to adopt it as they see it being to their mutual advantage, but to pro-actively foster such progressive initiatives.[40]

[40] Though it is well beyond the scope of this paper, another, less-explored avenue to improved local government efficiency would be to allow the voters in each county to decide, by referenda, whether the county assessor, sheriff, clerks, prosecuting attorney and circuit court clerks should be appointed (by the popularly elected county commission) or remain separate elected offices, burdened with their inherently greater operating costs and political biases, but rarely providing (due to specific centralized state law mandates governing the operation of their offices) the independent public accountability on which political science theory rests it case for their popular election.

For example, recent legislation, enabling multiple, local jurisdictional bonding compacts and authorities to finance road-building and maintenance and other infrastructure projects, through proposed expansion of local revenue-raising authority, should, if/when implemented, help relieve the presently unsustainable burden on the State of secondary road construction and maintenance.

J. AN IMPLEMENTING PROCESS WHICH IS BOTH HIGHLY RESPONSIBLE IN ITS CAUTIOUS RESTRAINT AND TRANSFORMATIONAL IN ITS RETURN OF GOVERNING POWER TO THE PEOPLE.

The Fiscal Scorecard illustration provided for the "Fair 55 Tax Reform Plan"©, at page 5, *supra.*, is designed to simply demonstrate, that, on a static basis, when certain assumed tax rates are applied to a newly defined broad base of a few simple primarily consumption taxes, unencumbered by a myriad of exceptions and preferences which characterize today's structure, a revenue-generating capacity, at least comparable, and ultimately superior, to the existing system, will result. Of course, as discussed in section B. *supra*, to achieve the optimum level of government funding, based on the policy debate of that question, it is prudent, and probably practically necessary, to first establish the substance of a fair and efficient structure through which the ultimate public expenditure policy is implemented.

However, to responsibly determine the final form of such a structure, dynamic econometric modeling must be done which shows both the shifting of burdens among different industrial sectors and organizations as well as the aggregate revenue yield and overall economic effect of the new structure. The GCFT did just that, and, ultimately was able to demonstrate in an objective manner, that, though there was burden-shifting (generally <u>from</u> makers and sellers of goods <u>to</u> supporting service industries), <u>all</u> industrial sectors were expected to grow and thrive under the reformed structure it proposed.

Further steps, which should be taken, include (as did the Legislature-driven tax reform effort of the mid-1980s), a few years of the filing of parallel information returns before full implementation of the co-dependent aspects of the Fair 55 Tax Reform Plan©, consisting of the repeal of the taxes on earned income and TPP, and the imposition of the ECT, occurs. The limitation of that "dry run" process, of course, is that, inherently, its results reflect the outcome as if the new structure were in place but is being applied to the results of economic-decision making influenced by the prior system. Even with that important conceptual limitation, the results of the information return program accompanying the mid-1980s' business and occupation tax (BOT) repeal, etc., acccurately confirmed what painfully came true, to-wit: that the replacement taxes (i.e. business franchise tax (BFT) and an 50% increase in the CNIT rate) were manifestly inadequate to generate revenues to fully offset those lost due to repeal of the BOT. The real fiscal pain came soon thereafter, when, starting in 1989, the actual new tax burden was increased more than 50% to make up for what would have been the resultant unconstitutional budget shortfall (and then some). Equally unfortunate then was the fact that it has now taken thirty (30) years, after that "reform" to finally shed, by phased-out repeal and reduction, the uncompetitive burden of those replacement taxes and higher rates.

A better, more responsible approach is to implement what can be done immediately, upon legal authorization, such as adoption of the broader-based GCT in place of the current consumers sales and use tax, but to phase out the other replaced taxes (i.e. the current income tax on individuals' earnings and C corporations' profits, and the tax on TPP as applied to everything but the immediately exempt motor vehicles, etc.) and to concurrently phase in the replacement tax, to-wit: the ECT, all based on achievement of stated multi-year fiscal milestones. This was exactly the approach the State took in successfully phasing down the rate of the CNIT based on achievement of minimum levels of surplus revenues in the rainy day funds.[41]

Finally, as one of the cornerstones of this proposal, and the ultimate means by which it can be said to achieve maximum fairness (to taxpayers as a whole, among taxpayers and to the government as the taxpayers' public servant), it is proposed that these changes be implemented through an amendment to West Virginia's Constitution. Thereby, the existing tax structure would be phased out, to the extent necessary as explained above, and the simpler, broader-based consumption tax structure, as succinctly described in the express language of the amendment, would be implemented on the same timetable. The description of the new structure in the amendment would include, not only a description of the bases, but also the initial rates, of the two, simple replacement consumption taxes (the GCT and ECT) and of the few retained other general fund taxes.

Of course, under the amendment, the Legislature would retain the full power to later change the initial rates as circumstances evolve, and the recurring debate over the proper size of government is settled, resumed and resettled from time to time. However, essential to the concept on which this proposal is based is the additional constitutional rule, in the amendment, that any change in the rate of the GCT, the ECT, the DPIT (until its full phase-out) or the severance tax, would automatically cause a change in the rates of the other three taxes that is exactly proportionate to the respective mathematical relationships among the initial rates of each of those same taxes. Thus, a 5% increase in the rate of the severance tax (from 2.5% to 2.625 %), would also automatically require that the rates of the GCT and the ECT be raised from 5.5%

[41] Indeed, the merits, of employing such "tax triggers" as policy analyst, Jared Walczak of the Tax Foundation described them to the Legislature's Joint Select Committee on Tax Reform in a September 20, 2016 presentation, were, thus, further affirmed as a prudent approach to tax reform.

to 5.775%, and the 3% rate of the limited DPIT (assuming it has not sunset under its own terms) would be increased to 3.15%.

Thus, through a structure, which the voters have overtly endorsed as "fair," the people's representatives in the Legislature would determine, from time to time, the proper level of government spending and taxation in light of evolving circumstances. The fiscal discipline and political accountability imposed by such mandated linkage of the rates of the major taxes would be almost unprecedented in its power to assure that actual levels of government taxing and spending had broad public support. Though certainly rare in the public revenue systems of the states of the U.S., and of nations which are home to free market economies, there are actual examples of that structure to be found.

Specifically, an example of the linked-tax-rate principle can be found very close to home in that it has been constitutionally embedded in West Virginia's own multi-rate property tax classification system for over three-quarters of a century. That is, subject to the maximum rates for each of what are now, functionally, two rate classifications, there is little doubt that the mathematical relationship between class II, on the one hand, and classes III and IV, on the other, must always be one to two. See, e.g. WV Code §11-8-6e(b)(5).[42] Another example of the arrangement could be found in the Midwestern state of Iowa the law of which provides that, "residential and agricultural classes of property are tied together for purposes of determining allowable growth in taxable value."[43]

[42] It is important to note that West Virginia's constitutionally embedded property tax rate classification linkage is cited here, not as an endorsement of the substantive policy it embodies, but solely to recognize the long-standing existence of such a procedural arrangement in a familiar tax structure. In fact, as explained in Section I, *supra*, the author of the Fair 55 Tax Reform Plan© strongly encourages, as an integral aspect of fundamentally reforming the entire structure, a reconsideration of the continuation of those property tax rate differentials, and of their function as maximum rates altogether.

[43] "The Property Tax Landscape" 2012, Taxpayer Association of Central Iowa.

The best example of a full-scale implementation of the linked-tax-rate principle, applied throughout an entire sovereign jurisdiction, is found in the eastern European nation of Estonia. Estonia (population: 1.3 million) is a democratic republic, home to a free market economy and a member of the Organization for Economic Co-operation and Development (OECD). Estonia also excels in competitiveness. Thus, "[a]ccording to [a recent] year's International Tax Competitiveness Index, Estonia has the most competitive tax system in the developed world."[44]

An important aspect of the tax structure of Estonia is a one-to-one ratio between the corporate income tax rate and the personal income tax rate, "[t]he business rate also is 21 percent and it will drop in lock-step with the personal income tax rate."[45] Estonia recently dropped both tax rates to 20 percent, maintaining the proportionality of the two rates.

Another authoritative report recommends that "Congress should look to the example set by Estonia. A tax code that correctly defines business income and eliminates all the biases against saving [and] investment would be a boon to US investment and economic growth."[46]

Wales and Scotland also recently saw legislation which proposed tying together the different bands [brackets] of income tax rates, meaning a change in one would require proportionate changes in all. "The lockstep, for those among you who have better things to do than focus on fiscal devolution, was the clause of the Wales Bill that would have ensured any

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[44] Lundeen, Andrew. "Estonia has the Most Competitive Tax System in the OECD". Tax Foundation, Sept. 2014.

[45] Mitchell, Daniel. "The Global Flat Tax Revolution: A Lesson for Policy Makers". Center for Freedom and Prosperity, Feb. 2008.

[46] Lundeen, *supra*.

change in the basic rate of Welsh income tax had to be mirrored by a similar change in the higher or top rate."[47]

Thus, though there is a paucity of precedent for the synchronized tax rate principle, the best example of a jurisdiction which actually did implement it (Estonia) is highly regarded with respect to the competitiveness of its tax system. Moreover, leading public finance commentators express support for the concept. Specifically, the Mirrlees Review "brought together a high-profile group of international experts and early career researchers to identify the characteristics of a good tax system for any open, developed economy in the 21st century."[48] Mirrlees states that, "too often policy on corporate taxes, personal income taxes, and taxes on savings are designed almost in isolation. The result is inefficiency, complexity, and opportunities for avoidance."[49] Mirrlees suggests looking at the system as an integrated whole. Thus, "the way that different tax rates fit together matters, as does being clear about the role of each tax within the system."[50]

The principle of proportionality among the rates of different taxes emphasizes the way the taxes are integrated in a coordinated system of taxation. Tying the different tax rates together and maintaining proportionality among them is an effective way to preserve the overall structure of a tax system. The Institute of Economic Affairs, a UK-based think tank, suggests "a reduction in corporation tax rates to the basic rate of income tax [and also

[47] Cornock, David, "Tax Powers Bill Clears Hurdle- how many more to come". BBC, Dec. 2014.

[48] "Reforming the Tax System for the 21st Century: The Mirrlees Review". Mirrlees Review, Institute for Fiscal Studies.

[49] Mirrlees, James. "The Mirrlees Review: A Proposal for Systematic Tax Reform". National Tax Journal, Sept. 2012.

[50] Id.

proposes] maintaining the link between the basic rate of income tax and the corporation tax rate as a basic principle of the tax system."[51]

This would have the effect of keeping a one-to-one ratio between the corporation tax rate and the basic rate of income tax. Daniel Goldberg, a professor of taxation law at the University of Maryland, says that, "these top rates should be tied together in structure, so that they could be increased or decreased in later years only simultaneously, not individually or separately."[52]

Such rate synchronization maintains the original balance designed into a coordinated tax structure. Peter Katt, a nationally recognized financial services expert, providing a thoughtful and real-world perspective beyond the public finance academic circle, suggests linking income tax and sales tax. He says, "requiring that any future increases or decreases in either income tax or national sales tax must be done in unison on a proportional basis."[53]. Katt would justify that linkage because it “would give us a greater sense of shared citizenship because every adult would have a stake not only in government spending decisions, but also in how government is funded, while still retaining a sense of fairness necessary to obtain bipartisan support." Also, "[l]inking a very low national sales tax with income tax rates is very visible and combines tax fairness with maximizing the number of citizens with a stake in paying for government."[54]

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[51] Booth, Phillip. "Aligning Corporate Tax and Income Tax- as a prelude to radical reform". Institute of Economic Affairs, March 2012.

[52] Goldberg, Daniel. "The Death of Income Tax", Oxford University Press, May 2013.

[53] Katt, Peter. "Tax Reform Proposals Need Reforming". Journal of Financial Planning, 1996

[54] Id.

CONCLUSION

The late United States Senator, Russell B. Long, who long-served as chairman of that body's Finance Committee, was famous for expressing an approach for tax reform to be "don't tax you, and don't tax me, tax the fellow behind the tree." Only when we abandon that cynical approach to reform of our public revenue systems will we truly achieve a tax system that is respected by all who contribute to it and who, in turn, are benefited by the responsible use of the revenues it generates. Likewise, only when we adopt a simple, transparent system, which effectively fosters private investment, economic growth and expanding opportunities for citizens' self-reliance, should we seek the consent of the governed to collect and expend pubic revenues in their name and for their benefit.