

FISCAL PROSPECTS & ALTERNATIVES: 1976

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A Staff Report To The Revenue Resources and Economic Commission

By

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with

Robert T. Benton Robert J. Griffis

John A. Garka Donald P. Lillywhite

Nancy D. Beistel Michael J. McCarthy

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Ernest F. Love

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Chapter I

SUMMARY

Introduction

This study serves as a framework for analysis to assist the Revenue Resources and Economic Commission in making decisions that will affect virtually every citizen of the Commonwealth. Building this framework for analysis involves making projections, investigating alternatives, and evaluating the results. Final recommendations are not given in this study, since they are the prerogatives of the members of the commission.

The authors are members of the Economic Research Section in the Division of State Planning and Community Affairs and of the Research Division in the Department of Taxation who have been on loan to the commission. The staff's opinions and conclusions are their own and do not necessarily represent the views of the Division of State Planning and Community Affairs, the Department of Taxation, or any other offices of state government.

In order to develop a clearer picture of the direction in which the state is moving in providing for the wants and needs of its citizens, the first chapter of this study presents an introductory overview of the roles of the state as well as the localities in providing for and financing public services, in particular education, health and welfare. Moreover, the first chapter serves as a focus for the entire study by summarizing the highlights of the study, including the state and local fiscal outlook, and by looking at alternative packages for financing present programs and new programs at the state level. To insure brevity and readability, several of the technical discussions involved with these topics are omitted in this summary chapter,

and some of the topics may be discussed out of the sequence in which they appear in later chapters.

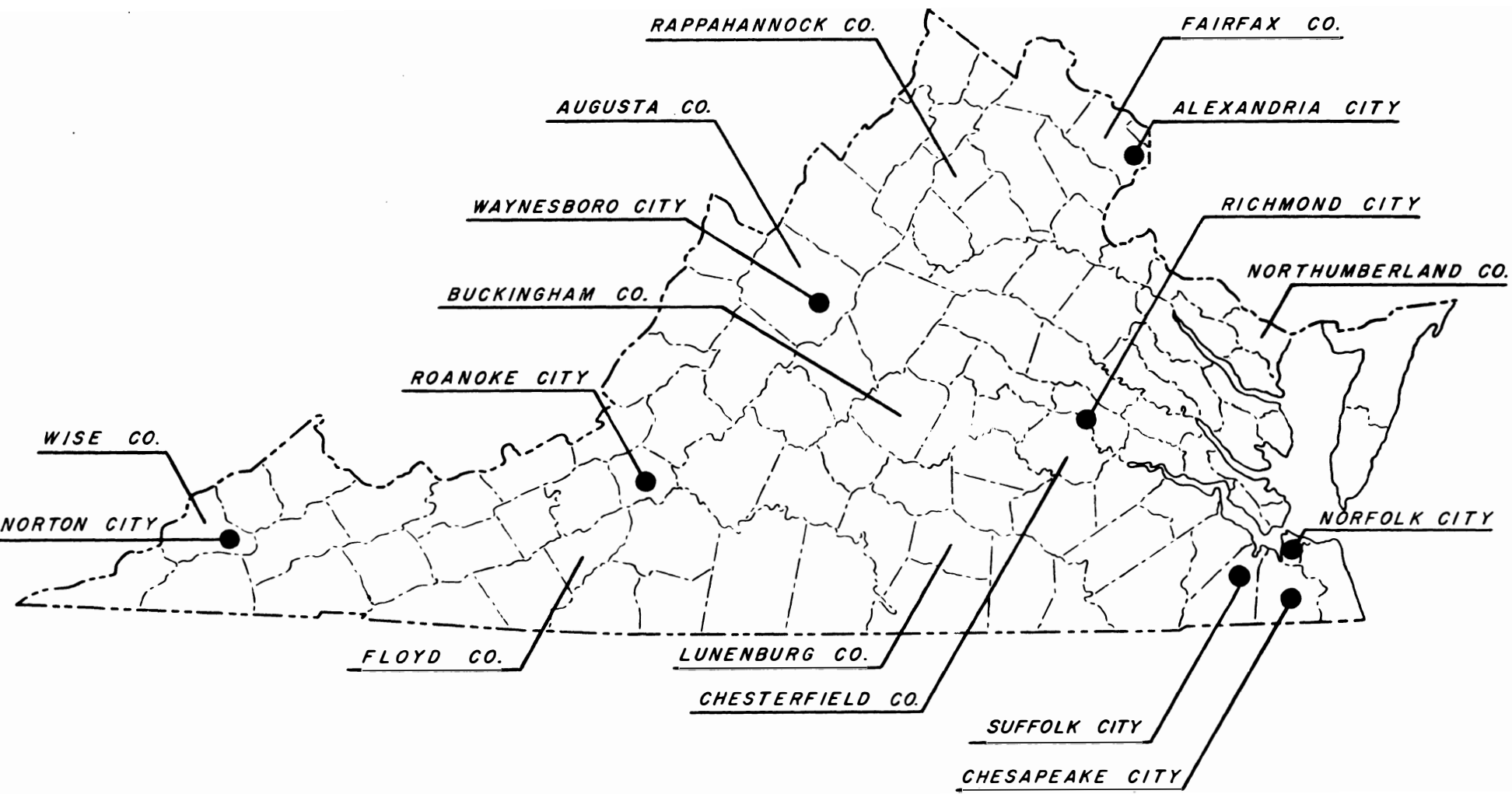
The summary chapter is followed by five major chapters and a statistical appendix. Chapter II provides background on state and local finance, including information on population, income, measures of fiscal effort and capacity, and major features of governmental finance in Virginia. Chapters III and IV furnish revenue and expenditure projections for the state's general fund and explore ways of increasing revenues. Chapter V provides revenue and expenditure projections for local governments, a discussion of central city, suburban, and rural finances, and an analysis of local revenue systems with special emphasis on the real property tax. Chapter VI analyzes new and alternative sources of local revenue, including state aid to localities.

Throughout the study the projection period extends to 1981-82, a seven year period from the current fiscal year or three biennia ahead if measured from the present biennium. At various points in the study, we present data for individual localities. Because of time and space limitations, we could not provide figures for each of the 133 cities and counties. Instead, we use a representative sample of seventeen cities and counties shown in Chart 1.1. The selection of sample areas was based on a desire to show effects due to size, geographic location, city or county status, and degree of urbanization.

The Role of State Government

Domestic responsibilities have traditionally been viewed by the states as their residual powers granted by the United States Constitution. The complexities of twentieth century America as exemplified by an expanding

CHART I.1-CITIES AND COUNTIES IN 17 AREA SAMPLE



economy, increasing urbanization, and the demands of specific segments of the population have, however, strained the boundaries of local, state, and national governments. At the same time, they have led to a recognition by most people for the necessity of an expanded role of government. Problems that once could be solved at the local level have come to require state attention, and those at the state level have come to demand federal attention.

In this overview we emphasize the role of state government in Virginia while recognizing the complementary roles of the federal and local governments. We begin with a brief description of the major roles that a state government performs and then turn to the means used to finance these activities. We continue with a discussion of three significant expenditure areas, education, health, and welfare, in which Virginia's state government participates. We use these to illustrate in historical perspective the interplay of the state's roles. We conclude with some observations on the future responsibilities of state government in Virginia.

Major Roles of State Government

We can view a state government as having three major roles or strategies that are economic as well as political in nature:

1. To provide services demanded by the citizens.
2. To reallocate resources to those geographic areas where the demand is deemed the greatest.
3. To redistribute income among the citizens.

A state government will perform these functions simultaneously and in concert with efforts to remain reasonably fair to the taxpayers, to adjust to rising prices and wages, and to at least not discourage economic growth in the state. To finance its efforts, it must rely on a fiscal system that

has evolved over a bicentennium.

Financing State Government

Under the U. S. Constitution a state has wide taxing powers, as does the national government. In fact, the only taxes explicitly placed off limits to a state are duties on imports and exports and tonnage taxes on ships.^{1/} Aside from these limitations, a state is free to determine for itself its sources of revenue.

Some states have imposed restrictions on themselves and on their political subdivisions by writing prohibitions against certain taxes into their constitutions and statutes. The Virginia constitution segregates for local taxation only real estate, coal and other mineral lands, and tangible personal property, except for the rolling stock of public service corporations. Furthermore, Virginia's constitution provides that all property, except as provided otherwise, is taxable but that all taxes must be uniform upon the same class of subjects within the territorial limits of the authority levying the tax.^{2/}

Although a state may have great latitude in the taxation area constitutionally, in actuality its taxing powers are circumscribed by such considerations as history, economics, politics, voters' attitudes, problems of enforcement, and competition with other states. For these and other reasons, states and localities have come to rely on several major sources of revenue--sales, income, and property taxation.

In 1972-73 the states as a whole derived 17.5 percent of their total general revenues from general sales taxes and 18.6 percent from corporate

^{1/} See the Constitution of the United States, Article I, Section 10.

^{2/} See the Constitution of Virginia, Article X, Sections 1 and 4.

and individual income taxes. Virginia slightly trailed in the sales tax area, deriving 12.7 percent of its total general revenues from this source. It was slightly ahead in income taxes, for 23.4 percent of total general revenues came from this source. Ten years earlier, before Virginia had established a sales tax, the states as a whole derived 16 percent of total general revenues from the sales tax and 13 percent from income taxes. Virginia in 1962-63 received 24.6 percent of total general revenue from income taxes. These figures indicate not only that Virginia's state government in the last decade has found a valuable new revenue source in the sales tax but also that it has continued to rely heavily on the income tax.

Localities in Virginia and nationally have traditionally relied on the property tax as their major single revenue source. Comparison of local revenues between 1962-63 and 1972-73 indicates, however, that reliance on this tax has decreased. In 1962-63 localities nationwide derived 47 percent of their total general revenues from the property tax while a decade later the tax accounted for only 37 percent. For Virginia for the same years it was a decrease from 38 percent to 29.7 percent.^{1/} This decreased local reliance on the property tax does not reflect lower tax rates or diminishing property values. On the contrary, it points out the increased importance of intergovernmental grants, in particular from the federal government, as a source of funds for local governments.

^{1/} Total general revenues comprise all general and special fund revenues from own sources plus intergovernmental grants. For an explanation of the other types of state and local revenues, see Chapters III and IV. These data come from U. S. Department of Commerce, Governmental Finances in 1962-63, G-GF63, No. 2 (Washington, D. C.: Government Printing Office, 1964), pp. 22, 31, 33 and Governmental Finances in 1972-73, GF 73, No. 5 (Washington, D. C.: Government Printing Office, 1974), pp. 31, 33. Virginia income tax data for fiscal year 1962-63 is from Report of the Comptroller to the Governor of Virginia for Fiscal Year Ending June 30, 1963 (Richmond: Department of Accounts, 1963), p. 17.

Such intergovernmental assistance has been in response to the states, which had retained most domestic responsibilities, not having foreseen that the demand for and cost of public services might one day overwhelm their own and their localities' fiscal systems. It reflects a national preference to leave the responsibility for implementation where it is, and to shift financial resources among the three levels of government to support expenditures.

State Expenditures

By 1972-73, total expenditures from all funds (general and special) had exceeded \$2 billion per year for Virginia's state government. Categories with significant amounts of spending were education, health, welfare, transportation, administration of justice, resource and economic development, and general administration. We have selected the first three functional categories to examine the major roles of Virginia's state government because they include the largest single expenditure area (education), as well as perhaps the most controversial (welfare); comprise over one-half of total and four-fifths of general fund outlays; involve significant amounts of intergovernmental assistance; and have had for some years in the case of education and health at least some state involvement.

Education

A major development in the twentieth century has been the rapid increase in the relative importance of state funds to assist in paying the costs of elementary and secondary education as well as higher education. It was not until 1870 that Virginia mandated a statewide public school system to be operated by the local governments. Prior to that time citizens had opposed government funded education on the grounds that it was "charity"

being given by the state, that education should be a church function, and that education was too large a function for state or local government to assume.^{1/} State government involvement at first was minimal. It consisted of creating a State School Board composed of the Governor, the Attorney General, and the State Superintendent of Public Instruction, who was elected by the General Assembly. This board appointed the local superintendent and school boards. Thus, there was some early recognition that the benefits of education spilled over local boundaries and that there should be some state role in the provision of public education.

In the first three decades of the twentieth century, state outlays for education rose significantly, increasing almost fivefold between 1913 and 1930. This growth resulted from many factors, but one nationwide phenomenon was the drop in local revenues because of the Depression and the demand by the public that state government fill the gap.^{2/} Since then, the increases in state aid to education have not abated. As Table 1.1 shows, there has been an enormous rise in the total outlay for education over the last four decades. After putting these expenditures on a per capita basis and deflating them to constant dollars, the table still indicates a definite and continuous effort by state government to stay ahead of population growth and price increases and to improve the scope and quality of public education in Virginia.

In the 1930's and 1940's, the state concentrated on programs to provide direct aid to localities for elementary and secondary education and to support institutions of higher learning. There were almost no efforts to reallocate

^{1/} James E. Pate, State Government in Virginia (Richmond: Appeals Press, 1932), pp. 131-132.

^{2/} Russell W. Maddox and Robert F. Fuquay, State and Local Government (Princeton: D. Van Nostrand Co., Inc., 1962), p. 635.

TABLE 1.1--TOTAL AND PER CAPITA EXPENDITURES OF VIRGINIA STATE GOVERNMENT,
BY MAJOR FUNCTIONS FOR GENERAL AND SPECIAL FUNDS, 1929-30 TO 1972-73

Fiscal Year	Education ^{a/}		Health ^{b/}		Welfare ^{c/}	
	Expenditures	Per Capita Expenditures in Constant (1929) Dollars ^{d/}	Expenditures	Per Capita Expenditures in Constant (1929) Dollars ^{d/}	Expenditures	Per Capita Expenditures in Constant (1929) Dollars ^{d/}
1929-30	\$ 14,959,587	\$ 6.20	\$ 1,036,856	\$.40	\$ 3,919,360	\$ 1.60
1939-40	21,415,764	8.60	1,264,376	.50	7,065,017	2.90
1949-50	73,784,499	12.60	22,563,676	4.80	19,693,742	3.80
1959-60	168,919,546	16.20	43,654,717	5.40	38,430,105	4.50
1969-70	736,868,104	40.40	129,261,942	9.10	113,532,417	8.00
1972-73	1,021,726,196	45.30	258,513,283	15.10	217,440,168	12.70

^{a/} Includes elementary - secondary and higher education and other education.

^{b/} For 1929-30 and 1939-40 includes T. B. sanatoria and other health; for the other fiscal years includes T. B. sanatoria, mental hygiene and hospitals, and other health.

^{c/} For 1929-30 and 1939-40, includes charities (welfare), hospitals (mental), and corrections; for the other fiscal years, includes only welfare aid and services and corrections.

^{d/} These expenditures account for slightly less than half of total expenditures in the first three fiscal years and over half in the last three and include both current and capital outlays. They have been adjusted to constant (1929) dollars by the appropriate price index selected from the implicit price deflator for the purchase of goods and services by state and local governments, the consumer price index, and the medical care portion of the consumer price index and then placed on a per capita basis.

SOURCES: The expenditures from 1929-30 through 1969-70 came from Report of the Comptroller to the Governor of Virginia for Fiscal Year Ending June 30, 19__ (Richmond: Department of Accounts, 19__). The expenditures for 1972-73 came from data collected from the Department of Accounts by the Commission on State Governmental Management. The price indexes were found in Economic Report of the President (Washington, D. C.: U. S. Government Printing Office, 1974), pp. 253 and 300 and U. S. Bureau of the Census, Historical Statistics of the United States, Colonial Times to 1957 (Washington, D. C.: U. S. Government Printing Office), pp. 125-126. The population data came from U. S. Bureau of the Census, Statistical Abstract of the United States: 1974, 95th Edition, (Washington, D. C.: U. S. Government Printing Office, 1974), pp. 12-14.

resources between various regions or localities across the state. Gradually programs evolved whose objectives was to place proportionately more resources in the poorer than in the richer regions of the state; these included for elementary-secondary education the Salary Equalization Fund, the Minimum Educational Program Fund, and finally the first version of the Basic School Aid Fund, which essentially provided relatively more funds to the localities with the lowest fiscal capacity as measured by real property values.

The most significant changes occurred in the 1960's with the introduction of the state sales and use tax in 1966. Quantitatively, Table 1.1 summarizes the period as per capita outlays in constant dollars almost trebled. Several specific changes do, nevertheless, merit attention. The proceeds from one percentage point of the sales tax were to be distributed on the basis of school age population. This was a definite attempt to reallocate financial resources from the prosperous urban and suburban localities with their shopping centers to the poorer localities. (A complement to this was the 1 percent local option sales and use tax that all cities and counties adopted). The community college system began in an effort to bring low cost higher education to all regions of the state. This too represented some reallocation of resources as the poorer regions of the state had their own institutions of higher learning for the first time. It was also at this time that the federal government began to make large categorical grants with a primary goal being to increase the educational opportunities of disadvantaged students.

Since 1972-73, the most significant development has been the consolidation of much aid to elementary-secondary education into the Standards of Quality program. This program mandates a minimum level of expenditure per pupil (\$680 per pupil in 1975-76) and provides aid to a locality in an inverse relation-

ship to its fiscal capacity as measured by its real property values, income, and taxable sales. Again, the result is a greater proportion of state funds flowing to a poorer locality or region of the state than to a rich one.

Thus, we see a definite expansion in the roles of Virginia's state government in the area of education since 1900. For years the state only aided the localities directly in their efforts to provide public education. Over the last quarter century, the state has also worked to equalize inter-regional differences in educational opportunity by using revenues from the richer areas primarily collected through the income and then the sales tax to fund programs designed to aid the poorer areas. In so doing, the state has probably had some indirect impact on the distribution of income, for its programs have benefitted the many lower income persons in these poorer areas.

Health

As with education, government in Virginia did not become involved with maintenance of the public health until the second half of the nineteenth century. By 1860 county government could require any person to be vaccinated at the county's expense.^{1/} With the discovery of germ theory by Louis Pasteur in 1866, public health programs could be based on prevention as well as curing. By 1872 a State Board of Public Health had been created and authorized to adopt rules and regulations to prevent the spread of contagious diseases.

In 1908 the state established a Department of Public Health for educational and publicity purposes while the local governments employed either full health units or at least a sanitary officer to monitor the local health situation.

^{1/} Hening's Statutes at Large, IX, p. 371, in Pate, State Government in Virginia, p. 223.

Since then, there have evolved such centralized programs as the collection of vital statistics, disease control, sanitation, sanitary engineering, diagnostic laboratory services, industrial hygiene, and health education as well as growth of local health services.

As Table 1.1 indicates, the 1960's had the most significant expansion in health services. Two programs stand out. One was the large increase in funding for the local health services program in the latter part of the decade. The state had shared in the funding of this program for years and in the early 1950's had begun to predicate its participation on local ability to pay as determined by real property values. Here again was an effort by the state government to reallocate resources from the richer to the poorer regions of the state. The other was the introduction of medicaid, a federal program with state financial participation, in 1968. Medicaid programs are designed to benefit public assistance recipients and certain medically needy persons and therefore complement the redistribution of income efforts made through the welfare system of transfer payments.

As with education, we see in the health area continuing growth in services once state involvement began. We also can observe similar efforts to undertake the two and even the three major state roles simultaneously.

Welfare

Until the Depression of the 1930's, the welfare or public assistance function was almost entirely a local responsibility. The basic approach had evolved from the English Poor Law of 1601 and relied on county poorhouses and distribution of money and groceries to the poor. Although there was a State Board of Charities and Corrections created in 1908, the state viewed its responsibility as one of providing institutions for the insane and criminal and of providing aid to such groups as the blind and veterans.

With the Depression, local governments were unable to meet the demands of the unemployed for welfare assistance. People realized that such problems spilled over both local and state boundaries. Passage of the Federal Social Security Act of 1935 mandated public assistance programs to help the elderly, the disabled, and the families with dependent children and called for some degree of state administration over them. Funding for these programs was to come predominantly from the federal and state governments. Since then, these programs have grown and have been redefined but have continued to make up the predominant share of public assistance in Virginia. In fact, much of the growth in the scope of welfare in the 1960's found in Table 1.1 reflects state efforts to upgrade the three programs and sharp increases in the number of persons applying for aid to families with dependent children. In January, 1972, the state assumed the local share of the assistance costs for the three programs plus aid to the blind, and in January, 1974, the federal government assumed the total program and administrative costs for aid to the elderly, the disabled, and the blind. These changes indicate an increased awareness that the economic and social costs produced by needy persons cannot be contained in a locality or a state and that only the state and federal governments with their more progressive tax systems centered around the income tax can effect a redistribution of income through transfer payments.

Future Roles for Virginia's State Government

We have suggested three major roles for a state government. From our brief analysis we can make several observations for Virginia:

1. The state government has made a definite and continuing effort to expand the scope and the quality of services provided to the public with a definite upsurge occurring in the 1960's.
2. It has attempted and has probably achieved some reallocation of resources between the various regions of the state,

3. There has been an effort, particularly by cooperating with the federal government, to redistribute income from higher to lower income persons.

Acceptance of the suggested roles in Virginia has evolved over the years and has been the response to public demands created by economic expansion and stagnation, urbanization, and population growth as well as many other social and political factors. Each of the three has had varying degrees of importance in the past, and we shall not try to say here which one should have precedence in the future.

As we look ahead, we do hope that this discussion will help the reader to begin to understand the expected and then the actual results from continuing present programs or substituting new ones. In either case, we must issue several caveats:

1. The demand for public goods and services has consistently grown in the twentieth century, and there is little likelihood that this trend will abate significantly in the near future. Thus, if present state programs are to meet future needs, they must be flexible enough to handle expansion, or new and better programs must be forthcoming.
2. Continuation of the existing federal-state-local mix of programs and roles reflects the present political consensus. Any attempt to modify the mix will require a shift in that consensus.
3. Within a state only the state government can reallocate resources from the richer to the poorer regions or from localities with large capacity and limited burdens to those with limited capacity and fiscal overburden. Any programs that imply such reallocation must therefore look to the state government for resolution.
4. Any efforts by the state government to redistribute income must recognize that the dominant vehicles for redistribution will continue to be the federal personal income tax and federal transfer payments. Over the last quarter century, the system led by this supposedly powerful combination has had only limited success in bringing about a redistribution of income across all income levels. It has had major impact only at the very low end of the income scale.^{1/}

^{1/} Richard A. Musgrave and Peggy B. Musgrave, Public Finance in Theory and Practice (New York: McGraw-Hill, Inc., 1973), pp. 655-657.

We devote the remainder of this chapter to a summary of the study's highlights, including the fiscal outlook of the state and the localities, and to alternative packages for financing present and new programs.

Significant Features of the Study

State Fiscal Outlook

Our discussion of the state fiscal outlook concentrates on the general fund. Even though the general fund currently represents less than half of total state revenues, it is the focus of most of the legislative appropriation process and therefore receive a large amount of attention. Moreover, much of the revenue outside of the general fund comes from the federal government or represents state taxes earmarked for highways.

Revenue Projections

Baseline general fund revenues are projected assuming no change in the present tax structure and rates. The projections are based on the relationship of revenues to predictive variables for each of the major sources. For example, projections of individual income tax receipts are based on projected changes in personal income.

During the 1960's general fund revenue growth received several one-time stimulants such as the adoption of individual income tax withholding, the new sales and use tax, and changes in administrative procedures resulting in an acceleration of collections. Furthermore, the 1960's were a time of economic prosperity with only a minor recession in 1960-61 and the beginning of another in the last few months of the decade. Price inflation, which usually stimulates revenues, was quite moderate in the first half of the decade, but accelerated toward the end. The combined

effect of these factors was a sharp rise in general fund revenues, particularly in the second half of the decade. Instead of growth of about 20 to 22 percent per biennium, revenues rose by 41 percent in 1966-68 and by 46 percent in 1968-70.

In the 1970-72 biennium revenues increased not quite 20 percent, reflecting the impact of the recession and slow recovery in 1970-71, some slowdown in the rate of inflation, and the 1968-70 base for calculating the relative change being swollen by one-time windfalls. Revenues for the 1972-74 biennium rose 32.8 percent, resulting primarily from a continuation of the rapid economic expansion that began in the second half of 1971-72 and lasted into 1973, the high rates of inflation in 1973 and early 1974, increases in the corporate income tax rate from 5 to 6 percent and the individual income tax rate from 5 to 5.75 percent over \$12,000 of taxable income adopted at the 1972 session of the General Assembly, and the introduction of federal general revenue sharing in 1972-73.

The official estimate for the 1974-76 biennium shows a gain of 25.7 percent in large part because of the high rates of inflation that continued from 1974 into 1975 and the economic recovery from the 1974-75 recession that is expected to begin in mid-1975. Our projections for the next three biennia show gains of 30.2 percent in 1976-78, 27.8 percent in 1978-80, and 30.0 percent in 1980-82. Thus, even with the two rate hikes in 1972, general fund revenues will not show percentage gains in the late 1970's and early 1980's as high as those experienced in the last two biennia of the previous decade.

Among the various sources of revenue, the individual income tax will continue to be preeminent. It presently accounts for two-fifths of general fund revenues and is expected to represent one-half by 1980-82. Although

the sales and use tax will continue to rank second in importance, its share of the total is expected to drop from 27 percent in the current biennium to 25 percent in 1980-82.

The baseline forecast assumes that federal general revenue sharing will cease at the end of 1976. Nevertheless, the likelihood is great that the program will be extended until 1982 and that it will provide about \$45 million per year to the general fund.

Furthermore, the forecast assumes that individual income tax conformity to federal law will continue with the 1974 standard deductions and not produce any revenue losses. The federal Tax Reduction Act of 1975 increased the standard deductions for 1975 only but created no fiscal problems for Virginia because of Senate Bill No. 645, which passed at the 1975 session of the General Assembly and froze the standard deductions at their 1974 levels for the present calendar year only. If the Tax Reduction Act provisions are allowed to expire, the federal standard deductions would revert to their 1974 levels, and Virginia would again conform without facing any revenue declines. If, as anticipated, the Congress continues into 1976 and beyond some version of the higher standard deductions allowed under the Act, the expectation would be for the state to offset any revenue shortfall.

Expenditure Projections

We first make baseline projections of maintenance and operating expenditures (current outlays). These forecasts assume no change in the scope or quality of programs but do allow for growth in population-workloads and for price increases. Forecasts of future population-workloads for specific functions (e.g., enrollment in elementary and secondary schools)

were obtained from the appropriate state agencies. The workload figures are crude estimates, and we take full responsibility for them; they should not be confused with more detailed figures used in the regular budget process. Table 1.2 summarizes actual appropriations for the current biennium and projected baseline expenditures for the future. Through the next three biennia elementary-secondary education, higher education, public welfare, and medicaid are expected to account for about three-fourths of operating expenses. For elementary-secondary education, enrollment is projected to decline slightly throughout the projection period. However, the annual rate of inflation will more than offset the enrollment decline and will cause outlays to rise. In other words, the number of students will decrease, but the cost per student will increase. In higher education, expenditures will increase as enrollment grows in all types of institutions. The rate of growth of enrollment is, however, projected to be lower than in recent years. Public welfare outlays will increase more gradually than they have in recent biennia. One factor is the complete federal takeover on January 1, 1974, of the program and administrative costs for old age assistance, aid to the permanently and totally disabled, and aid to the blind. Another is that caseloads are expected to rise in the major, nonfederalized programs but at lower rates than in the past. A factor contributing to growth in public welfare outlays is the anticipated expansion of services under Title XX of the Social Security Act. Outlays for medicaid will grow at a fairly constant rate as the number of recipients increases at an average annual rate of 6 percent. In the other functional categories, the population served is projected to remain nearly constant (mental health) or to increase in proportion to general

TABLE 1.2 --GENERAL FUND OPERATING EXPENSES: ACTUAL APPROPRIATIONS AND PROJECTED EXPENDITURES, 1962-64 TO 1980-82

Operating Expenses	Actual Appropriations							Projected Expenditures		
	1962-64	1964-66	1966-68	1968-70	1970-72	1972-74	1974-76	1976-78	1978-80	1980-82
EDUCATION										
Elementary-Secondary Education	\$280,645,293	\$327,200,480	\$519,817,355	\$686,913,870	\$825,392,410	\$1,004,948,335	\$1,236,341,690	\$1,475,697,000	\$1,621,439,000	\$1,772,771,000
Higher Education	69,749,766	80,395,135	131,337,775	202,894,180	279,746,730	384,420,580	514,767,790	\$659,192,000	\$790,776,000	\$905,667,000
Other Education and Cultural	2,240,020	2,372,890	3,333,370	4,590,190	5,652,590	8,017,700	10,314,300	12,131,000	14,016,000	15,846,000
HEALTH AND WELFARE										
Mental Health	46,721,835	50,674,850	66,116,860	84,729,935	110,848,930	117,749,150	150,271,760	159,765,000	174,756,000	192,199,000
Public Health	21,860,105	23,611,645	32,132,590	40,353,040	55,203,330	60,067,610	71,220,915	81,916,000	93,719,000	107,610,000
Medicaid	...	...	...	20,226,205	57,504,670	110,890,685	150,059,095	198,638,000	248,582,000	307,163,000
Public Welfare	21,648,965	27,400,060	33,013,545	48,364,760	78,211,125	142,016,990	163,325,930	218,359,000	274,393,000	346,176,000
Vocational Rehabilitation	129,245	207,405	2,752,160	4,097,525	5,787,635	6,872,380	8,535,300	9,972,000	11,573,000	13,209,000
ADMINISTRATION OF JUSTICE	36,545,785	39,225,935	67,879,485	90,543,675	120,155,455	157,940,450	242,796,645	292,022,000	337,414,000	383,859,000
RESOURCE AND ECONOMIC DEVELOPMENT	19,716,720	23,259,730	31,479,679	38,467,210	45,890,605	57,910,310	69,475,685	78,579,000	90,794,000	103,292,000
GENERAL ADMINISTRATION AND LEGISLATIVE										
General Administration	18,723,525	20,702,400	29,589,135	38,859,365	49,157,080	59,956,495	74,197,690	87,772,000	101,415,000	115,375,000
Legislative	2,365,180	2,432,835	2,984,955	3,702,010	5,348,850	7,122,220	13,477,075	15,992,000	18,478,000	21,622,000
TRANSPORTATION	2,821,940	2,863,510	4,156,010	4,244,620	8,146,615	8,578,770	7,164,510	8,130,000	9,394,000	10,687,000
UNALLOCATED BY FUNCTION										
Employee Benefits	11,588,835	12,701,385	23,443,890	28,002,255	32,843,380	62,211,655	80,851,175	96,866,000	111,946,000	127,356,000
State Aid to Localities--Shared Revenues	...	...	25,140,000	25,890,000	28,476,000	33,600,000	41,100,000	57,082,000	44,267,000	46,826,000
Debt Service	1,730,000	225,000	130,000	5,000	18,716,600	17,794,400	16,657,600	15,608,000	14,564,000	13,592,000
Other	2,439,395	8,962,500	4,554,885	15,948,120	25,508,170	32,940,445	65,614,270	95,878,000	110,752,000	126,631,000
TOTAL OPERATING EXPENSES	\$538,926,609	\$622,235,760	\$977,851,694	\$1,337,832,160	\$1,752,590,175	\$2,273,038,175	\$2,916,171,450	3,563,619,000	4,068,308,000	4,600,878,000

SOURCE: Table 4.20

population growth (e.g., public health, vocational rehabilitation, and resource and economic development), which is expected to be 1.3 percent per year through 1980 and 1.2 percent per year thereafter.

After obtaining baseline projections, we rework the data to yield forecasts that allow for increases in maintenance and operation expenditures because of improvements in scope and quality. These are defined as new programs or expansion of old ones. For example, an increase in state aid to elementary-secondary education would be an expansion in scope and quality. Scope and quality expenditures grew by roughly 6 percent annually between fiscal 1968 and fiscal 1974 and, on average, we anticipate a similar growth rate for our forecast period.

Projections of current outlays without allowance for capital outlays are unrealistic, particularly if one allows for increases in scope and quality. Two sets of projections are made for capital outlays. The first assumes that only baseline maintenance and operation expenditures will be made. The second assumes that such expenditures will be increased to allow for changes in scope and quality. Both sets are projected by assuming that capital outlays will represent about 6.3 percent of current outlays.

Revenue-Expenditure Gaps

We have discussed the method for deriving the baseline revenue projection and four projections of expenditures. Combining them yields the results presented in Table 1.3. Chart 1.2 displays graphically the

TABLE 1.3.--SUMMARY OF GENERAL FUND REVENUES AND EXPENDITURES,
1976-78 TO 1980-82 BIENNIA
(Millions of Dollars)

	<u>1976-78</u>	<u>1978-80</u>	<u>1980-82</u>
Baseline revenues	\$3,882.2	\$4,960.0	\$ 6,448.7
Expenditures			
Baseline	3,563.6	4,068.3	4,600.9
Scope and quality	3,891.7	4,883.5	6,122.3
Baseline plus capital outlay	3,788.1	4,324.6	4,890.8
Scope and quality plus capital outlay	4,136.9	5,191.2	6,508.0
Gap			
Baseline	+318.6	+891.7	+1,847.8
Scope and quality	- 9.5	+ 76.5	+ 326.4
Baseline plus capital outlay	+ 94.1	+635.4	+1,557.9
Scope and quality plus capital outlay	-254.7	-231.2	- 59.3

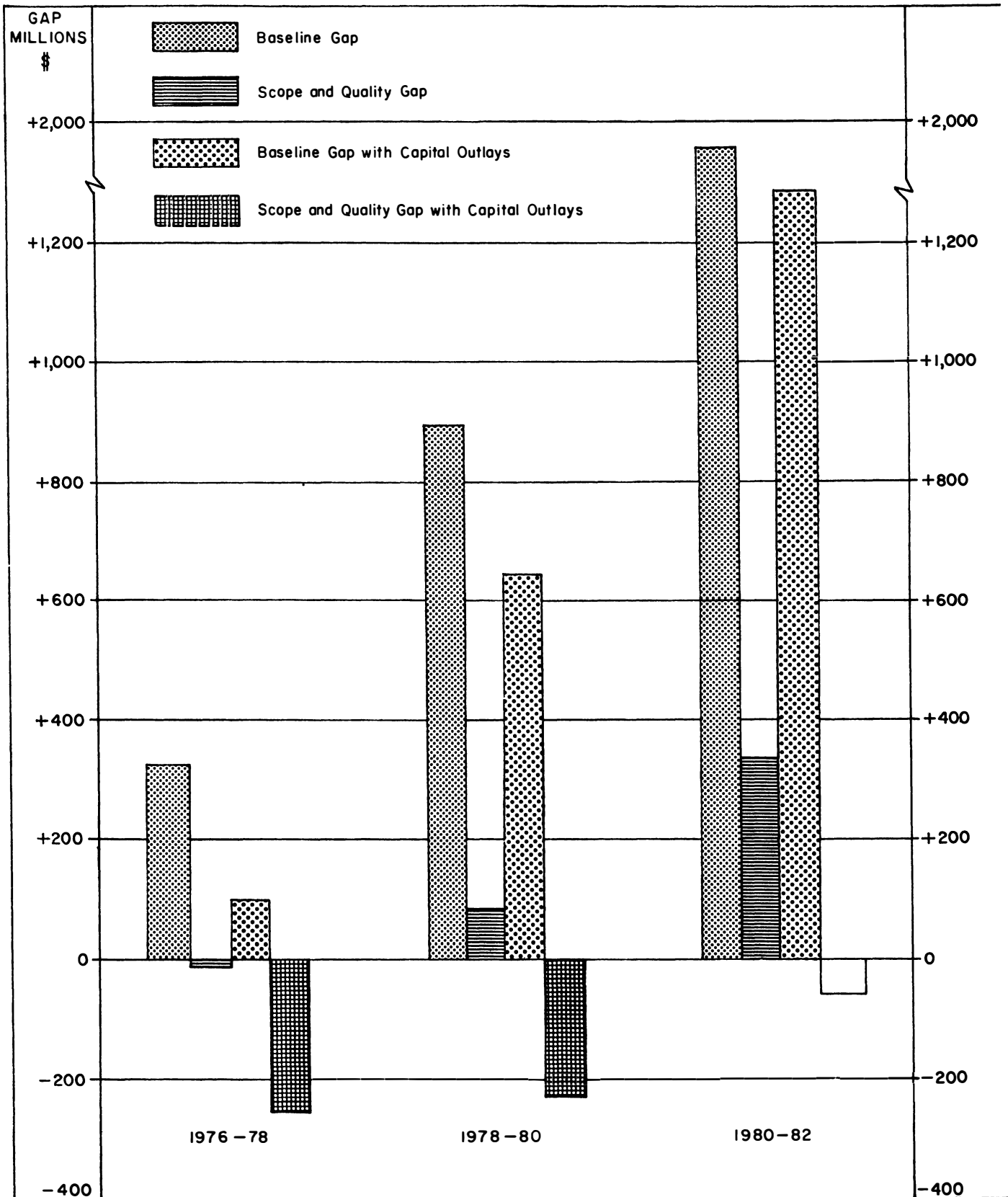
SOURCE: Tables 3.7 & 4.20, pp. 342, 346.

"gaps: (revenues minus expenditures) that are projected. In the next three biennia we project in all but one case positive gaps or surpluses for each of the first three concepts. For the scope and quality gap in 1976-78 we have a small negative gap or deficit of -\$9.5 million. For the fourth and broadest concept, scope and quality plus capital outlay, we forecast deficits in each of the next three biennia, -\$254.7 in 1976-78, -\$231.2 in 1978-80, and -\$59.3 in 1980-82.

The gaps forecast are projections based on reasonable assumptions but are, of course, subject to error. Such a residual measure is particularly sensitive to estimating errors, since a small change in projected revenues or expenditures will have a magnified impact on the gap. In addition, the short-run forecasts are generally more accurate

CHART 1.2

GENERAL FUND REVENUE EXPENDITURE GAP - BIENNIUMS 1976-78 TO 1980-82



Note: Gap equals projected revenues minus projected expenditures.

than the long-run forecasts.

Another note of caution in evaluating the gaps is that the methodology for the expenditure projections has an upward bias. It assumes that all current expenditure programs will continue at baseline levels or will be expanded for improvements in scope and quality. There is no allowance for new priorities that would lower or eliminate expenditures on some programs. Moreover, there is no provision for new, lower cost methods of fulfilling program requirements.

In our previous efforts to determine the fiscal outlook for the state, Fiscal Prospects and Alternatives, published in 1971, and Fiscal Prospects and Alternatives: 1974, published in 1973, we have found that the scope and quality plus capital outlay expenditure forecast best approximates the actual general fund budget of the Commonwealth. Using this concept in 1971, we projected for 1972-74 expenditures of \$2,384.0 million and a \$321.3 million deficit with the tax structure and rates existing at the time. The budget proposed to the 1972 session of the General Assembly called for \$2,495.2 million in appropriations and income tax rate hikes of \$215 million to make up the anticipated shortfall in revenues. The General Assembly pared appropriations to \$2,375.6 million but still had to increase the corporate and individual income tax rates enough to cover a gap estimated at \$85 million. With the introduction of federal general revenue sharing in late 1972, and the willingness of the 1973 session of the General Assembly to appropriate some of those monies, appropriations rose to \$2,450.4 million for 1972-74. In 1973, we projected for 1974-76 scope and quality plus capital outlay expenditures of \$3,048.4 million and a surplus of +\$44.5 million. The budget approved by the 1974 session

of the General Assembly had \$2,974.3 million in appropriations and no tax increases. Adjustments at the 1975 session increased total appropriations to \$2,990.9 million.

New Revenue Sources and Borrowing

If the scope and quality plus capital outlay gaps are accurate, there are three ways to make up the deficits--reduce expenditures, raise taxes, or borrow for capital outlay. If there were in addition a desire to undertake large, new programs, these two would require additional revenue. We discuss below alternative means of raising more revenue and the state's borrowing potential.

New Revenue Sources

Table 1.4 summarizes the revenue potential of modifications in several general fund revenue sources. Since nearly three-fourths general fund is expected to come from two sources--the individual income tax and the sales and use tax--significant demands for more revenue would require raising one or both of them.

Under the individual income tax, one issue requiring resolution will be continued conformity to the federal structure. If, as seems most likely, Congress extends to 1976 and beyond the higher standard deductions allowed for the current year under the Tax Reduction Act of 1975, revenues would decline 3 percent per year. The alternatives proposed by President Ford and the House Ways and Means Committee prior to the passage of the 1975 Act would each cause a 6.2 percent annual loss. One way to offset any decline would be to adjust the rates.

TABLE 1.4--PROJECTED REVENUES FROM ALTERNATIVE,
CHANGES IN REVENUE STRUCTURE AND/OR RATES,
1976-78 BIENNIUM
(Millions of Dollars)

Revenue Source	1976-77		1977-78	
	Projected Revenue	Change from Present Tax	Projected Revenue	Change from Present Tax
CORPORATIONS--INCOME TAX				
Present structure; present 6% rate	\$ 133.9	...	\$ 155.0	...
Present structure; 7% rate	162.6	+28.7	180.8	+25.8
INDIVIDUALS AND FIDUCIARIES--INCOME TAX				
Present structure:				
Present rates	810.2	...	977.6	...
Rate schedule A	886.6	+76.4	1,047.0	+69.4
Rate schedule B	901.7	+91.5	1,060.7	+83.1
Rate schedule C	928.6	+118.4	1,085.1	+107.5
Rate schedule D	1,013.6	+203.4	1,162.4	+184.8
Structure based on the Tax Reduction Act of 1975:				
Present rates	785.9	-32.3	948.3	-29.3
Rate schedules E, F, G, and H	810.2	...	977.6	...
Rate schedule J	866.2	+56.0	1,028.4	+50.8
Rate schedule K	944.7	+134.5	1,099.8	+122.2
Rate schedule L	955.5	+145.3	1,109.6	+132.0
Rate schedule M	989.9	+179.7	1,140.9	+163.3
Structure based on President Ford's plan:				
Present rates	760.0	-66.7	917.0	-60.6
Rate schedule I	810.2	...	977.6	...
Rate schedule N	906.0	+95.8	1,064.6	+87.0
Rate schedule O	938.3	+128.1	1,093.9	+116.3
Rate schedule P	955.5	+145.3	1,109.6	+132.0
Rate schedule Q	1,026.5	+216.3	1,174.1	+196.5
Structure based on the House Ways and Means Committee plan:				
Present rates	760.0	-66.7	917.0	-60.6
Rate schedule I	810.2	...	977.6	...
Rate schedule N	906.0	+95.8	1,064.6	+87.0
Rate schedule O	938.3	+128.1	1,093.9	+116.3
Rate schedule P	955.5	+145.3	1,109.6	+132.0
Rate schedule Q	1,026.5	+216.3	1,174.1	+196.5
Taxation of 100 percent of all capital gains			An additional \$10 to \$15 million in each fiscal year	
Elimination of the Virginia dividend exclusion			An additional \$3 to \$5 million in each fiscal year	
TAX CREDIT TO COMPENSATE FOR SALES TAX ON FOOD (EXCLUDING LOCAL OPTION)				
\$22 credit per exemption	-103.1	-103.1	-104.5	-104.5
\$22 credit per exemption but limited to AGI of under \$10,000	-55.1	-55.1	-55.8	-55.8
\$22 credit per exemption but limited to AGI of under \$7,000	-39.8	-39.8	-40.3	-40.3
STATE SALES AND USE TAX (EXCLUDING LOCAL OPTION)				
Present structure; present rate	486.4	...	552.7	...
Present structure; 4% rate	637.0	+150.6	736.9	+184.2
Excluding food purchases; present rate	378.4	-108.0	420.6	-132.1
Excluding food purchases; 4% rate	493.0	+6.6	560.8	+8.1
Excluding food and nonprescription drugs; present rate	371.2	-115.5	411.8	-140.9
Excluding food and nonprescription drugs; 4% rate	483.4	-3.0	549.0	-3.7
Adding selected services; present rate	529.8	+43.4	605.8	+53.1
Adding selected services; 4% rate	694.8	+208.4	807.7	+255.0
INHERITANCE TAX				
Present structure; present rates	21.9	...	23.0	...
Present structure:				
Rate schedule 1	24.3	+2.4	27.1	+4.1
Rate schedule 2	25.5	+3.6	29.2	+6.2
Rate schedule 3	25.4	+3.5	29.0	+6.0
Rate schedule 4	23.5	+1.6	25.8	+2.8
Present structure with inclusion of insurance; present rates	23.0	+1.1	24.9	+1.9
TOBACCO PRODUCTS TAX				
Present structure; present rates	19.1	...	20.5	...
Present structure; 5 cent rate; no change in sales	38.2	+19.1	41.0	+20.5
Present structure; 5 cent rate; 5% drop in sales	36.3	+17.2	38.9	+18.4
Present structure; 5 cent rate; 10% drop in sales	34.4	+15.3	36.9	+16.4
Present structure; 5 cent rate; 20% drop in sales	30.6	+11.5	32.8	+12.3

TABLE 1.4--PROJECTED REVENUES FROM ALTERNATIVE
CHANGES IN REVENUE STRUCTURE AND/OR RATES,
1976-78 BIENNIUM
(Millions of Dollars) (Continued)

Revenue Source	1976-77		1977-78	
	Projected Revenue	Change from Present Tax	Projected Revenue	Change from Present Tax
ALCOHOLIC BEVERAGES STATE TAX				
Present structure; present 14% rate	31.2	...	33.0	...
Present structure; 15% rate	33.2	+2.0	35.1	+2.1
BEER AND BEVERAGE EXCISE TAX				
Present structure; present rates	24.2	...	26.6	...
Present structure; 25% increase in rates	29.2	+5.0	32.8	+6.2
CROWN TAX ON SOFT DRINKS				
Average per capita revenue of states with the tax	10.4	+10.4	12.0	+12.0
PARI-MUTUEL BETTING AND LOTTERY				
Pari-mutuel betting	From two racing facilities the state could expect about \$3 million in the first year of operation, \$7.5 million after two or three years, and around \$10 million after five years. Only the \$3 million figure might be achieved in the next biennium.			
Lottery	Estimated receipts for a year range between \$12 million and \$20 million depending on the degree of public acceptance.			

Note: For a summary of the methodology, see notes to Table 3.46. For additional detail, see the discussion of each source in Chapter III.

Table 1.5 provides four alternatives, Rate Schedules E, F, G, and H, that just eliminate the impact of the Tax Reduction Act changes. The table then gives four others, Schedules J, K, L, and M, that not only resolve the conformity issue but also produce additional revenues ranging from about \$50 to \$160 million per year.

An increase in the state sales tax rate from 3 to 4 percent would produce another \$150.6 million in 1976-77 and \$184.2 million in 1977-78. Making the sales tax applicable to selected services not presently taxed would expand the base by nearly 10 percent and lead to additional revenues of \$43.4 million in 1976-77 and \$53.1 million in 1977-78. If food for home consumption and nonprescription drugs were excluded from the sales tax base, revenues would decline by about one-fourth, or \$115.5 million in 1976-77 and \$140.9 million in 1977-78. Application of the 4 percent rate to the lowered base would come within \$3 to \$4 million per year of offsetting this loss.

An alternative form of relief for the sales tax paid on food and nonprescription drugs would be an individual income tax credit. It would avoid the administrative costs and difficulties that exclusion would involve. In the next biennium a \$22 credit per exemption for Virginia residents would cost \$103 to \$104 million per year. Limiting the credit to eligible persons with adjusted gross incomes under \$10,000 would reduce the cost to about \$55 million per year. A \$7,000 income constraint would further

TABLE 1.5-RATE SCHEDULES TO OFFSET THE REVENUE LOSS UNDER THE TAX REDUCTION OF 1975 AND TO RAISE ADDITIONAL REVENUE UNDER THE TAX REDUCTION ACT OF 1975

Present Rate Schedule

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	5%
over - \$12,000	5.75%

Alternative Rate Schedules to Offset Revenue Loss Under the Tax Reduction Act of 1975

Schedule E

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 2,000	2%
\$ 2,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	5%
over - \$12,000	5.75%

Schedule F

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	5%
over - \$12,000	6.75%

Schedule G

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	5%
\$12,001 - \$20,000	6%
\$20,001 - \$30,000	7%
over - \$30,000	8%

Schedule H

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$10,000	5%
\$10,001 - \$25,000	6%
\$25,001 - \$50,000	7%
over - \$50,000	8%

Alternative Rate Schedules to Raise Additional Revenue Under the Tax Reduction Act of 1975

Schedule J

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	5%
\$12,001 - \$20,000	7%
\$20,001 - \$30,000	8%
over - \$30,000	9%

Schedule K

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$10,000	6%
\$10,001 - \$25,000	7%
\$25,001 - \$50,000	8%
over - \$50,000	9%

Schedule L

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	6%
over - \$12,000	8%

Schedule M

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 2,000	2%
\$ 2,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	6%
over - \$12,000	8%

reduce the cost to \$40 million per year.^{1/} Rate Schedules J through M would produce the additional revenue necessary to offset these varying costs.

There are other ways to raise small amounts of additional revenue mentioned in Table 1.4 that would also improve the horizontal or vertical equity of the tax structure. These include taxation of 100 percent of capital gains, elimination of the Virginia dividend exclusion, and changing the present inheritance tax rate schedule. An alternative to the present system of retirement income tax relief might not produce more revenue but could lead to a more equitable approach than the one provided by the existing array of exclusions.

Borrowing

It is not necessary to finance all capital outlays from general fund revenues; general obligation borrowing could be another source. Under the present constitution, limitations for general obligation borrowing have been liberalized to allow more borrowing. Under a conservative interpretation of the constitutional formula, the following maximum amounts of borrowing could be authorized:

<u>Year</u>	<u>Millions of Dollars</u>
1976	\$268.0
1978	87.7
1980	126.3

SOURCE: Table 4.25.

^{1/} We follow conventional terminology in calling the proposal a "credit." Actually, it would not be a credit, since all eligible persons would be entitled to the full amount regardless of their tax liability.

Thus, the new debt provisions will permit large new borrowings in the next three biennia if the General Assembly and the voters wish to use the maximum authority. Only in the 1976-78 biennium, however, could the maximum debt that could be authorized (\$268.0 million) completely substitute for general fund revenues as a method of financing projected capital outlays (\$245.2 million with \$224.5 million in baseline capital outlays and \$20.7 million in scope and quality capital outlays). In the last two biennia, maximum debt authorizations would cover only about 30 percent of projected capital outlays. Of course, any new authorized debt would have to be serviced out of general fund revenues. We project the following amounts for debt service in the next three biennia if the maximum amount of general obligation borrowing were authorized:

<u>Biennium</u>	<u>Millions of Dollars</u>
1974-76	\$27.4
1976-78	62.1
1978-80	80.7

SOURCE: Table 4.26.

Local Fiscal Outlook

State and local finances are closely intertwined--localities are limited to revenue sources permitted by the state, and many of their expenditure programs depend upon state aid in the form of cash transfers or services rendered. In order to obtain some idea of future requirements at the local level, we make projections of local revenues and expenditures to complement the state's general fund projections.

Local Revenue Projections

We project local baseline revenues from own sources by using a methodology similar to the one developed for projecting state general fund revenues. For state transfers from the general fund, we use figures developed for that fund, and we use a variety of techniques for other types of federal and state aid.

According to our projections, local revenues will grow at an average annual rate of 8.2 percent during the next seven years. This compares with an annual growth rate of 13.8 percent from 1967-68 to 1972-73. The major reason for the difference is that the projections make no allowance for increases in tax rates which contribute to revenue growth in the earlier period. Separating revenues into their two major components, we project a 11.4 percent average annual increase in local sources and a 6.1 percent annual increase in state and federal transfers, which include federal general revenue sharing.

Local Expenditure Projections

The basic projection methodology is the same as for general fund outlays, but we merge current and capital outlay expenditures because of a lack of detailed data. From 1974-75 to 1980-81, total baseline plus capital outlay expenditures are projected to grow at an average annual rate of 6.0 percent. During this time, education, public welfare, police and fire protection, and sewerage and sanitation will remain the major expenditure items and will account for nearly three-fourths of total expenditures by fiscal year 1981-82. Scope and quality changes are allowed for by assuming a 4.2 percent average annual increase in

the baseline projections of outlays financed from own sources in fiscal year 1973-74.

Local Revenue-Expenditures Gaps

Negative baseline gaps are anticipated for 1974-75 and 1975-76 and positive baseline gaps are projected for each year of the projection period thereafter. With allowance for scope and quality changes, however, all projected gaps show negative amounts (see Table 1.6 and Chart 1.3). These estimated gaps for local governments are subject to the same limitations as previously mentioned with respect to the state's general fund.

The projected gaps assume no borrowing--a rather unrealistic premise if one considers the past behavior of Virginia local governments which have regularly borrowed for capital outlays. If local governments increase their debt at a rate consistent with past growth (about 8.4 percent annually), then the following amounts will be available from borrowing in each fiscal year:

<u>Fiscal Year</u>	<u>Borrowing</u> (Mil.)	<u>Less Allowance</u> <u>for Debt Service</u> (Mil.)	<u>Amount</u> <u>Available^{a/}</u> (Mil.)
1975-76	\$213.0	49.9	163.1
1976-77	\$230.9	73.3	157.6
1977-78	\$250.3	98.3	152.0
1978-79	\$271.3	124.8	146.5
1979-80	\$294.1	153.2	140.9
1980-81	\$318.8	183.3	135.5
1981-82	\$345.6	215.5	130.1

^{a/} Although debt service costs would come from current outlays, we have assumed that they would have the effect of reducing total funds available for financing a negative gap.

SOURCE: Table 5.13.

TABLE 1.6--SUMMARY OF LOCAL GOVERNMENT REVENUES AND EXPENDITURES
 FISCAL YEARS 1973-74 TO 1981-82
 (Millions of Dollars)

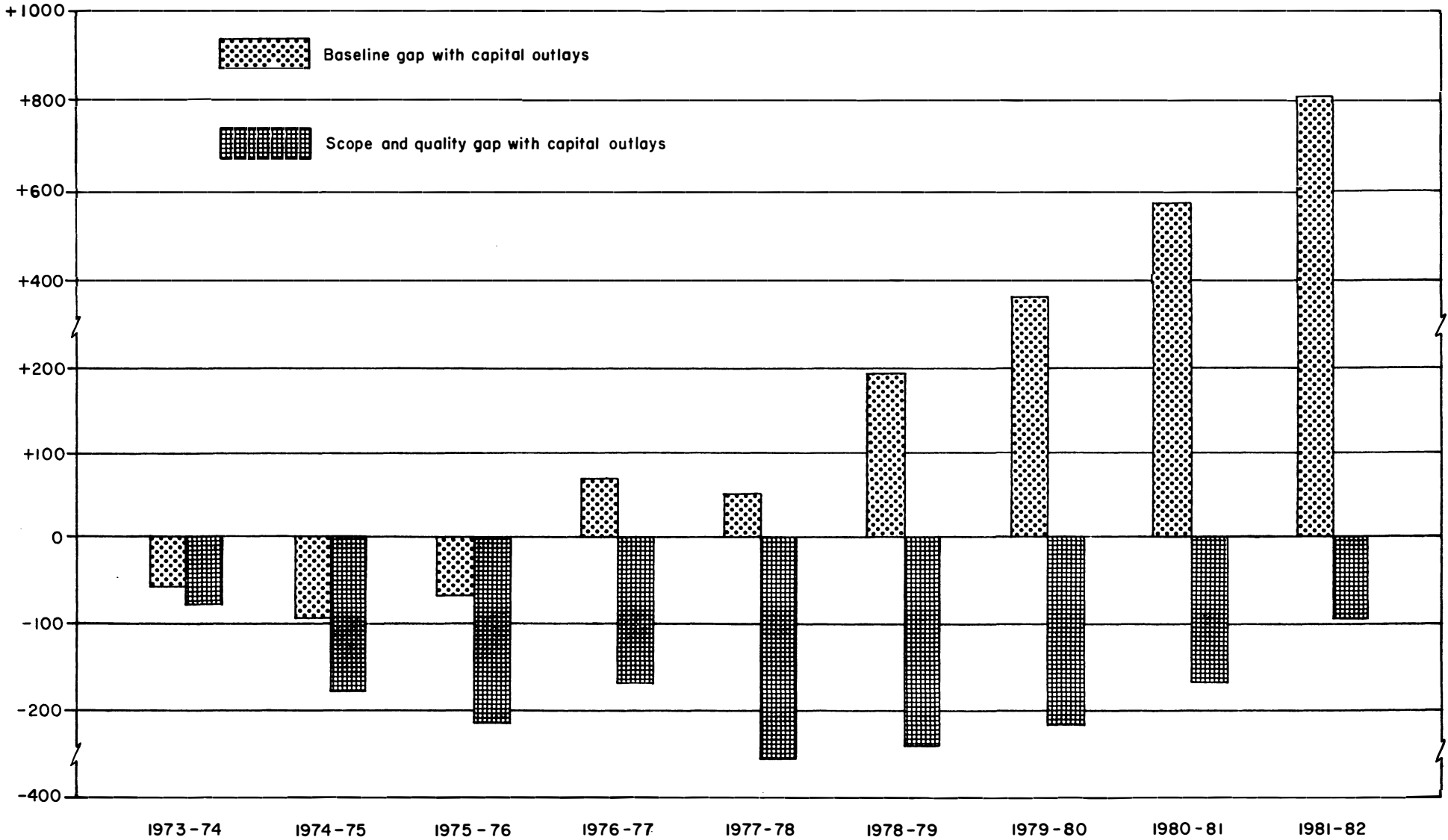
	<u>1973-74</u>	<u>1974-75</u>	<u>1975-76</u>	<u>1976-77</u>	<u>1977-78</u>	<u>1978-79</u>	<u>1979-80</u>	<u>1980-81</u>	<u>1981-82</u>
Revenues	\$2,349.0	\$2,574.3	\$2,825.7	\$3,206.1	\$3,379.9	\$3,695.7	\$4,035.6	\$4,424.3	\$4,828.6
Expenditures									
Baseline plus capital outlay	2,405.9	2,671.2	2,893.3	3,133.0	3,328.1	3,497.1	3,667.7	3,850.3	4,024.9
Scope and quality plus capital outlay	2,425.6	2,751.3	3,048.7	3,369.4	3,689.0	3,971.8	4,268.8	4,591.9	4,923.2
Gap									
Baseline plus capital outlay	- 56.9	- 96.9	- 67.6	+ 73.1	+ 51.8	+198.6	+367.9	+574.0	+803.7
Scope and quality plus capital outlay	- 76.6	-177.0	-223.0	-163.3	-309.1	-276.1	-233.2	-167.6	- 94.6

SOURCES: Tables 5.10 and 5.12.

CHART 1.3

LOCAL GOVERNMENT REVENUE EXPENDURE GAP - FISCAL YEARS 1973-74 TO 1981-82

GAP
\$ MILLIONS



Note: Gap equals projected revenues minus projected expenditures.

Such borrowing could substitute for the use of current revenues for capital projects.

Another factor to consider is that the baseline revenue projections allow for no new taxes and no changes in the structure or rates of existing taxes. An increase in the rates on major tax bases (i.e. property taxes, gross receipts taxes, the 1 percent local option sales tax, etc.) would offer a substantial increase in local revenues even if these rates were only raised by a modest amount. Also, any new federal and state aid would be additional sources of revenue not included in the baseline revenue projections.

The fiscal projections in this study are for all local governments, and the estimates are done on an overall, not an additive, basis. The projections therefore do not necessarily indicate the financial outlook for a particular city or county. In fact, based on information in this study and other reports, it appears that the fiscal outlook for large central cities is not as optimistic as for local governments in general.

Chapter VI covers the principal devices that the state could use to assist local governments, and a synopsis is provided here. Before mentioning them, we must discuss the real property tax--the most important source of local revenue. In many localities the tax has not been administered in an equitable or efficient manner. Different classes of property such as residential, commercial, and farm property have been assessed at different ratios, and even within classes, ratios have shown large differences. Even today only 19 cities and 9 counties employ full-time assessors, and many localities assess only as required by law--every four

years for cities and every six years for counties. The Revenue Resource and Economic Commission recognized these problems in 1974 and recommended after substantial study nine property tax reform bills to the 1975 session of the General Assembly. The General Assembly passed these bills within the basic framework recommended by the commission. They included: (1) requiring the maintenance of an inventory and assessment of all real property exempt or immune from taxation; (2) requiring that property owners be notified of any changes in assessment; (3) making all property appraisal cards or sheets, excluding those with confidential information, open to public inspection and all working papers for an individual taxpayer open to his inspection; (4) requiring the establishment of a training program by the Department of Taxation for voluntary use by assessing personnel; (5) requiring the preparation and issuance by the State Tax Commissioner of an annual assessment/sales ratio study for each major class of property in localities; (6) having the State Tax Commissioner establish a real property classification system to be placed in the local land books for use in the annual ratio studies; and (7) requiring that all real property be assessed at 100 percent of fair market value except public service corporation property assessed under §58-512.1 (the "Bemiss Act"). Areas that still warrant study include: (1) methods to improve the review and appeal procedures at both the local and state levels; (2) a shortening of the assessment cycle, which is currently six years for counties and four years for cities; (3) the imposition of a statewide severance tax on minerals in lieu of the current property tax on minerals in the ground; (4) the examination

of alternatives to the current property based service charge on exempt property; and (5) the evaluation of statewide mass appraisal. In addition, some attention could be given to property tax relief plans for the elderly such as the various circuit-breaker proposals.

State Aid to Localities

If the state wishes to increase aid to localities, it can do so in a variety of ways that fall under three broad categories--participating in local expenditure programs, revenue sharing, and provision of new local tax powers.

Participation in Local Expenditure Programs

The state already plays a major role in financing local governments. In 1972-73, 36 percent of local funds came from the state government either as appropriations of state funds or as federal revenues passed through the state government. There are numerous programs receiving state aid and many possibilities for expansion. We shall limit our analysis to four important areas--education, welfare, health, and highways.

Education

Education is the largest category of expenditure in local budgets, and, statewide, the state government bears about 41 percent of the cost. For 1973-74 the major types of state aid were the basic school aid fund, the local share of the state sales and use tax, and state paid fringe benefits. Together these programs accounted for \$9 out of every \$10 of state aid. For the 1974-76 biennium, on the other hand, a new method

for distributing state aid was developed to meet the state constitutional requirements for funding the actual cost of quality education. Major concepts incorporated into this new aid program are: (1) a new measure of local fiscal capacity which includes local personal income and taxable sales in addition to the true value of real estate; (2) a new formula that incorporates the new local fiscal capacity measure and the standards of quality cost per pupil; (3) aid for compensatory education that is distributed on the basis of reading test scores; (4) incentive grants for those localities that expend more than the standards of quality cost; (5) recognition of differences in local costs, particularly as these costs relate to exceptional pupils; and (6) a new method of funding teacher fringe benefits at the state level.

Welfare

Welfare funding has become more and more a federal and state responsibility. On January 1, 1972, the state assumed the local share of welfare assistance costs for old age assistance, aid to the permanently and totally disabled, aid to families with dependent children, and aid to the blind. On January 1, 1974, the federal government took over the program and administrative costs for old age assistance, aid to the permanently and totally disabled, and aid to the blind. Localities will continue to be responsible for their share of public assistance costs for the three state-local programs--general relief, foster care and hospitalization of the indigent--and some administrative costs. Complete state take-over of local welfare costs would have cost the state about \$11.7 million in

1973-74 and would have primarily helped the central cities with their high welfare loads.^{1/}

Health

The State Department of Health now operates all local health departments with the state bearing the major share of their costs. The state share varies from 55 percent to 82 percent of the costs depending upon local ability to pay as measured by the true value of real property. Generally, the central cities pay larger percentages of cost than rural areas. A new method of deriving local shares could be developed which would have all localities paying the same share. Ninety percent funding by the state in 1973-74 would have required an additional \$12.4 million.

Highways

Highways are an important cost item to the municipalities and two counties that maintain their own systems. Revisions could be made in the level and method of funding. A switch from the present 2 to 3 ratio of local to state funding to a one to one ratio would have provided about \$11 million extra in fiscal year 1972-73 for local governments maintaining their own highways.

^{1/} This estimate assumes the circumstances that prevailed as of January 1, 1974. As of that date the federal government became responsible for all administrative and program costs for old age assistance, aid to the permanently and totally disabled, and aid to the blind.

Revenue Sharing

The term "revenue sharing" is now popularly associated with the federal program, but the concept also applies to state government. In Virginia, we already have revenue sharing with the sales and use tax, A.B.C. profits, and the wine and spirits tax. Although additional revenue sharing could be applied to many sources of revenue, we concentrate on the two largest sources, the individual income tax and the sales and use tax. An increase in the individual income tax could be shared with localities with the amount available depending on the increase in rates. Table 1.4 indicates the additional revenues that various alternative rate schedules would produce in the next biennium. How to distribute the money is the big question with this or any other proposal for revenue sharing. Distribution on the basis of taxpayer residence would help the higher income localities. A per capita distribution would help lower income localities. Distribution by place of primary employment would help central cities that have a large number of net in-commuters.

A 1 percentage point increase in the state sales and use tax could be shared with localities in the same way as the existing local share (on the basis of school age population) or a new allocator such as place of sale could be used. The latter approach would, of course, be preferred by central cities and other areas with well developed retail sales centers. The amount available for distribution would be about \$150 million in fiscal year 1976-77.

New Local Tax Powers

Local governments receive their taxing powers from the state, and, as a consequence, they are subject to several statutory limitations. For

example, they are not permitted to levy taxes on income, and they cannot impose a sales and use tax exceeding 1 percent.

If it were felt desirable to expand local tax powers, there are several possibilities including, but not restricted to, a local surtax on the state individual income tax (a so-called "piggyback" tax), another 1 percent local option on the sales tax, a local crown tax, a local motor fuels tax, and a local motor vehicle sales and use tax. The details of these alternatives are shown in Chapter VI. Here, we shall limit discussion to the two proposals involving large dollar amounts--a local income tax and another 1 percent local option sales tax. We shall also mention the potential for replacing or reforming another significant source of local revenue--license taxation.

Local Income Tax

A local income tax would be a new and significant source of revenue for local governments. The tax could take many forms and might even substitute in part for the property tax as in Indiana. The options with the greatest administrative feasibility would utilize the present state individual income tax. A local tax could then be administered by the state with great savings in costs and convenience. The tax could be a surtax on the state tax or could take the form of progressive rates for different brackets of taxable income. Neither form would be in any sense a commuter tax, since revenue would be returned to the taxpayer's resident community. If a local tax took one of these forms and had an effective rate equivalent to a 20 percent surtax on the state tax on individuals and fiduciaries, it would raise about \$215 million in 1976-77 and \$196 million in 1977-78.^{1/} Inci-

^{1/} The projected changes for 1976-77 include seventeen months of revenues because an effective date of January 1, 1976, is assumed with a thirty day collection lag. These estimates assume the present Virginia individual income tax structure.

dentally, if such a tax were adopted by all localities, it would be the same as an equivalent state individual income tax increase earmarked for distribution to local governments on the basis of taxpayer residence.

Additional 1 Percent Local Option Sales and Use Tax

All localities impose a 1 percent local option sales tax that is collected by the state and returned to localities on the basis of place of sale. As an alternative to the present system, the limit on the local rate could be raised to 2 percent. Assuming all localities exercised the new option, the revenue impact would be virtually the same as an additional 1 percent state levy distributed on the basis of place of sale. Thus, about \$150 million would be made available in fiscal year 1976-77.

Changes in Local License Taxation

The current structure of local license taxes produces inequities that make the tax disagreeable to businesses, professions, and occupations and can create interlocality differences in the availability of goods and services. There are several alternatives that would provide greater equity, reduce interlocality discrepancies in tax treatment, and fulfill both the revenue and regulatory requirements of local government. The local license taxes based on gross receipts could be repealed with replacement revenues coming from a local income tax, an increase in the local option sales tax, or a state revenue sharing program. If these alternatives are unacceptable, localities could retain gross receipts as a tax base, but the state could require modifications in the application of the tax. One modification would be a state mandated classification system whereby all local tax rates would have to reflect the same relative differences as in profitability. The other

modification would require that local tax rates be tied to various ranges of profitability so that all activities with similar rates of return would be taxed equally. To provide for regulation, mandatory guidelines could be set forth that would limit license fees for most ordinary market activities but would impose no constraint on fees for others.

At the state level, license taxes are not an important source of revenue, and the regulation that they provide is secondary to that of other state agencies and the localities. Thus, state license taxes could either be completely abolished or abolished in stages with limited fiscal impact.

Alternative Policy Options

This final section contains a discussion of four alternative fiscal policies designed to offset the state's scope and quality with capital outlays deficit projected for 1976-78. Tax policy options A and B presume the current individual income tax structure while policy options C and D presume that Congress will extend the Tax Reduction Act of 1975 with an associated 1976-78 biennial revenue loss of \$61.6 million. We derive these policy options in large part from Table 1.4. We must again note that the projected gap assumes no federal general revenue sharing beyond calendar year 1976. If extended, revenue sharing would mean another \$55 million in 1976-78 that could substitute for some of the alternatives mentioned here.

As Table 1.3 indicates, the largest source of the \$254.7 million scope and quality with capital expenditures deficit is capital outlay projects. Since these have an extended life, it would not be unreasonable to borrow part or all of the capital funds and pay off the general obligation bonds from revenues generated during the useful life of these projects rather than attempting to pay for them entirely out of 1976-78 revenues. The maximum general obligation borrowing authorization for 1976-78 is \$268.0 million.

Tax Policy Option A

Tax policy option A is divided into three suboptions, each of which is designed to offset the \$254.7 million gap while assuming that both the federal and Virginia individual income tax laws return to the taxable year 1974 structure on January 1, 1976. Suboption 1 would offset the \$254.7 million gap by increasing individual income tax revenues \$145.8 million through the use of Rate Schedule A, mentioned in Table 1.4, and using a \$108.9 million general obligation bond issue, one well under the constitutional limit for 1976-78. Rate Schedule A has the following brackets and rates:

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	5%
\$12,001 - \$25,000	7%
\$25,001 - \$50,000	8%
over - \$50,000	9%

Suboption 2 would combine the same individual income tax hike as in suboption 1 with an extension of the sales tax base to selected services. Extending this tax to selected services would raise \$96.5 million of which \$64.3 million could be utilized to offset the gap. Under the current law the remaining \$32.2 million would have to be returned to localities on the basis of school age population. Under this option \$44.6 million would be raised from general obligation borrowing.

Suboption 3 would utilize the same individual income tax schedule as in suboptions 1 and 2, but would eliminate all borrowing by extending the sales tax to services, eliminating the Virginia dividend exclusion, taxing capital gains at 100 percent, and raising the inheritance tax rates according to Schedule 3 in Table 1.4. These changes would produce \$145.8 million, \$64.3 million, \$8.0

million, \$25.0 million, and \$9.5 million, respectively, during the 1976-78 biennium. This program would fall \$2.1 million short of the \$254.7 million gap.

Tax Policy Option B

Tax policy option B would offer a way to offset the gap as well as to extend relief for the sales tax paid on food by Virginia residents with adjusted gross incomes under \$10,000 by extending a \$22 individual income tax credit for personal and dependent exemptions. This credit would cost the state approximately \$110.9 million during the 1976-78 biennium. The revenue required to make up the gap and fund the \$22 credit would come from an individual income tax increase of \$225.9 million produced by Schedule C coupled with a general obligation bond issue of \$143.4 million. Rate Schedule C has the following brackets and rates:

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$10,000	5%
\$10,001 - \$20,000	7%
\$20,001 - \$30,000	8%
\$30,001 - \$50,000	9%
over - \$50,000	10%

Tax Policy Option C

Tax policy option C is divided into four suboptions, each with a different type of policy assumption but each presuming that the provisions of the Tax Reduction Act of 1975 are made permanent at a cost of \$61.6 million in individual income tax revenue during the 1976-78 biennium. Suboption 1 assumes that all capital outlay projects would be deferred so that essentially the target is only the scope and quality gap of \$9.5 million given in Table 1.3. Therefore, this policy option would require only the offsetting of the \$61.6 million lost from the Tax Reduction Act

of 1975 structure and finding additional revenues of \$9.5 million. Individual income tax Schedule G in Table 1.5 would offset the revenue loss from the structural change. Elimination of the Virginia dividend exclusion would produce approximately \$8.0 million, but raising the inheritance tax by using Schedule 3 would exactly offset the gap.

Suboption 2 assumes that \$100.0 million would either be cut from capital outlays or selectively cut from current programs so that the overall scope and quality with capital outlays gap would fall to \$154.7 million, but would rise to \$216.3 million with the Tax Reduction Act loss. Individual income tax Schedule J in Table 1.5 would offset the \$61.6 million loss and raise \$106.8 million in additional revenue. The remaining \$48.5 million would come from a general obligation bond issue.

Suboption 3 presumes the entire \$254.7 million gap and the income tax loss of \$61.6 million for a total of \$316.3 million. This gap could be offset by raising individual income taxes through Schedule J as in suboption 2, adding selected services to the sales tax base, which would produce approximately \$64.3 million net of the education share, and raising \$83.4 million through a general obligation bond issue.

Suboption 4 assumes the entire \$254.7 million gap, the Tax Reduction Act structure loss of \$61.6 million, and a loss of \$80.1 million for a \$22 credit for sales tax on food for home consumption. This credit would be granted to Virginia resident taxpayers having adjusted gross incomes under \$7,000. The \$396.4 million would come in large part from an individual income tax rate increase as outlined in Schedule K in Table 1.5, which would produce the \$61.6 million offset and \$256.7 million in additional revenues. Eliminating the Virginia dividend exclusion would result in another \$8.0 million, and extending the sales tax base to services would produce an additional \$64.3

million in net revenues. These steps would fall \$5.8 million short of raising the required revenue.

Tax Policy Option D

Tax policy option D assumes that the full \$254.7 million scope and quality plus capital outlay deficit and the \$61.6 million revenue loss from the Tax Reduction Act of 1975 structure would be made up by a 1 percentage point increase in the state sales and use tax. Under this assumption proceeds from 1 percentage point of the sales tax would continue to be returned to localities on the basis of school age population while proceeds from 3 rather than the current 2 percentage points would be available to support state general fund programs. Under the assumptions the entire \$316.3 million shortfall would be offset by the state sales tax rate increase with an additional \$18.6 million available to fund other projects.

A second suboption assumes that the state would provide sales tax relief to Virginia residents having adjusted gross incomes under \$7,000 through a \$22 credit. The cost of this credit combined with the revenue loss from the Tax Reduction Act structure would require \$396.4 million in revenues. The sales tax rate increase would produce \$334.9 million, and individual income tax Schedule G in Table 1.5 would just offset the \$61.6 million revenue loss caused by the Tax Reduction Act. The two steps would completely raise the \$396.4 million required.

General Comments on Tax Policy Options

Tax policy options A through D contain only a limited number of the possible options available to state policy makers. If we assume that the state desires to fund the entire \$254.7 million scope and quality with capital outlays deficit, the decision would have to involve raising the monies through

a general obligation bond issue, through tax increases, or through some combination of these. Since capital projects are the largest single source of the deficit, borrowing is reasonable since it would allow the state to more closely match the useful lives and costs of the projects. Only the individual income tax and the sales tax have the revenue potential to offset a revenue gap of this size. Of the two the individual income tax is generally presumed to be the more equitable tax since it is tied to the income measure of ability-to-pay. If an individual income tax increase were chosen, it could be designed to add significantly more progressivity to the tax base while also closing certain loopholes like the Virginia dividend exclusion. Alternatively, there is the sales tax, which is viewed by many economists as relatively regressive, since they presume that consumers bear the burden of the tax and observe that low income taxpayers pay a larger proportion of their incomes in sales taxes than do higher income persons. The ultimate tax policy options chosen will be affected by federal government decisions on extending general revenue sharing and/or the Tax Reduction Act.

CHAPTER II

BACKGROUND ON STATE AND LOCAL GOVERNMENT FINANCES

A subject as big as fiscal prospects and alternatives cannot be tackled without first laying some groundwork regarding salient features of the state's economy and of its existing revenue structure. This chapter develops five important topics essential to an understanding of the more detailed analysis which follows in later chapters. The topics are population, personal income, state and local government finances, intergovernmental relationships, and county and city fiscal capacity and effort.

Population

In 1974, the Bureau of the Census estimated the population of Virginia to be 4,908,000, up from the 1970 census count of 4,651,487. The average annual rate of growth over this four-year period was 1.4 percent as compared to a 1.6 percent average yearly growth experienced between 1960 and 1970. Population growth in Virginia since 1970 is about 40 percent above the national growth rate. In that the state's natural increase rate (births minus deaths per 1,000 population) is now very close to the national average, the higher rate of growth for Virginia is almost totally the result of a greater level of net in-migration.

As for the pattern of growth, the change between 1960 and 1970 was familiar since it was a replay of the events in the 1950's. From 1970 to 1973, on the other hand, the data suggest that new trends are emerging. For example, the latest figures indicate that the rates of growth experienced during the 1960's have declined in all areas of the state with the exception of rural and small urban centers. In addition, the population of metropolitan cities which grew by more than 13 percent during the last decade is now

estimated to have declined since 1970. More surprisingly, however, is the revitalization of population growth in the rural areas. As shown below, this classification which has traditionally shown declines in population between census counts is estimated to have grown by 0.9 percent annually from 1970 to 1973.

	<u>1960-70</u>		<u>1970-73</u>	
	<u>Total % Change</u>	<u>Average Annual Rate of Change</u>	<u>Total % Change</u>	<u>Average Annual Rate of Change</u>
State total	+17.6	+1.6	+3.4	+1.1
Urban areas	+21.5	+2.0	+3.5	+1.2
metropolitan cities	+13.4	+1.3	-0.6	-0.2
metropolitan counties	+46.3	+3.9	+8.3	+2.7
small urban areas	+7.9	+0.8	+3.6	+1.2
Rural areas	-3.0	-0.3	+2.7	+0.9

Note: Grouping of individual cities and counties is shown in Appendix Table A.1.

In looking to the future, Virginia's population is likely to reach 5,295,400 by 1980 for a total increase of approximately 644,000 from the 1970 census count (see Table 2.1). The projected 1980 figure will represent an increase of almost 14 percent for the decade or an average annual increase of 1.3 percent. The rates of population increase projected for the 1970's are somewhat less than experienced during the last decade. There are several reasons for the slower anticipated rates of growth. Chief among them is the generally lower birth rate reflected by Virginia's lower natural increase rate experienced in recent years. The overall natural increase rate in Virginia for the 1960's averaged 13 per thousand annually, but from 1970-74 it was only about 9 per thousand.

For net in-migration, the rate experienced by Virginia is closely related to federal civilian and military activity. About three-fourths of total net in-migration during the 1960's was accounted for by Northern Virginia and Hampton Roads, two regions heavily affected by the presence of the federal government. Another factor significantly influencing in-migration to the state is manufacturing growth.

In both federal government and manufacturing, the greatest expansion occurred in the early and mid-1960's, with much more modest growth in the last few years of the decade. Manufacturing employment experienced a slight downturn in Virginia during 1970 and 1971 but rebounded and showed significant gains in 1972 and 1973. During the last year, manufacturing activities remained relatively stable with the 1974 level of employment roughly equal to that of 1973. Total employment in the federal sector, on the other hand, has declined somewhat since 1970. Yet, the civilian portion grew to an all time high in 1971 and has declined only slightly from that level.

Since these activities have a direct bearing on in-migration, we assume that net in-migration also tapered off in the last few years of the 1960's and is presently maintaining more modest levels than were evident in the early 1960's. Thus, with a significantly lower natural increase rate and in-migration approximating the average rate of the 1960 to 1970 period, population growth for the 1970's is projected at a lesser rate than that experienced in the 1960's.

For the decade of the 1970's, therefore, the population projection for Virginia is anticipated to fall within the Census Series E fertility assumption range. According to this series, births and deaths will approach equality; however, due to a larger proportion of the population in prime child-bearing age groups, near zero growth will not be reached until the middle of the 21st century. As a result, Virginia's natural increase rate is expected to average about 9 per thousand annually for the 1970's. This

is the same rate as that experienced from 1970 to 1974 but not nearly as high as the 13 per thousand annual rate of the 1960's. Net in-migration, on the other hand, is expected to remain at roughly the same average as

TABLE 2.1--PROJECTED VIRGINIA POPULATION, 1975 TO 1985

<u>Actual</u>	<u>Population</u>
1970 (census) April 1	4,651,487 ^{a/}
<u>Estimated</u>	
1971 July 1	4,720,000
1972 July 1	4,765,000
1973 July 1	4,844,000
1974 July 1	4,908,000
<u>Projected</u>	
1975 July 1	4,971,000
1976 July 1	5,034,000
1977 July 1	5,099,000
1978 July 1	5,164,000
1979 July 1	5,230,000
1980 July 1	5,295,400
1981 July 1	5,359,000
1982 July 1	5,423,000
1983 July 1	5,488,000
1984 July 1	5,554,000
1985 July 1	5,621,000

a/ The state total for 1970 incorporates corrections in the 1970 Census counts made after the release of the official state total of 4,648,494.

Sources: University of Virginia, Tayloe Murphy Institute, "Estimates of the Population of Virginia Counties and Cities: July 1, 1971 and July 1, 1972," Tayloe Murphy Institute, "Estimates of the Population of Virginia Counties and Cities: July 1, 1972 and July 1, 1973," U. S. Department of Commerce, "Estimates of the Population of States: July 1, 1973 and 1974," Division of State Planning and Community Affairs, "Population Projections: Virginia Cities and Counties 1980 through 2000" (March, 1975).

that experienced over the decade of the 1960's (4 persons per thousand annually). Even though the rapid expansion of federal government activity is not expected to be duplicated in the 1970's, the growth of manufacturing is anticipated to continue at a great enough pace to maintain the level of in-migration at the projected rate.

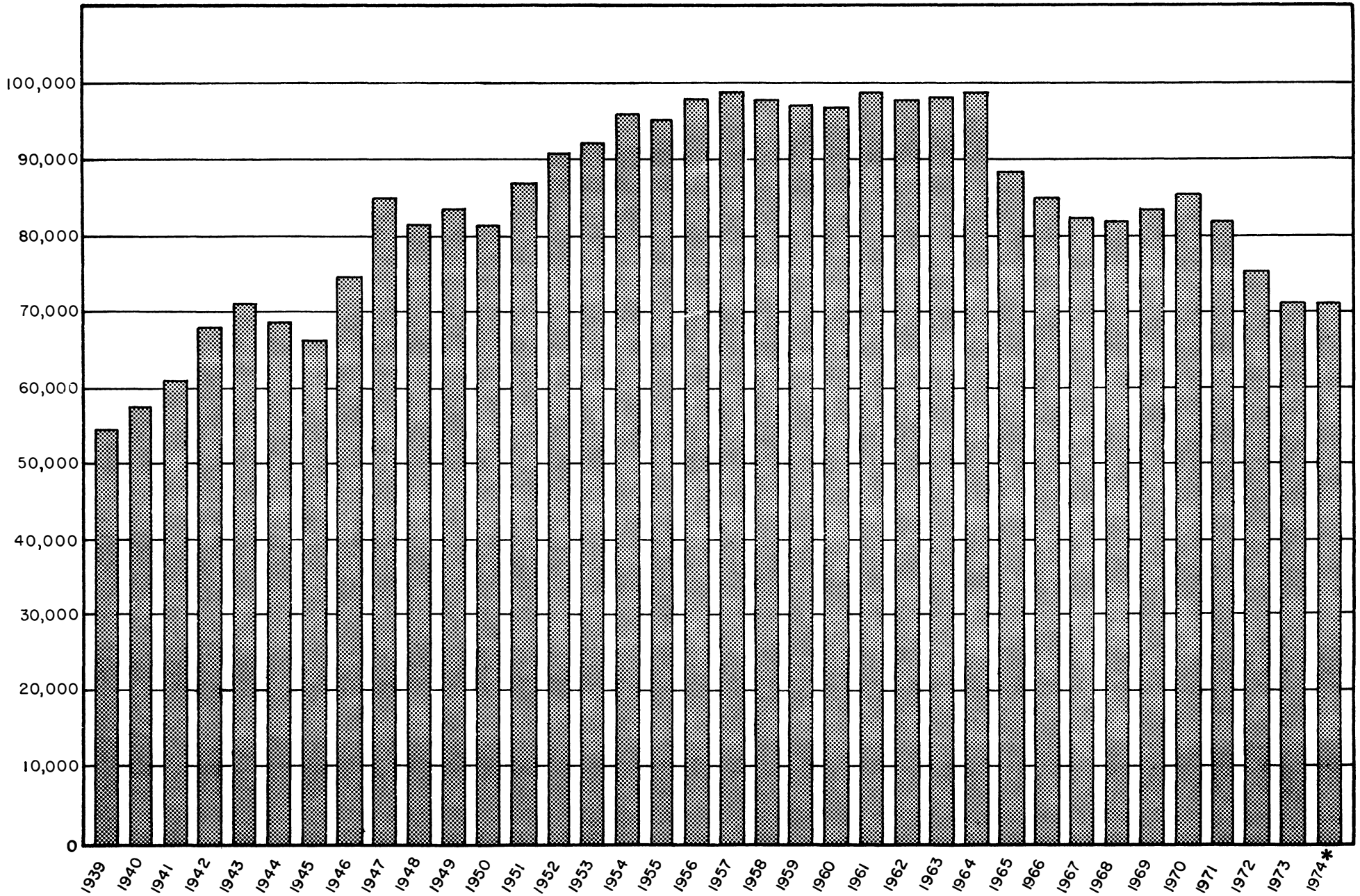
The age distribution of the population is an important determinant of the size of public outlays. Of particular importance are the number of persons of school age (5 to 17) and of college age (18 to 21).

Birth data are an excellent indicator of future age distributions. Thus, by analyzing Chart 2.1, the reader can see a major reason why college enrollment spurted upward in the 1960's. Persons who were 18 to 21 during that decade were born from 1939 to 1952, a period in which births rose sharply. In the 1970's, college enrollment will not be subject to as much population pressure. Persons who will be 18 to 21 during the 1970's were born from 1949 to 1962, a period in which births did not increase as much as during the previous decade.

The lag time between births and enrollment is very brief for public schools, amounting to only five years. The primary school grades are now being affected by the downturn in births that began in 1965, and the low number of births in the 1960's will have a dramatic effect on public school enrollment for the remainder of the current decade, as well as the early part of the 1980's. In some years of the 1970's and 1980's public school enrollment will be lower than in the 1960's.

Projected age distributions for 1980, along with actual age distributions for 1960 and 1970, are shown in Tables 2.2 and 2.3. These projections were derived by applying survival ratios to the 1970 population with provision for births and net in-migration.

CHART 2.1
 VIRGINIA BIRTHS, 1939 TO 1974



Source : Virginia Department of Health

* Preliminary Estimate

TABLE 2.2--AGE DISTRIBUTION OF VIRGINIA'S POPULATION, 1960 TO 1980

	1960	1970	1980
	<u>Actual</u>	<u>Actual</u> Number of Persons	<u>Projected</u>
Total	3,954,429	4,648,494	5,295,400
0 to 4	456,885	392,093	452,918
5 to 19	1,132,536	1,372,112	1,276,603
20 to 64	2,083,447	2,518,268	3,098,741
65 and over	281,561	366,021	467,138
	<u>Percent of Total</u>		
Total	100.0	100.0	100.0
0 to 4	11.6	8.4	8.6
5 to 19	28.6	29.5	24.1
20 to 64	52.7	54.2	58.5
65 and over	7.1	7.9	8.8

Sources: U. S. Bureau of the Census, 1960 Census of Population, Vol. 1, Characteristics of the Population, Part 48, Virginia (Washington: Government Printing Office, 1963), Table 94, p. 315; U. S. Bureau of the Census, 1970 Census of Population, Vol. 1, Characteristics of the Population, Part 48, Virginia (Washington: Government Printing Office, 1973), Table 19, p. 48; "Virginia Population Projections by Age, Sex, and Color 1980," from a report prepared for the Division of State Planning and Community Affairs by Research Triangle Park (April, 1975).

TABLE 2.3--CHANGE IN AGE DISTRIBUTION OF VIRGINIA'S POPULATION, 1960-70 AND 1970-80

	<u>1960-70 (Actual)</u>		<u>1970-80 (Projected)</u>	
	<u>Number</u>	<u>%</u>	<u>Number</u>	<u>%</u>
Total	+694,065	+17.6	+646,906	+13.9
0 to 4	-64,792	-14.2	+60,825	+15.5
5 to 19	+239,576	+21.2	-95,509	-7.0
20 to 64	+434,821	+20.9	+580,473	+23.0
65 and over	+84,460	+30.0	+101,117	+27.6

Source: Table 2.2.

Personal Income

Personal income is a good measure of total economic activity. In the last ten years (1964-1974), Virginia's total personal income has grown at an average annual rate of 9.9 percent, a rate higher than the national average of 8.7 percent. Most of the difference reflected an improvement in individual incomes, although a portion was due to Virginia's faster growth of population. Per capita income, which adjusts for population differences, provides a good measure of Virginia's relative gain. In 1964, Virginia per capita income was 88.4 percent of the national average; ten years later, it was 96.9 percent (see Table 2.4). The Virginia per capita personal income annual growth rate during this period was 8.6 percent - significantly higher than the U. S. average of 7.6 percent.

Composition of personal income in Virginia is unlike the nation in several respects. The outstanding difference is the relative importance of the federal government whose wage and salary payments in 1972 accounted for 18.4 percent of all personal income in the Commonwealth compared with 5.2 percent nationally. This is due to the large number of federal civilian employees living in Northern Virginia and the location of several big military installations in Virginia of which the naval complex at Norfolk is paramount.

Wage and salary payments are the principal form of income for both the state and the nation, but there is a significant difference in their relative importance. Virginians do not derive as much relative income from property and proprietorships as the national average. This is the major reason why wage and salary payments in 1972 represented a larger percentage of income in Virginia (72.7 percent) than nationally (66.7 percent).

The composition of Virginia's personal income has changed significantly

TABLE 2.4--VIRGINIA PERSONAL INCOME, TOTAL AND PER CAPITA, 1950 to 1974

Year	Personal Income			Personal Income		
	Total (\$Mil.)			Per Capita		
	Va.	U.S.	% of U.S.	Va.	U.S.	% of U.S.
1950	\$ 4,070	226,214	1.80	\$ 1,228	1,496	82.1
1951	4,763	253,232	1.88	1,387	1,652	84.0
1952	5,150	269,769	1.91	1,470	1,733	84.8
1953	5,292	285,456	1.85	1,488	1,804	82.5
1954	5,338	287,607	1.86	1,501	1,785	84.1
1955	5,638	308,266	1.83	1,571	1,876	83.7
1956	6,084	330,479	1.84	1,634	1,975	82.7
1957	6,349	348,460	1.82	1,652	2,045	80.8
1958	6,680	358,252	1.86	1,707	2,067	82.6
1959	7,136	381,890	1.87	1,806	2,166	83.4
1960	7,426	399,947	1.86	1,863	2,222	83.8
1961	7,868	415,984	1.89	1,921	2,274	84.5
1962	8,537	442,078	1.93	2,042	2,381	85.8
1963	9,099	465,234	1.96	2,128	2,469	86.2
1964	10,029	497,268	2.02	2,302	2,603	88.4
1965	10,870	538,690	2.02	2,464	2,785	88.5
1966	11,859	586,736	2.02	2,661	3,001	88.7
1967	12,960	629,204	2.06	2,875	3,188	90.2
1968	14,353	688,978	2.08	3,149	3,457	91.1
1969	15,733	751,425	2.09	3,410	3,733	91.3
1970	17,249	808,223	2.13	3,707	3,966	93.5
1971	18,791	864,989	2.17	3,981	4,195	94.9
1972	21,015	947,066	2.22	4,410	4,549	96.9
1973	23,579	1,057,825	2.23	4,868	5,041	96.6
1974	25,842	1,148,720	2.25	5,265	5,434	96.9

Note: Includes Alaska and Hawaii for 1960-71, but not in earlier years.

Source: Survey of Current Business, Vol. 55, No. 4 (April, 1975), p. 19; Vol. 54, No. 8 (August, 1974) pp. 32 and 33; Vol. 49, No. 4 (April, 1969), pp. 22 and 26.

in the last twenty-two years (see Table 2.5). Since 1950, wage and salary payments are a much more important source of income having moved from 68.9 percent to 72.7 percent of the total. The relative decline of agriculture was the major reason for this change, as people switched away from operating their own farms to jobs paying wages and salaries. Proprietors' farm income fell from 6.4 percent of income in 1950 to 1.1 percent in 1972.

Another development was the growth of government as a source of income. Already big in 1950, it has become larger even though in the last several years its relative importance has declined slightly. The gains were due to much larger payments by federal civilian government and state and local government. The relative importance of federal military wage and salary payments was less in 1972 than in 1950, but was greater than in some of the intervening years. Increases in federal programs have made transfer payments a much more important source of personal income in 1972 (9.7 percent) than they were in 1950 or 1960 (both 6.2 percent).

Several important types of revenue--particularly, individual income taxes and sales taxes--bear a close relationship to personal income. Thus, projections of personal income are needed to make revenue projections. The method of projecting income is explained in Chapter III. Table 3.3 shows actual Virginia personal income adjusted to fiscal years for 1957-58 to 1973-74 and our projections of personal income through 1981-82. The projections anticipate a slightly higher rate of growth for personal income than that which was experienced during the early part of the 1970's.

State and Local Government Finances

State governments differ in their responsibilities (e.g., in some states the state government bears the brunt of financing schools and highways; in

TABLE 2.5.--PERCENTAGE DISTRIBUTION OF PERSONAL INCOME PAYMENTS BY SOURCE,
VIRGINIA, 1950 TO 1972, AND UNITED STATES, 1972

Type of Income	Percent of Total				United States 1972
	Virginia				
	1950	1960	1970	1972	
Total personal income.....	100.0	100.0	100.0	100.0	100.0
Wage and salary disbursements.....	68.9	72.7	73.1	72.7	66.7
Farms.....	1.3	0.8	0.3	0.3	0.4
Mining.....	1.5	0.9	0.7	0.7	0.7
Contract construction.....	3.6	4.0	4.3	4.6	4.1
Manufacturing.....	15.1	15.8	14.2	14.1	18.8
Wholesale and retail trade.....	10.0	10.6	10.2	10.1	11.1
Finance, insurance, and real estate.....	2.2	2.7	2.9	3.0	3.5
Transportation, communications, and public utilities.....	6.5	6.3	5.0	5.1	5.1
Services.....	5.6	7.1	8.0	8.2	8.9
Government.....	22.8	24.3	27.5	26.4	13.9
Federal, civilian.....	10.4	11.4	12.2	12.0	3.4
Federal, military.....	8.2	7.0	7.3	6.4	1.8
State and local.....	4.2	6.0	8.0	8.0	8.6
Other industries.....	0.2	0.1	0.1	0.1	0.1
Other labor income.....	1.4	2.5	3.3	3.7	4.3
Proprietors' income.....	15.0	9.7	6.5	6.3	8.0
Farm.....	6.4	2.6	1.1	1.1	2.2
Nonfarm.....	8.6	7.0	5.4	5.2	5.8
Property income.....	10.0	11.5	12.1	11.6	13.7
Transfer payments.....	6.2	6.2	8.6	9.7	11.0
Less: personal contributions for social insurance.....	1.5	2.5	3.6	3.9	3.7

Note: Details may not add to totals due to rounding.

Source: Survey of Current Business, Vol. 52, No. 8 (August, 1972); Vol. 53, No. 8 (August, 1973), pp. 44 and 47; unpublished data from the U. S. Department of Commerce, Office of Business Economics.

others, these functions are mainly the responsibility of local governments). Because of the diversity of state government functions, comparisons of revenue burdens involve problems similar to comparing apples and oranges. To get around this problem, it is best to compare combined revenue burdens of state and local governments.

In 1972-73, general revenues of all Virginia governments (state and local) from their own sources represented 13.8 percent of personal income compared with the national average of 16.1 percent.^{1/}

Since 1958-59 Virginia state and local government revenues have risen sharply. In 1958-59, state and local government revenues from Virginia sources represented 9.3 percent of total personal income. Since then there has been an almost steady rise to 13.7 percent in 1973 (see Table 2.6 and Chart 2.2).

How does the burden of financing Virginia state and local governments compare with other states? Before this question can be answered, it is necessary to arrive at a means for measuring burden. This report employs two widely used approaches--per capita revenues and revenues per \$1,000 of personal income. These measures consider only one side of the fiscal equation--the revenue side--and a strong case can be made for also considering the amount and incidence of expenditure benefits. However, analysis of the expenditure side is beyond the scope of this inquiry.

Per Capita Revenue

Virginia's general revenue from its own sources^{2/} was 83.3 percent of the

^{1/} Source: U. S. Bureau of the Census, Governmental Finances in 1972-73, GF73, No. 5 (Washington: Government Printing Office, 1974), p. 50.

^{2/} All revenue except utility revenue, liquor store revenue, insurance-trust revenue, and transfers from the federal government.

TABLE 2.6.--VIRGINIA STATE AND LOCAL GENERAL REVENUE
FROM OWN SOURCES AS A PERCENTAGE OF PERSONAL INCOME,
FISCAL YEARS 1958-59 TO 1972-73 ^{a/}

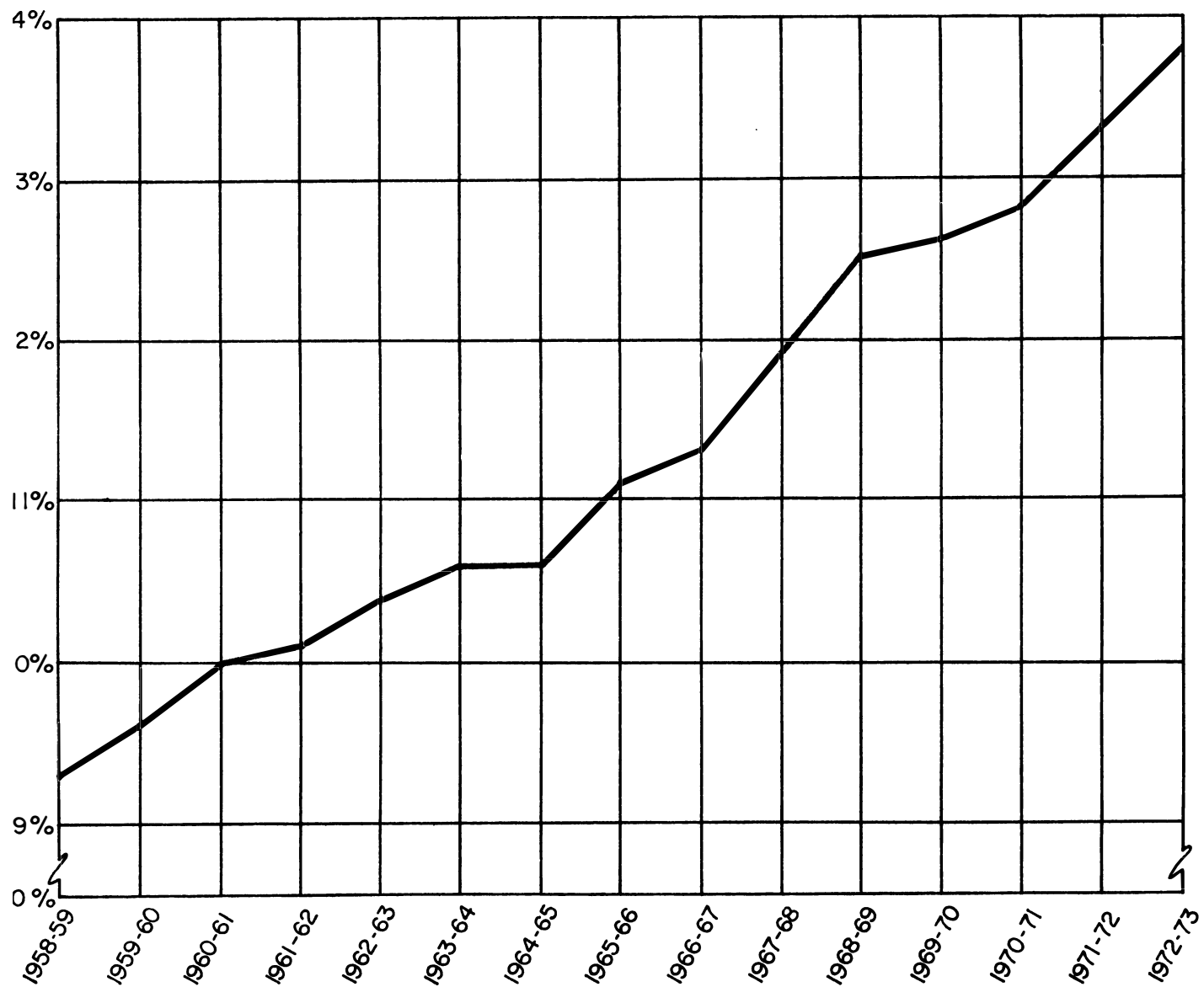
<u>Fiscal Year</u>	<u>General Revenue from Own Sources (\$Mil.)</u>	<u>Personal Income (\$Mil.)</u>	<u>General Revenue from Own Sources as a % of Personal Income</u>
1958-59	620.7	6,680	9.3
1959-60	685.7	7,136	9.6
1960-61	745.2	7,426	10.0
1961-62	792.3	7,868	10.1
1962-63	886.3	8,537	10.4
1963-64	968.4	9,099	10.6
1964-65	1,059.4	10,029	10.6
1965-66	1,203.7	10,870	11.1
1966-67	1,343.8	11,859	11.3
1967-68	1,536.8	12,960	11.9
1968-69	1,796.0	14,353	12.5
1969-70	1,985.2	15,733	12.6
1970-71	2,205.0	17,249	12.8
1971-72	2,503.3	18,791	13.3
1972-73	2,881.3	21,015	13.7

^{a/} Personal income for the whole year which represents the first part of the fiscal year, e.g., personal income for calendar year 1972 is compared with general revenue for fiscal year 1972-73.

Sources: U. S. Bureau of the Census, Governmental Finances in 19--, selected editions (Washington: Government Printing Office); Survey of Current Business, Vol. 54, No. 8 (August, 1974), pp.32 and 33; Survey of Current Business, Vol. 55, No. 4 (April, 1975), p.19.

CHART 2.2

VIRGINIA STATE AND LOCAL GENERAL REVENUE
FROM OWN SOURCES AS A PERCENTAGE OF PERSONAL INCOME
FISCAL YEARS 1958-59 TO 1972-73



Source: Table 2.6

national average in 1972-73, which placed it thirty-seventh in rank (see Table 2.7). Although the state's national position was low, when compared with neighboring states Virginia's per capita revenue was higher than in Kentucky, West Virginia, North Carolina, and Tennessee. Only Maryland and the District of Columbia exceeded Virginia.

The preceding measure was of general revenue which includes other revenues in addition to taxes. Table 2.8 shows Virginia's rank for per capita taxes. Virginia's relative position for per capita taxes changed considerably when compared to the above measure of general revenue from own sources. The state's figure was 83.1 percent of the national average, and it ranked thirty-first. Compared with neighboring states, Virginia's per capita taxes were higher than in North Carolina, Kentucky, West Virginia, and Tennessee.

Revenue Per \$1,000 of Personal Income

The above comparisons have used per capita amounts and do not take into account fiscal capacity to pay. A popular device for relating revenues to capacity is to compute revenues per \$1,000 of personal income. Such a measure adjusts for the fact that Virginia's per capita income is about 3 percent below the national average.

Revenues from its own sources per \$1,000 of personal income were 87.2 percent of the national average in 1972-73, and the state ranked forty-third (see Table 2.9). Using this measure all neighboring states except the District of Columbia and North Carolina made a greater revenue raising effort than Virginia.

A similar measure using taxes rather than all revenues shows a slightly different picture. As shown in Table 2.10, Virginia's tax load of \$112.70 per \$1,000 of personal income was 87.0 percent of the national average and placed

TABLE 2.7--PER CAPITA AMOUNTS OF STATE AND LOCAL GENERAL REVENUE
FROM OWN SOURCES, FISCAL YEAR 1972-73

Rank	State	Amount	Percent of U.S. Average
1	New York	\$1,073.56	149.3
2	Alaska	1,013.72	141.0
3	Nevada	918.89	127.8
4	California	895.30	124.5
5	Hawaii	882.26	122.7
6	Connecticut	840.31	116.8
7	Minnesota	832.05	115.7
8	Massachusetts	824.06	114.6
9	District of Columbia	812.58	113.0
10	Wisconsin	812.57	113.0
11	Michigan	799.39	111.2
12	Maryland	785.81	109.3
13	Washington	781.82	108.7
14	Wyoming	779.86	108.4
15	Delaware	775.74	107.9
16	Vermont	759.77	105.6
17	New Jersey	758.21	105.4
18	Illinois	717.01	99.7
19	Colorado	716.13	99.6
20	Oregon	705.09	98.0
21	Arizona	696.52	96.8
22	Pennsylvania	683.20	95.0
23	North Dakota	680.64	94.6
24	Montana	667.50	92.8
25	Iowa	667.36	92.8
26	Nebraska	662.86	92.2
27	Kansas	659.67	91.7
28	Rhode Island	648.02	90.1
29	South Dakota	643.02	89.4
30	Florida	634.20	88.2
31	Louisiana	621.76	86.5
32	New Mexico	619.54	86.1
33	Ohio	611.33	85.0
34	Utah	608.50	84.6
35	Maine	605.57	84.2
36	Indiana	600.14	83.4
37	VIRGINIA	598.89	83.3
38	Georgia	585.29	81.4
39	Idaho	577.64	80.3
40	Missouri	576.59	80.2
41	New Hampshire	561.52	78.1
42	Texas	555.07	77.2
43	Oklahoma	550.41	76.5
44	North Carolina	526.57	73.2
45	Kentucky	525.69	73.1
46	West Virginia	523.22	72.8
47	Tennessee	522.21	72.6
48	Mississippi	518.07	72.0
49	South Carolina	515.25	71.6
50	Alabama	496.56	69.0
51	Arkansas	458.77	63.8
Exhibit:			
	United States Average	719.18	100.0
	Median State	662.86	92.2

TABLE 2.8--PER CAPITA AMOUNTS OF STATE AND LOCAL TAXES, FISCAL YEAR 1972-73

<u>Rank</u>	<u>State</u>	<u>Amount</u>	<u>Percent of U.S. Average</u>
1	New York	\$ 893.61	154.8
2	California	738.84	128.0
3	Connecticut	727.21	126.0
4	Massachusetts	713.88	123.7
5	Nevada	687.59	119.1
6	Hawaii	683.52	118.4
7	District of Columbia	664.44	115.1
8	Wisconsin	664.35	115.1
9	Minnesota	649.51	112.6
10	Michigan	635.11	110.1
11	New Jersey	630.51	109.3
12	Maryland	628.56	108.9
13	Vermont	618.23	107.1
14	Illinois	613.03	106.2
15	Delaware	586.14	101.6
16	Pennsylvania	581.34	100.7
17	Washington	574.71	99.6
18	Arizona	556.75	96.5
19	Colorado	542.92	94.1
20	Rhode Island	542.09	93.9
21	Wyoming	534.31	92.6
22	Oregon	532.78	92.3
23	Iowa	529.65	91.8
24	Montana	527.26	91.4
25	Kansas	517.09	89.6
26	Maine	514.32	89.1
27	Nebraska	503.27	87.2
28	South Dakota	495.84	85.9
29	Alaska	494.05	85.6
30	Florida	491.25	85.1
31	VIRGINIA	479.71	83.1
32	Ohio	475.42	82.4
33	Missouri	472.68	81.9
34	Indiana	469.57	81.4
35	Utah	469.29	81.3
36	North Dakota	469.15	81.3
37	New Hampshire	453.55	78.6
38	Louisiana	449.02	77.8
39	Idaho	447.39	77.5
40	New Mexico	438.31	76.0
41	Georgia	433.25	75.1
42	North Carolina	425.32	73.7
43	Texas	418.77	72.6
44	West Virginia	415.99	72.1
45	Kentucky	403.94	70.0
46	Oklahoma	393.38	68.2
47	Tennessee	391.76	67.9
48	South Carolina	391.04	67.8
49	Mississippi	381.67	66.1
50	Alabama	351.48	60.9
51	Arkansas	341.94	59.3
Exhibit:			
	United States Average	577.08	100.0
	Median State	514.32	89.1

Source: U. S. Bureau of the Census, Governmental Finances in 1972-73, Series GF73, No. 5 (Washington: Government Printing Office, 1974), p.45.

TABLE 2.9--STATE AND LOCAL GENERAL REVENUE FROM OWN SOURCES
PER \$1,000 OF PERSONAL INCOME, FISCAL YEAR 1972-73

<u>Rank</u>	<u>State</u>	<u>Amount</u>	<u>Percent of U.S. Average</u>
1	Vermont	\$207.01	128.3
2	New York	203.66	126.2
3	Alaska	200.20	124.1
4	Minnesota	193.63	120.0
5	Wisconsin	193.04	119.6
6	Nevada	188.17	116.6
7	North Dakota	184.35	114.2
8	Wyoming	184.27	114.2
9	Hawaii	182.60	113.2
10	California	180.66	112.0
11	New Mexico	180.51	111.9
12	Louisiana	177.58	110.1
13	South Dakota	175.09	108.5
14	Washington	174.09	107.9
15	Arizona	172.87	107.1
16	Massachusetts	170.64	105.8
17	Utah	167.75	104.0
18	Oregon	167.72	103.9
19	Maine	167.62	103.9
20	Montana	167.40	103.7
21	Mississippi	166.46	103.2
22	Michigan	163.12	101.1
23	Colorado	161.86	100.3
24	Maryland	161.50	100.1
25	Connecticut	157.41	97.6
26	Iowa	156.34	96.9
27	Idaho	155.63	96.4
28	Nebraska	153.89	95.4
29	Florida	153.21	94.9
30	Georgia	152.82	94.7
31	Pennsylvania	152.71	94.6
32	Delaware	152.45	94.5
33	South Carolina	151.55	93.9
34	Kansas	149.47	92.6
35	Kentucky	147.57	91.5
36	Oklahoma	146.65	90.9
37	West Virginia	146.62	90.9
38	Alabama	146.40	90.7
39	Tennessee	145.62	90.2
40	Rhode Island	145.28	90.0
41	New Jersey	144.80	89.7
42	Texas	140.83	87.3
43	VIRGINIA	140.70	87.2
44	Arkansas	140.40	87.0
45	North Carolina	140.17	86.9
46	Illinois	139.31	86.3
47	Indiana	138.13	85.6
48	New Hampshire	135.83	84.2
49	Missouri	134.43	83.3
50	Ohio	134.19	83.2
51	District of Columbia	129.36	80.2
Exhibit:			
	United States Average	161.36	100.0
	Median State	156.34	96.9

Source: U. S. Bureau of the Census, Governmental Finances in 1972-73,
Series GF73, No. 5 (Washington: Government Printing Office, 1974), p.50.

TABLE 2.10--STATE AND LOCAL TAXES PER \$1,000 OF PERSONAL INCOME,
FISCAL YEAR 1972-73

<u>Rank</u>	<u>State</u>	<u>Amount</u>	<u>Percent of U.S. Average</u>
1	New York	\$169.52	130.9
2	Vermont	168.44	130.1
3	Wisconsin	157.83	121.9
4	Minnesota	151.15	116.7
5	California	149.09	115.2
6	Massachusetts	147.83	114.2
7	Maine	142.36	110.0
8	Hawaii	141.46	109.3
9	Nevada	140.81	108.8
10	Arizona	138.12	106.7
11	Connecticut	136.22	105.2
12	South Dakota	135.01	104.3
13	Montana	132.23	102.1
14	Pennsylvania	129.94	100.4
15	Michigan	129.60	100.1
16	Utah	129.37	99.9
17	Maryland	129.18	99.8
18	Louisiana	128.24	99.0
19	Washington	127.97	98.8
20	New Mexico	127.70	98.6
21	North Dakota	127.06	98.1
22	Oregon	126.73	97.9
23	Wyoming	126.24	97.5
24	Iowa	124.08	95.8
25	Colorado	122.71	94.8
26	Mississippi	122.64	94.7
27	Rhode Island	121.53	93.9
28	Idaho	120.53	93.1
29	New Jersey	120.42	93.0
30	Illinois	119.11	92.0
31	Florida	118.67	91.7
32	Kansas	117.17	90.5
33	Nebraska	116.84	90.2
34	West Virginia	116.57	90.0
35	Delaware	115.19	89.0
36	South Carolina	115.02	88.8
37	Kentucky	113.39	87.6
38	North Carolina	113.22	87.4
39	VIRGINIA ←	112.70	87.0
40	Georgia	112.38	86.8
41	Missouri	110.21	85.1
42	New Hampshire	109.71	84.7
43	Tennessee	109.25	84.4
44	Indiana	108.08	83.5
45	Texas	106.25	82.1
46	District of Columbia	105.78	81.7
47	Oklahoma	104.81	81.0
48	Arkansas	104.65	80.8
49	Ohio	104.36	80.6
50	Alabama	103.62	80.0
51	Alaska	97.57	75.4
Exhibit:			
	United States Average	129.47	100.0
	Median State	122.63	94.7

Source: U. S. Bureau of the Census, Governmental Finances in 1972-73, Series GF73, No. 5 (Washington: Government Printing Office, 1974), p.50.

it thirty-ninth in rank. Among neighboring states, Virginia's effort exceeded that of Tennessee and the District of Columbia.

In rather widely publicized work for the Southern Regional Education Board, Kenneth E. Quindry uses taxes per \$1,000 of personal income as a basis for developing estimates of state and local net unutilized revenue potential. This figure is derived by multiplying the "average rate" per \$1,000 of personal income for each of fourteen tax sources by the state's personal income. The actual collections are subtracted from the hypothetical yields for each tax to give collections above or below average for each source. These amounts are then summed to show the net unutilized potential, a figure estimated by Quindry to be \$474,831,000 in 1972-73 for Virginia.^{1/}

Another way to derive an overall estimate of revenue potential is to take the difference between Virginia and national averages for all taxes per dollar of personal income and then to multiply this figure by Virginia personal income. $(\$.12947 - \$.11270)(\$21,015,000,000) = \$352,422,000$.

This figure is \$122 million lower than Quindry's. Most of the difference is attributable to his concept of the "average rate" for each tax source, which is defined as average collections per \$1,000 of personal income for all states using the tax source. Several sources such as the real property tax are used in all states so that a weighted national average for states using the tax is the same as a 50-state weighted average. But for other sources, such as the individual income tax which was used in only 44 states in 1972-73, the weighted average for states with the tax is much higher than a 50-state weighted average. For example, using Quindry's data, the 44 state weighted average for states with the individual income tax was \$20.803 per \$1,000 of

^{1/} Kenneth E. Quindry and Carol S. Meyers, State and Local Revenue Potential 1973, (Atlanta: Southern Regional Education Board, 1974), p.98.

personal income, but based on 50 states and the District of Columbia, the average was \$16.988.^{1/} By using the 44 state average Quindry shows that Virginia collected \$47,004,000 below the yield collectible at the "average rate."^{2/} Substitution of the average of the 50 states and D. C. raises the comparable figure to \$42,680,000 above the average yield.

The Advisory Commission on Intergovernmental Relations (ACIR) has also developed data showing additional revenue Virginia might raise if it exerted an "average effort." For each major tax source ACIR calculated the state's tax base and then multiplied the base by the weighted national average ratio of tax receipts to tax base. Using 1968-69 data, ACIR estimated Virginia's tax capacity to be \$63 million greater than its tax revenues.^{3/} If this same relationship held in 1972-73 Virginia's potential additional tax revenue if average rates were applied would have been \$101.2 million.

This figure is considerably lower than Quindry's \$474 million, and also lower than the \$352 million estimated above. These differences underline the observation that any method used to estimate overall tax effort and to calculate unused tax potential is most useful as a guide to further inquiry rather than as a definitive blueprint for policy. Measurements based solely on personal income or population fail to take account of income distribution; composition of personal income (e.g., much of military personal income is not taxable in Virginia); differences in industrial composition, value of property, and natural resources; and trade-offs between tax and nontax sources of revenue (e.g.,

^{1/} Ibid., pp., 27, 52-53. The 50-state average was computed from data in the report.

^{2/} Ibid., p. 91

^{3/} Advisory Commission on Intergovernmental Relations, Measuring the Fiscal Capacity and Effort of State and Local Areas, M-58 (Washington: Government Printing Office, 1971), p.209.

alcoholic beverages can be taxed and/or provide nontax revenues from state controlled monopolies). Measurements which rely on estimates of tax bases are preferable to simplistic methods but are very sensitive to the manner in which estimates are constructed.

Although the Quindry and ACIR estimates of unutilized potential differ, an interesting conclusion of both studies is that the major unutilized tax sources in Virginia are the real property tax and the general sales tax.^{1/}

Intergovernmental Relationships

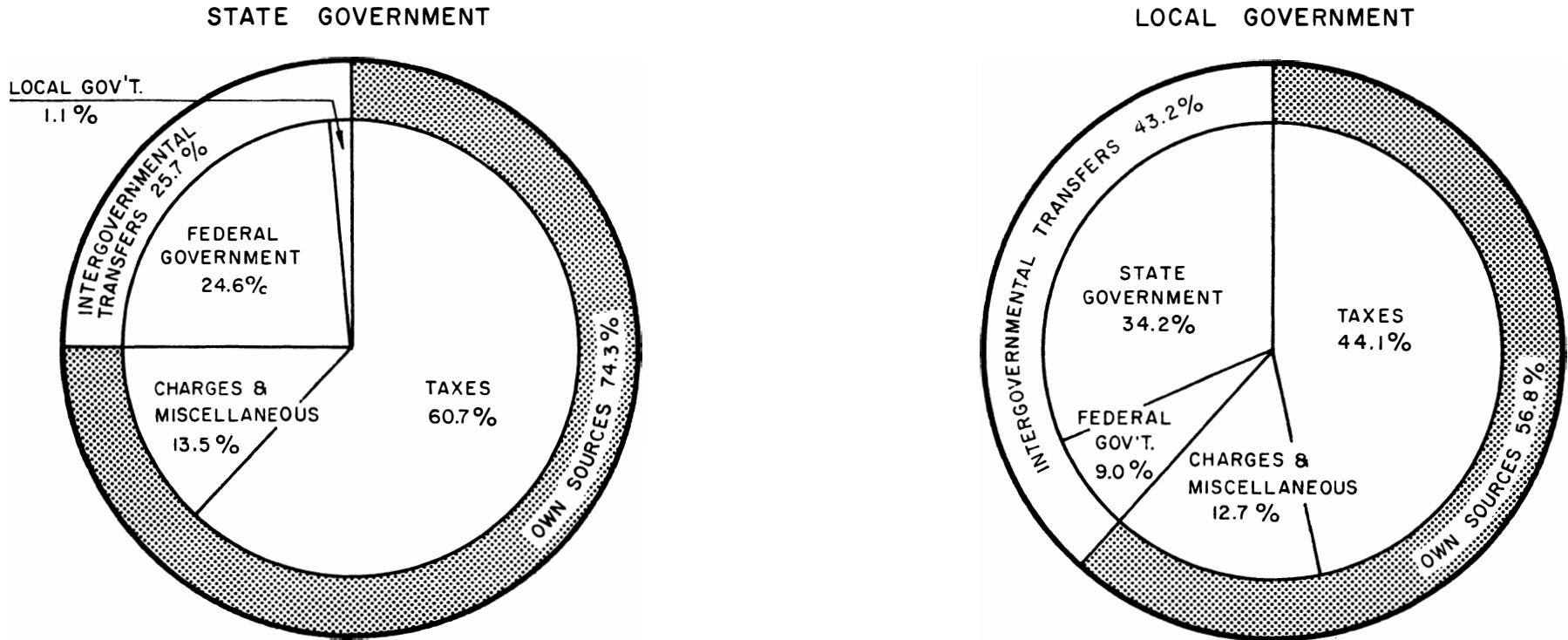
State and local government finances cannot be analyzed in a vacuum. In our nation, we have three broad levels of government--federal, state, and local--and what happens on one level is bound to have an impact on the others.

Chart 2.3 shows the sources of general revenue for the state government and for all local governments in fiscal year 1972-73. First, consider the state government. Almost three-fourths of its revenue is raised from its own sources--state imposed taxes, institutional charges, and miscellaneous fees and receipts. Nearly all of the remaining funds come from the federal government.

The local governments present a different picture. Their own sources provide 56.8 percent of general revenue which is lower than the case for the state government. The federal government is a relatively small source of direct aid, accounting for only 9 percent of total revenue, even though its proportion of total local revenues has increased considerably with the enactment of general revenue sharing. On the other hand, the most significant characteristic of local finances is the large contribution of state government transfers, either in the form of shared revenues or cash transfers. In 1972-73, 34.2 percent of local government general revenue came from the state government.

^{1/} Quindry and Meyers, State and Local Revenue Potential, 1973, p. 91: ACIR, Measuring the Fiscal Capacity and Effort, p. 79.

CHART 2.3
 MAJOR SOURCES OF REVENUES OF THE STATE AND LOCAL GOVERNMENTS IN VIRGINIA



STATE GOV'T.

\$ MIL.

2305.4	————— Total general revenue
1712.5	————— Own sources
1400.2	————— Taxes
312.3	————— Charges & miscellaneous
592.9	————— Intergovernmental transfers
567.1	————— Federal Government
	————— State Government
25.8	————— Local Government

LOCAL GOV'T.

\$ MIL.

2056.2	————— Total general revenue
1168.7	————— Own sources
907.7	————— Taxes
261.1	————— Charges & miscellaneous
887.5	————— Intergovernmental transfers
185.2	————— Federal Government
702.3	————— State Government

Note: Details may not add to totals due to rounding.

Source: U.S. Bureau of the Census, Governmental Finances in 1972-73, Series GF 73, No.5 (Washington: Government Printing Office, 1974) p.33.

Most of this aid--just under 65 percent for fiscal year 1972-73--was spent for one function, education. The remainder was primarily devoted to public welfare, highways, and general local government support.

The above analysis is limited to cash flows; it does not cover performance of services which can relieve a level of government from financial burdens it would otherwise bear. For example, the State Department of Health now provides local health services to many localities which formerly paid for such services out of their own resources.

To provide some perspective on the scope of state government assistance to localities, we can focus on three major governmental functions--education, highways, and welfare--which represent almost two-thirds of all state and local government direct general expenditures (see Table 2.11).

Education, the largest single category of state-local expenditures, is composed of amounts spent for higher education and for elementary and secondary education. Higher education is primarily a state government function and absorbs the bulk of state direct outlays^{1/} for education. Elementary and secondary education is a combined function of local governments and the state. In 1972-73 transfers from the state provided 50.3 percent of the funding of local public schools.

Highways are primarily a state function. Of total direct expenditure in 1972-73, 84 percent was borne by the state government.^{1/} In addition, the state transferred funds to localities which perform their own construction and maintenance. Municipalities of 3,500 or more population receive annual payments of \$2,500 per lane mile for maintenance of urban extensions of primary

^{1/} The terms "direct outlays" and "direct expenditures" refer to all payments other than intergovernmental payments.

TABLE 2.11.--CASH TRANSFERS TO LOCAL GOVERNMENTS IN VIRGINIA, FISCAL YEAR 1972-73
(Millions of Dollars)

	<u>Total Local Government Direct General Expenditure</u>	<u>State Cash Transfers^{a/}</u>		<u>Federal Cash Transfers</u>	
		<u>Amount</u>	<u>% of Local Expenditure for Function</u>	<u>Amount</u>	<u>% of Local Expenditure for Function</u>
All Functions	\$1,970.8	\$771.5 ^{b/}	39.1	\$185.2	9.4
Education	996.4	500.8	50.3	n.a.	n.a.
Highways	79.9	31.2	39.0	n.a.	n.a.
Welfare	192.7	171.1	88.8	n.a.	n.a.

n.a. - not available

a/ Includes federal funds transferred to the state government and then transferred to local governments.

b/ Differs from \$702.3 million shown in Chart 2.3 due to differences in the end of month fiscal years of local governments, sampling problems, and accounting differences.

Sources: U. S. Bureau of the Census, Governmental Finances in 1972-73, Series GF73, No. 5 (Washington: Government Printing Office, 1974), pp. 33 and 38; U. S. Bureau of the Census, State Government Finances in 1973, GF73, No. 3 (Washington: Government Printing Office, 1973), p. 38.

routes. For streets not a part of the primary system but meeting certain engineering standards, they receive \$1,500 per lane mile. The state also pays 85 percent of the municipalities' new construction costs. Of the total amount spent by localities on streets and highways in 1972-73, state aid covered 39 percent of the cost.

Most direct expenditures for welfare are made by local governments, but the majority of the funding of local outlays is from the state government. In 1972-73, almost 90 percent of local expenditures were financed directly by the state government or in its capacity as an agent for federal funds.

The trend of Virginia's intergovernmental fiscal relationships from 1958-59 to 1972-73 is shown in Table 2.12 which breaks down the sources of revenue by the originating level of government before cash transfers among governments and then shows the level of government which is the final recipient after intergovernmental transfers. Financing of welfare payments provides an example of how the table is organized. Certain amounts used for welfare payments are originally collected by the federal government, transferred to the state government, and then transferred once again by the state government to local governments. In this case, the originating level of government is the federal government, while the final recipient level is the local government.

What has happened during recent years is clear. The federal government has become an increasingly more important source of revenue for the state and local governments. In 1958-59, it provided 13.5 percent of the state and local government revenues in Virginia. In 1972-73, it provided 20.7 percent. Most of the money received from the federal government goes to the state government. In 1972-73 the state's share amounted to 75 percent.^{1/} A portion of the

^{1/} Derived from Chart 2.3, p. 71.

TABLE 2.12.--ORIGIN AND ALLOCATION BY LEVEL OF GOVERNMENT
OF GENERAL REVENUE OF STATE AND LOCAL GOVERNMENTS IN VIRGINIA,
FISCAL YEARS 1958-59 TO 1972-73

Fiscal Year	Percent Distribution						
	By Originating Level of Govern- ment (prior to State-Local and Local-State Transfers)				By Final Recipient Level of Government (After State-Local and Local- State Transfers)		
	Total	Federal	State	Local	Total	State	Local
1958-59	100.0	13.5	46.5	39.9	100.0	40.5	59.5
1959-60	100.0	15.8	44.4	39.7	100.0	40.4	59.6
1960-61	100.0	14.1	48.0	37.9	100.0	42.0	58.0
1961-62	100.0	16.3	46.7	37.0	100.0	43.1	56.9
1962-63	100.0	16.4	47.0	36.6	100.0	44.1	55.9
1963-64	100.0	17.6	45.5	36.9	100.0	44.1	55.9
1964-65	100.0	20.2	44.0	35.8	100.0	45.0	55.0
1965-66	100.0	19.2	44.0	36.8	100.0	44.2	55.8
1966-67	100.0	18.1	46.7	35.0	100.0	43.8	56.1
1967-68	100.0	17.3	47.7	34.8	100.0	44.1	55.8
1968-69	100.0	16.6	51.3	31.9	100.0	47.7	52.2
1969-70	100.0	17.0	49.4	33.4	100.0	45.4	54.5
1970-71	100.0	19.1	47.5	33.3	100.0	45.3	54.6
1971-72	100.0	18.8	47.5	33.5	100.0	43.7	56.2
1972-73	100.0	20.7	47.1	32.2	100.0	44.1	55.9

Source: U. S. Bureau of the Census, Governmental Finances in 19--, selected editions (Washington: Government Printing Office).

federal funds received at the state level is later transferred to local governments. Because the money is pooled with funds from state sources, there is some difficulty in estimating the exact percentage of federal funds transferred by the state government to the localities, but it is in the neighborhood of one-fourth. The state government's share of total revenues has risen slightly while the local share has dropped (from 39.9 percent in 1958-59 to 32.2 percent in 1972-73).

The breakdown by final recipient level shows that the local governments account for the majority of general revenues (55.9 percent in 1972-73), but their share is lower than what it was fifteen years ago--an indication that even though the state government is transferring large amounts to local governments, its own direct expenditures are growing faster.

County and City Fiscal Capacity and Effort

Interstate comparisons of state and local finances provide an incomplete picture of fiscal relationships because they do not tell us anything about intrastate variations in local finances. Comparisons among localities within the state are hampered by the absence of timely and complete information. There are no comprehensive reports on the finances of incorporated towns, and the State Auditor's reports on counties and cities have a three-year lag, are not comparable, and lack many types of needed information.

Notwithstanding these problems, there is still a need for intrastate comparisons. The following analysis addresses this need despite the limited data available.

Local Fiscal Capacity

Local fiscal capacity is a measure of the ability of a local government to obtain resources for public purposes. The economic well-being of the residents of a community only partially determines the financial capability of their local government since business activity also has an effect. For example, a locality with the property tax base provided by a big power generating plant may have a fiscal capacity quite large relative to the incomes and property values of the resident population.

Table 2.13 shows three measures of fiscal capacity. Two, of them, true value of real estate per capita and personal income per capita, are traditional measures with certain limitations that are explained below. As an alternative, computed revenue capacity per capita, is also shown.

Standardizing by resident population is a common method of making data for different sized localities comparable, and it has been used for the capacity measures. However, the population used in the denominator may not always be representative of the population receiving a full range of governmental services. Most affected by such considerations are localities with military bases and colleges.

True Value of Real Estate Per Capita

This measure recognizes that real estate is the most important source of local revenues, accounting for 50 percent statewide. However, caution should be exercised in using real estate as the sole measure of capacity since it does not represent all locally raised revenues, and in many cases, it is not a good predictor of other revenue bases. Furthermore, the relative importance of real estate taxes varies, ranging from 29 percent in Franklin City to 82 percent in Fluvanna.^{1/} As a rule, the real property tax tends to be relatively more important as a revenue source in rural areas since they lack the variety of sources and commercial revenue bases available in urban areas.

The state weighted average true value of real estate per capita was \$8,659 in 1971. The median was \$8,336 and the range 9.8 to 1, with the high

^{1/} John L. Knapp, Measuring Fiscal Capacity to Finance Public Education in Virginia (Tayloe Murphy Institute, University of Virginia, 1973), pp. 8, 35-40.

TABLE 2.13 SELECTED MEASURES OF LOCAL FISCAL CAPACITY

	Amount			Relative to State Average x 100		
	True Value of Real Estate Per Capita, 1971	Per Capita Personal Income, 1971	Computed Revenue Capacity Per Capita, 1971	True Value of Real Estate Per Capita, 1971	Per Capita Personal Income, 1971	Computed Revenue Capacity Per Capita, 1971
State	\$ 8,659	\$ 3,918	\$184.90	100	100	100
Counties						
Accomack	6,744	3,354	151.67	78	86	82
Albemarle	12,475	3,714	213.17	144	95	115
Alleghany	6,778	3,076	137.75	78	79	74
Amelia	10,062	2,855	173.22	116	73	94
Amherst	5,703	2,711	84.57	66	69	46
Appomattox	8,497	2,929	161.51	98	75	87
Arlington	14,183	6,344	288.78	164	162	156
Augusta	8,159	3,097	162.37	94	79	88
Bath	9,147	3,245	184.17	106	83	100
Bedford	8,707	3,080	163.12	101	79	88
Bland	6,635	2,625	134.62	77	67	73
Botetourt	8,766	3,223	167.18	101	82	90
Brunswick	6,851	2,494	133.41	79	64	72
Buchanan	7,524	2,554	144.08	87	65	78
Buckingham	10,719	2,176	167.20	124	56	90
Campbell	7,388	3,611	160.72	85	92	87
Caroline	11,254	3,126	188.71	130	80	102
Carroll	4,016	2,443	101.98	46	62	55
Charles City	7,335	2,619	132.74	85	67	72
Charlotte	7,049	2,520	134.54	81	64	73
Chesterfield	10,645	4,755	210.57	123	121	114
Clarke	13,034	3,277	216.89	151	84	117
Craig	6,634	2,886	136.63	77	74	74
Culpeper	11,696	3,053	203.44	135	78	110
Cumberland	8,969	2,387	153.16	104	61	83
Dickenson	9,409	2,434	157.79	109	62	85
Dinwiddie	4,578 ^a	2,347	100.33	53	60	54
Essex	11,607	2,972	205.35	134	76	111
Fairfax	12,849	5,196	249.41	148	133	135
Fauquier	16,937	3,701	267.22	196	94	145
Floyd	7,003	2,449	134.30	81	63	73
Fluvanna	14,587	2,575	214.62	168	66	116
Franklin	6,043	2,731	133.43	70	70	72
Frederick	8,342	3,035	169.17	96	77	91
Giles	8,941	3,162	170.98	103	81	92
Gloucester	10,818	3,524	196.28	125	90	106
Goochland	12,816	4,050	221.33	148	103	120
Grayson	5,655	2,080	109.55	65	53	59
Greene	6,953	2,582	132.80	80	66	72
Greensville	8,721	2,583	156.09	101	66	84

TABLE 2.13.--SELECTED MEASURES OF LOCAL FISCAL CAPACITY (Continued)

	Amount			Relative to State Average x 100		
	True Value of Real Estate Per Capita, 1971	Per Capita Personal Income, 1971	Computed Revenue Capacity Per Capita, 1971	True Value of Real Estate Per Capita, 1971	Per Capita Personal Income, 1971	Computed Revenue Capacity Per Capita, 1971
Halifax	5,883	2,339	119.41	68	60	65
Hanover	9,666	4,279	196.52	112	109	106
Henrico	8,067	4,992	201.67	93	127	109
Henry	6,088	3,445	145.77	70	88	79
Highland	11,237	2,111	172.79	130	54	93
Isle of Wight	10,175	3,712	189.70	117	95	103
James City	7,554	3,022	147.63	87	77	80
King and Queen	11,001	2,836	179.46	127	72	97
King George	9,529	5,120	204.19	110	131	110
King William	12,988	4,479	234.98	150	114	127
Lancaster	13,698	3,034	229.32	158	77	124
Lee	4,428	1,922	97.08	51	49	52
Loudoun	19,337	4,438	308.68	223	113	167
Louisa	8,782	2,539	155.30	101	65	84
Lunenburg	6,701	2,783	137.74	77	71	74
Madison	10,985	2,500	178.79	127	64	97
Mathews	9,804	2,533	169.10	113	65	91
Mecklenburg	6,539	2,894	141.28	76	74	76
Middlesex	13,795	2,613	218.39	159	67	118
Montgomery	6,244	2,992	139.56	72	76	75
Nelson	9,469	2,611	161.17	109	67	87
New Kent	10,306	2,519	175.13	119	64	95
Northampton	5,638	3,089	135.49	65	79	73
Northumberland	10,454	2,542	174.77	121	65	95
Nottoway	6,126	3,241	142.88	71	83	77
Orange	12,221	3,103	208.41	141	79	113
Page	8,990	2,876	169.21	104	73	92
Patrick	7,377	2,599	141.30	85	66	76
Pittsylvania	5,826	2,505	120.70	67	64	65
Powhatan	8,330	2,926	152.04	96	75	82
Prince Edward	7,337	3,075	156.15	85	78	84
Prince George	3,527 ^{a/}	4,273	120.78	41	109	65
Prince William	10,512	3,797	199.51	121	97	108
Pulaski	6,319	3,023	141.26	73	77	76
Rappahannock	17,392	2,923	250.09	201	75	135
Richmond	9,924	2,758	184.98	115	70	100
Roanoke	8,692	4,285	191.49	100	109	104
Rockbridge	8,543	2,783	157.77	99	71	85
Rockingham	7,105	3,339	152.44	82	85	82
Russell	8,009	2,536	146.51	92	65	79
Scott	4,323	2,421	103.81	50	62	56
Shenandoah	8,927	3,122	174.22	103	80	94

TABLE 2.13.--SELECTED MEASURES OF LOCAL FISCAL CAPACITY (Continued)

	Amount			Relative to State Average x 100		
	True Value of Real Estate Per Capita, 1971	Per Capita Personal Income, 1971	Computed Revenue Capacity Per Capita, 1971	True Value of Real Estate Per Capita, 1971	Per Capita Personal Income, 1971	Computed Revenue Capacity Per Capita, 1971
Smyth	5,230 ^{b/}	2,928	127.54	60	75	69
Southampton	7,312	2,341	132.55	84	60	72
Spotsylvania	10,585	2,778	181.04	122	71	98
Stafford	8,740	3,314	165.45	101	85	89
Surry	33,627	2,444	413.76	388	62	224
Sussex	8,435	2,667	154.88	97	68	84
Tazewell	4,982	2,962	128.52	58	76	70
Warren	12,918	3,506	226.88	149	89	123
Washington	5,160 ^{b/}	2,953	126.09	60	75	68
Westmoreland	10,048	2,297	165.54	116	59	90
Wise	3,438	2,765	106.53	40	71	58
Wythe	6,061	2,736	134.82	70	70	73
York	8,913	3,843	172.55	103	98	93
<u>Cities</u>						
Alexandria	11,576	5,412	255.04	134	138	138
Bedford	7,651	4,066	174.07	88	104	94
Bristol	6,171	3,769	167.94	71	96	91
Buena Vista	6,480	3,180	147.65	75	81	80
Charlottesville	9,697	3,708	211.47	112	95	114
Chesapeake	6,651	3,487	148.92	77	89	81
Clifton Forge	5,570	3,536	146.69	64	90	79
Colonial Heights	7,247	4,949	185.47	84	126	100
Covington	6,734	4,010	171.75	78	102	93
Danville	6,538	3,757	168.37	76	96	91
Emporia	6,358	3,660	169.31	73	93	92
Fairfax	12,116	4,518	257.70	140	115	139
Falls Church	14,310	7,318	377.24	165	187	204
Franklin	6,588	4,074	167.48	76	104	91
Fredericksburg	9,480	3,764	224.68	109	96	122
Galax	8,530	4,082	213.98	99	104	116
Hampton	6,290	3,734	154.96	73	95	84
Harrisonburg	8,921	4,134	220.65	103	106	119
Hopewell	7,058	4,162	171.33	82	106	93
Lexington	6,303	2,934	145.53	73	75	79
Lynchburg	7,315	4,159	189.95	84	106	103
Martinsville	8,846	4,611	212.27	102	118	115
Newport News	6,422	4,206	162.84	74	107	88
Norfolk	6,030	3,797	155.42	70	97	84
Norton	5,977	3,714	167.60	69	95	91
Petersburg	7,813 ^{e/}	4,727	200.23	90	121	108
Portsmouth	5,334	3,406	137.17	62	87	74
Radford	5,619	3,483	144.48	65	89	78
Richmond	7,980	4,506	200.49	92	115	108
Roanoke	6,406	4,084	180.51	74	104	98

TABLE 2.13.--SELECTED MEASURES OF LOCAL FISCAL CAPACITY (Continued)

	Amount			Relative to State Average x 100		
	True Value of Real Estate Per Capita, 1971	Per Capita Personal Income, 1971	Computed Revenue Capacity Per Capita, 1971	True Value of Real Estate Per Capita, 1971	Per Capita Personal Income, 1971	Computed Revenue Capacity Per Capita, 1971
Salem	8,490	3,986	194.34	98	102	105
South Boston	6,890	4,100	177.49	80	105	96
Staunton	7,213	3,971	176.33	83	101	95
Suffolk ^{a/}	6,674	3,184	149.32	77	81	81
Virginia Beach	8,668	3,836	180.04	100	98	97
Waynesboro	9,067	4,353	206.49	105	111	112
Williamsburg	13,989	3,889	294.12	162	99	159
Winchester	10,008	4,234	220.37	116	108	119

^{a/} Adjusted due to annexation by Petersburg City effective January 1, 1972.

^{b/} Adjusted to exclude Olin Mathieson Corporation deeded to town of Saltville in 1972.

^{c/} Adjusted due to annexation from Dinwiddie County and Prince George County effective January 1, 1972.

^{d/} Adjusted due to the merger of the city of Nansemond with the city of Suffolk effective January 1, 1974.

Sources: Department of Taxation, "Estimated True (Full) Value of Locally Taxed Property in Virginia Counties, Cities, and Towns Constituting Special School Districts--1971 (Real Estate and Public Service Corporation):" (June 15, 1973); University of Virginia, Tayloe Murphy Institute, "Personal Income Estimates for Virginia Cities and Counties, 1971:" (December, 1973); University of Virginia, Tayloe Murphy Institute, "Estimates of the Population of Virginia Counties and Cities: July 1, 1971 and July 1, 1972:" (June, 1973); "Report of the Department of Taxation to the Governor of Virginia for the Fiscal Year Ending June 30, 1971:" (November 1, 1971).

represented by Surry, the location of a large nuclear generating plant, and the low by Wise, a rural county in southwest Virginia.

Personal Income Per Capita

Although Virginia counties and cities are prohibited from taxing income directly, it can be used as a general measure of ability to pay other taxes and nontax charges. A limitation of this approach is that sole reliance on income as a measure of capacity understates tax bases not locally owned. The existence of a large public service corporation would not be reflected by an income measure despite the fact that it would represent a major tax base.

The statewide weighted average was \$3,918 and the median was \$3,184. The range was 3.8 to 1 with the high represented by Falls Church and the low represented by Lee.

Computed Revenue Capacity Per Capita

This method is based on the ACIR "average effort" approach which was explained in the section on interstate comparisons. Each major tax base in a locality was multiplied by the statewide average effort. The true value of real estate was multiplied by \$.0106, and personal income, a proxy for nonproperty and nonsales taxes and other revenues was multiplied by \$.0160. The number of motor vehicles was multiplied by \$27.29 as a proxy for personal property taxes. The resulting products were added to local option sales tax collections to obtain computed revenue which was then standardized by dividing by population.

This method gives a more balanced picture of local fiscal capacity than a single measure such as true value of real estate or personal income. The state weighted average was \$184.90 per capita and the median was

\$169.13. The range from highest to lowest locality was 4.3 to 1 with Surry the highest area and Lee the lowest.

Local Fiscal Effort

Effort measures are obtained by relating revenues raised from own sources to fiscal capacity. A measure of fiscal effort gauges how much of capacity is being used.

Four measures of local fiscal effort are shown in Table 2.14. Three of the measures relate revenues from own sources (excluding state and federal aid) to the capacity measures already developed. The true tax rate on real estate is included as a fourth measure.

The figures for revenues from own sources exclude incorporated towns since they are not reported by the State Auditor. Inclusion of the towns would have increased total county revenues from own sources by about 5 percent.^{1/} The impact for counties containing incorporated towns would have been relatively larger.

Revenues from Own Sources per \$100 of True Value of Real Estate

This measure relates locally raised revenues to a single revenue base, the true value of real estate. The logic for this approach is the predominance

^{1/} County general revenues from own sources for 1971-72 totaled \$483 million as reported by the 1972 Census of Governments. The increase from including incorporated towns would have been approximately \$25 million. This was estimated by subtracting the total of general revenues from own sources for the 25 independent cities with a 1970 population under 25,000 from the total of general revenues from own sources for all municipalities with a 1970 population under 25,000.

Sources: U. S. Bureau of the Census, Census of Governments, 1972, Volume 4, No. 4 (Washington: U. S. Government Printing Office, 1974) p. 130; U. S. Bureau of the Census, Census of Governments, 1972, Volume 4, No. 5 (Washington: U. S. Government Printing Office, 1974) pp. 578-581.

TABLE 2.14.--SELECTED MEASURES OF LOCAL FISCAL EFFORT

State Counties	Amount			Average Effective True Tax Rate per \$100 on Real Estate 1971	Relative to State Average x 100, 1970-71 Revenues from Own Sources				1970-71 Revenues from Own Sources Per Capita ÷ Computed Revenue Capacity, Per Capita, 1971		Relative to State Average x 100, Average Effective True Tax Rate on Real Estate, 1971			
	1970-71 Revenues from Own Sources				Per \$100 True Value of Real Estate, 1971		Per \$100 of Personal Income 1971		Per \$100 of Personal Income 1971		Per \$100 of Personal Income 1971		Per \$100 of Personal Income 1971	
	Per \$100 True Value of Real Estate, 1971	Per \$100 of Personal Income 1971	Per Capita 1971		Amount	Rank	Amount	Rank	Amount	Rank	Amount	Rank	Amount	Rank
	\$2.08	\$4.61	\$184.90	\$1.06	100		100		100		100			
Accomack	1.21	2.42	81.33	.55	58	63.5	52	102.5	54	75.5	52	85.5		
Albemarle	1.47	4.94	183.52	.72	71	48	107	21.5	86	33.5	68	55.5		
Allegheny	1.56	3.43	105.42	.79	75	46	74	66.5	77	42	75	46.5		
Amelia	.63	2.21	63.20	.32	30	129	48	113.5	36	127.5	30	128.5		
Amherst	.99	2.09	56.63	.38	48	80.5	45	120.5	67	50.5	36	122.5		
Appomattox	.87	2.52	73.71	.48	42	102.5	55	93.5	46	102.5	45	101.5		
Arlington	2.81	6.28	398.22	1.32	135	10	136	4	138	3	125	12.5		
Augusta	1.30	3.41	105.71	.67	62	55.5	74	66.5	65	52.5	63	65.5		
Bath	1.26	3.56	115.66	.70	61	59	77	55.5	63	57.5	66	59.5		
Bedford	1.23	3.47	106.78	.47	59	60.5	75	63.5	65	52.5	44	105.5		
Bland	.81	2.04	53.60	.31	39	112.5	44	124.5	40	120.5	29	130		
Botetourt	.98	2.66	85.78	.55	47	84.5	58	87.5	51	81.5	52	85.5		
Brunswick	1.00	2.74	68.32	.54	48	80.5	59	84.5	51	81.5	51	88.5		
Buchanan	.99	2.91	74.40	.52	48	8.5	63	80.5	51	81.5	49	92.5		
Buckingham	.56	2.73	59.50	.27	27	131	59	84.5	36	127.5	25	132		
Campbell	1.01	2.06	74.43	.51	49	78.5	45	120.5	46	102.5	48	94.5		
Caroline	.65	2.33	72.83	.40	31	128	51	104.5	39	124	38	118.5		
Carroll	1.37	2.25	54.94	.72	66	52	49	109.5	54	75.5	68	55.5		
Charles City	.89	2.49	65.18	.51	43	98.5	54	95.5	49	91.5	48	94.5		
Charlotte	.83	2.33	58.72	.43	40	111	51	104.5	44	110.5	41	111.5		
Chesterfield	2.32	5.18	246.46	.86	112	26	112	15.5	117	12	81	40.5		
Clarke	.90	3.56	116.72	.58	43	98.5	77	55.5	54	75.5	55	79.5		
Craig	.99	2.26	65.36	.61	48	80.5	49	109.5	48	94.5	58	69.5		
Culpeper	.81	3.11	95.11	.50	39	112.5	67	75.5	47	100.5	47	98.5		
Cumberland	.79	2.95	70.41	.39	38	115	64	79	46	102.5	37	120.5		
Dickenson	.92	3.54	86.11	.51	44	94.5	77	55.5	55	71.5	48	94.5		
Dinwiddie	1.29 ^{a/}	2.51	58.96 ^{a/}	.59	62	55.5	54	95.5	59	65.5	56	77.5		
Essex	.87	3.41	101.25	.43	42	102.5	74	66.5	49	91.5	41	111.5		
Fairfax	2.37	5.87	305.10	1.41	114	21.5	127	9	122	8.5	133	7		
Fauquier	.77	3.52	130.31	.42	37	116.5	76	58.5	49	91.5	40	116.5		
Floyd	.85	2.43	59.55	.50	41	107.5	53	98.5	44	110.5	47	98.5		
Fluvanna	.76	4.31	111.08	.38	37	116.5	93	31	52	80	36	122.5		
Franklin	.91	2.00	54.75	.47	44	94.5	43	126	41	115.5	44	105.5		
Frederick	1.35	3.72	113.00	.57	65	53	81	48.5	67	50.5	54	81.5		
Giles	1.29	3.66	115.74	.52	62	55.5	79	51.5	68	48.5	49	92.5		
Gloucester	.87	2.67	94.03	.48	42	102.5	58	87.5	48	94.5	45	101.5		
Goochland	.88	2.78	112.39	.60	42	102.5	60	83	51	81.5	57	74.5		
Grayson	.71	1.92	40.01	.34	34	122.5	42	127.5	37	125.5	32	126.5		
Greene	.96	2.59	66.98	.61	46	88.5	56	91.5	50	88.5	58	69.5		
Greensville	1.14	3.84	99.08	.38	55	67.5	83	44.5	63	57.5	36	122.5		
Halifax	.98	2.46	57.57	.44	47	84.5	53	98.5	48	94.5	42	108.5		
Hanover	.91	2.06	88.33	.59	44	94.5	45	120.5	45	108.5	56	77.5		
Henrico	2.55	4.12	205.48	1.00	123	17	89	35.5	102	21.5	94	31		
Henry	1.10	1.95	67.18	.56	53	73	42	127.5	46	102.5	53	83.5		
Highland	.97	5.15	108.65	.54	47	84.5	112	15.5	63	57.5	51	88.5		

TABLE 2.14.--SELECTED MEASURES OF LOCAL FISCAL EFFORT (continued)

Counties (continued)	Amount			Average Effective True Tax Rate per \$100 on Real Estate 1971	Relative to State Average x 100, 1970-71 Revenues from Own Sources				1970-71 Revenues from Own Sources		Relative to State Average x 100, Average Effective True Tax Rate on Real Estate, 1971	
	1970-71 Revenues from Own Sources				Per \$100 True Value of Real Estate, 1971		Per \$100 of Personal Income 1971		Per Capita : Computed Revenue Capacity, Per Capita, 1971		Amount Rank	
	Per \$100 True Value of Real Estate, 1971	Per \$100 of Personal Income 1971	Per Capita 1971		Amount	Rank	Amount	Rank	Amount	Rank	Amount	Rank
Isle of Wight	.90	2.46	91.50	.48	43	98.5	53	98.5	48	94.5	45	101.5
James City	1.40	3.49	105.47	.98	67	50.5	76	58.5	71	45	92	34
King George	1.19	2.22	113.78	.71	57	65.5	48	113.5	63	57.5	67	57.5
King & Queen	.66	2.56	72.71	.53	32	127	56	91.5	36	127.5	50	91
King William	.58	1.69	75.73	.51 ^{b/}	28	130	37	131	32	132	48	94.5
Lancaster	.70	3.14	92.20	.42	34	122.5	68	73.5	40	120.5	40	116.5
Lee	1.40	3.23	62.06	.73	67	50.5	70	71.5	64	56	69	52.5
Loudoun	.85	3.72	165.10	.73	41	107.5	81	48.5	53	78.5	69	52.5
Louisa	.73	2.52	63.97	.43	35	119.5	55	93.5	41	115.5	41	111.5
Lunenburg	.94	2.26	62.98	.60	45	91.5	49	109.5	46	102.5	57	74.5
Madison	.69	3.02	75.46	.43	33	125.5	66	77.5	42	114	41	111.5
Mathews	.94	3.64	92.28	.58	45	91.5	79	51.5	55	71.5	55	79.5
Mecklenburg	.89	2.02	58.31	.45	43	98.5	44	124.5	41	115.5	42	108.5
Middlesex	.69	3.63	94.86	.40	33	125.5	79	51.5	43	113	38	118.5
Montgomery	1.04	2.17	64.78	.57	50	74.5	47	117	46	102.5	54	81.5
Nelson	.95	3.46	90.24	.34	46	88.5	75	63.5	56	70	32	126.5
New Kent	1.01	4.13	103.91	.61	49	78.5	90	34	59	65.5	58	69.5
Northampton	1.23	2.25	69.52	.65 ^{c/}	59	60.5	49	109.5	51	81.5	61	67
Northumberland	.81	3.33	84.75	.54	39	112.5	72	70	48	94.5	51	88.5
Nottoway	1.18	2.23	72.43	.69	57	65.5	48	113.5	51	81.5	65	62.5
Orange	1.03	4.07	126.44	.70	50	74.5	88	38	61	62.5	66	59.5
Page	.77	2.39	68.89	.45	37	116.5	52	102.5	41	115.5	42	108.5
Patrick	.86	2.45	63.72	.43	41	107.5	53	98.5	45	108.5	41	111.5
Pittsylvania	.92	2.14	53.49	.73	44	94.5	46	118.5	44	110.5	69	52.5
Powhatan	.96	2.74	80.26	.80	46	88.5	59	84.5	53	78.5	75	46.5
Prince Edward	.70	1.67	51.35	.29	34	122.5	36	132	33	131	27	131
Prince George	1.89 ^{a/}	1.56	66.64 ^{a/}	.70	91	38.5	34	133	55	71.5	66	59.5
Prince William	2.05	5.68	215.86	1.16	99	35	123	10	108	15	109	17.5
Pulaski	1.13	2.36	71.33	.56	54	69.5	51	104.5	50	88.5	53	83.5
Rappahannock	.51	3.02	88.40	.32	25	132	66	77.5	35	130	30	128.5
Richmond	1.03	3.71	102.19	.55	50	74.5	80	50	55	71.4	52	85.5
Roanoke	1.65	3.35	143.50	.90	79	45	73	69	75	43	85	36.5
Rockbridge	1.30	3.98	110.87	.67	62	55.5	86	40.5	70	46.5	63	65.5
Rockingham	.86	1.82	60.88	.47	41	107.5	39	129	40	120.5	44	105.5
Russell	1.12	3.52	89.38	.61	54	69.5	76	58.5	61	62.5	58	69.5
Scott	1.20	2.14	51.75	.61	58	63.5	46	118.5	50	88.5	58	69.5
Shenandoah	.72 ^{a/}	2.07	64.51	.37	35	119.5	45	120.5	37	125.5	35	125
Smyth	.97 ^{a/}	1.74	50.87	.49	47	84.5	38	130	40	120.5	46	100
Southampton	1.13	3.52	82.37	.63	54	69.5	76	58.5	62	61	59	68
Spotsylvania	1.12	4.25	118.08	.77	54	69.5	92	32.5	65	52.5	73	48
Stafford	1.22	3.22	106.86	.87	59	60.5	70	71.5	65	52.5	82	38.5
Surry	.25	3.46	84.56	.24	12	133	75	63.5	20	133	23	133
Sussex	.88	2.79	74.43	.48	42	102.5	61	82	48	94.5	45	101.5
Tazewell	1.31	2.21	65.33	.71	63	54	48	113.5	51	81.5	67	57.5
Warren	.72	2.67	93.47	.39	35	119.5	58	87.5	41	115.5	37	120.5

TABLE 2.14.--SELECTED MEASURES OF LOCAL FISCAL EFFORT (continued)

	Amount			Average Effective True Tax Rate per \$100 on Real Estate 1971	Relative to State Average x 100, 1970-71 Revenues from Own Sources				1970-71 Revenues from Own Sources Per Capita †		Relative to State Average x 100, Average Effective True Tax Rate on Real Estate, 1971		
	1970-71 Revenues from Own Sources				Per \$100 of Real Estate, 1971	Per \$100 True Value of Real Estate, 1971		Per \$100 of Personal Income 1971		Per Capita, 1971	Rank	Amount	Rank
	Per \$100	Per \$100	Per			Amount	Rank	Amount	Rank				
Counties (continued)													
Washington	1.43 ^{d/}	2.50	73.77	.68	69	49	54	95.5	58	68	64	64	
Westmoreland	.94	4.09	94.04	.82	45	91.5	89	35.5	57	69	77	44.5	
Wise	1.89	2.36	65.15	.87	91	38.5	51	104.5	61	62.5	82	38.5	
Wythe	1.04	2.31	63.30	.60	50	74.5	50	108	47	100.5	57	74.5	
York	1.14	2.64	101.56	.75 ^{e/}	55	67.5	57	90	59	65.5	71	49.5	
Cities													
Alexandria	2.79	5.96	322.54	1.73	134	11	129	7.5	126	7	163	3	
Bedford	1.66	3.12	127.02	.69	80	44	68	73.5	73	44	65	62.5	
Bristol	2.89	4.73	178.19	1.33	139	9	103	23.5	106	17	125	12.5	
Buena Vista	2.29	4.66	148.20	1.16	110	27.5	101	26	100	26	109	17.5	
Charlottesville	2.28	5.96	221.15	1.07	110	27.5	129	7.5	105	18.5	101	23.5	
Chesapeake	2.29	4.37	152.37	1.56	110	27.5	95	30	102	21.5	147	6	
Clifton Forge	2.70	4.25	150.22	1.27	130	13	92	32.5	102	21.5	120	15	
Colonial Heights	2.11	3.09	152.99	1.13	101	34	67	75.5	82	40	107	19.5	
Covington	2.38	4.00	160.51	1.05	114	21.5	87	39	93	30	99	27	
Danville	2.20	3.83	143.99	.90	106	30.5	83	44.5	86	33.5	85	36.5	
Emporia	2.20	3.83	140.11	.75	106	30.5	83	44.5	83	38.5	71	49.5	
Fairfax	2.74	7.35	332.04	1.60	132	12	159	2	129	6	151	5	
Falls Church	2.52	4.93	360.66	1.32	121	19	107	21.5	96	27.5	125	12.5	
Franklin	3.09	5.01	204.18	1.07	149	6	109	19	122	8.5	101	23.5	
Fredericksburg	2.41	6.07	228.33	1.12	116	20	132	6	102	21.5	106	21	
Galax	2.37	4.96	202.44	.82	114	21.5	108	20	95	29	77	44.5	
Hampton	2.64	4.44	165.94	1.34	127	15.5	96	28.5	107	16	126	11	
Harrisonburg	2.38	5.14	212.32	.85	114	21.5	111	17	96	27.5	80	42	
Hopewell	2.65	4.50	187.25	1.11	127	15.5	98	27	109	14	105	22	
Lexington	2.37	5.08	149.14	.93	114	21.5	110	18	102	21.5	88	35	
Lynchburg	3.13	5.51	229.23	1.25	150	5	120	11	121	10.5	118	16	
Martinsville	2.03	3.89	179.32	.99	98	36	84	43	84	35.5	93	32.5	
Newport News	3.06	4.68	196.66	1.75	147	7	102	25	121	10.5	165	2	
Norfolk	3.41	5.42	205.66	1.37	164	3	118	12	132	4	129	10	
Norton	2.94	4.74	175.95	.99	141	8	103	23.5	105	18.5	93	32.5	
Petersburg	2.67 ^{f/}	4.41	208.28 ^{f/}	1.62	128	14	96	28.5	104	20	153	4	
Portsmouth	3.36	5.27	179.32	1.40	162	4	114	14	131	5	132	8	
Radford	1.79	2.89	100.71	1.02	86	41.5	63	80.5	70	46.5	96	29.5	
Richmond	4.20	7.45	335.53	1.76	202	1	162	1	167	1	166	1	
Roanoke	3.98	6.23	254.65	1.38	191	2	135	5	141	2	130	9	
Salem	1.92	4.09	163.06	1.13	92	37	89	35.5	84	35.5	107	19.5	
South Boston	2.18	3.62	148.61	1.06	105	32.5	79	51.5	84	35.5	100	25.5	
Staunton	2.18	3.96	157.17	.83	105	32.5	86	40.5	89	31	78	43	
Suffolk ^{g/}	1.79	3.76	119.78	1.03	86	41.5	82	47	80	41	97	28	
Virginia Beach	1.73	3.91	150.17	.86	83	43	85	42	83	38.5	81	40.5	

TABLE 2.14.--SELECTED MEASURES OF LOCAL FISCAL EFFORT (continued)

Cities (continued)	Amount			Average Effective True Tax Rate per \$100 on Real Estate 1971	Relative to State Average x 100, 1970-71 Revenues from Own Sources				1970-71 Revenues from Own Sources Per Capita † Computed Revenue Capacity, Per Capita, 1971		Relative to State Average x 100, Average Effective True Tax Rate on Real Estate, 1971			
	1970-71 Revenues from Own Sources				Per \$100 True Value of Real Estate, 1971		Per \$100 True Value of Real Estate, 1971		Per \$100 of Personal Income 1971		Per Capita † Computed Revenue Capacity, Per Capita, 1971		Per Capita † Computed Revenue Capacity, Per Capita, 1971	
	Per \$100 True Value of Real Estate, 1971	Per \$100 of Personal Income 1971	Per Capita 1971		Amount	Rank	Amount	Rank	Amount	Rank	Amount	Rank	Amount	Rank
Waynesboro	2.54	5.29	230.39	1.02	122	18	115	13	112	13	96	29.5		
Williamsburg	1.83	6.60	256.49	.75	88	40	143	3	87	32	71	49.5		
Winchester	1.49	3.52	149.17	1.06	72	47	76	58.5	68	48.5	100	25.5		

a/ Adjusted due to annexation by Petersburg City effective January 1, 1972.

b/ Applied only to real estate outside the Town of West Point.

c/ Applies only to real estate outside the Town of Cape Charles.

d/ Adjusted to exclude Olin Mathieson Corporation deeded to Town of Saltville in 1972.

e/ Applies only to real estate outside the Town of Poquoson.

f/ Adjusted due to annexation from Dinwiddie County and Prince George County effective January 1, 1972.

g/ Adjusted due to consolidation of Nansemond city and Suffolk city into new city of Suffolk January 1, 1974.

Sources: Sources used for Table 2.13 plus the following: Report of Auditor of Public Accounts of Commonwealth of Virginia on Comparative Cost of County Government, Year Ended June 30, 1971 (Richmond, 1973), p. 16; Report of Auditor of Public Accounts of Commonwealth of Virginia on Comparative Cost of City Government, Year Ended June 30, 1971 (Richmond, 1973), p. 10; "1973 Virginia Assessment/Sales Ratio Study," Department of Taxation (February, 1975) pp. 22-25.

of the real estate tax base in most local revenue bases. Nonetheless, as already mentioned, there is a great deal of diversity within Virginia as to the relative importance of the real estate tax. The state weighted average effort was \$2.08 per \$100 of true value. The range was 16.8 to 1 represented by Richmond City (\$4.20) and Surry \$0.25).

Revenue from Own Sources per \$100 of Personal Income

Like the previous measure, this one relates locally raised revenues to a single revenue base, personal income, which is used as a general measure of ability to pay. The limitations of sole reliance on personal income have already been developed. The state weighted average effort was \$4.61 per \$100 of personal income, and the range was 4.8 to 1 represented by Richmond City (\$7.45) and Prince George (\$1.56).

Revenue from Own Sources Divided by Computed Revenue Capacity^{1/}

This measure provides a comprehensive picture of local effort, and it avoids some of the extremes inherent in the use of other methods. By definition, the state average had an index value of 100. The range was from 8.4 to 1, represented by Richmond City (167) and Surry (20).

Real Estate True Tax Rate

The true tax rate is often used as the sole measure of local effort, an inappropriate procedure in view of the previous remarks. However, the true tax rates for 1971 are included in Table 2.14 in order to facilitate comparisons. The weighted state average was \$1.06 per \$100 and the range

^{1/} Although per capita relationships are shown in Table 2.14, the index has the same value when total amounts are used since the same population is used in the numerator and the denominator.

was from 7.3 to 1, represented by Richmond City (\$1.76) and Surry (\$0.24).

The Department of Taxation has recently released a study for 1973 which is based on new and improved techniques for measuring effective tax rates. The data could not be incorporated in the tables since they cover a later year than currently available for many of the other measures. Although there was general correspondence in the 1971 and 1973 effective tax rates, the ranking for some areas differed significantly. Statewide the weighted average was \$0.72, and the range was 9.2 to 1, represented by Richmond City (\$1.65) and Surry (\$0.18).

Conclusion

The answer to "how much fiscal effort does a locality make?" depends on the measure used, as well as the efficiency of local government and the preference of the local population for governmental services. If a single measure must be chosen, the most preferred is revenue from own sources divided by computed revenue capacity. If several measures can be used, then an effective approach is to determine those localities that are consistently in the top and bottom quartiles in terms of rank. On that basis, the following 23 localities were in the top one-fourth no matter which measure was used: Alexandria, Bristol, Buena Vista, Charlottesville, Chesapeake, Clifton Forge, Fairfax City, Falls Church, Franklin City, Fredericksburg, Hampton, Hopewell, Lynchburg, Newport News, Norfolk, Norton, Petersburg, Portsmouth, Richmond City, Roanoke City, Waynesboro, and the counties of Arlington and Fairfax. The nine localities that were consistently in the bottom one-fourth were Amelia, Bland, Caroline, Charlotte, Grayson, Page, Prince Edward, Rockingham, and Shenandoah.

CHAPTER III

STATE REVENUES: GENERAL FUND AND SPECIAL FUNDS

Introduction

This chapter looks at the revenue sources used to fund programs in the general fund and the special funds. General fund revenue is all revenue of the Commonwealth of Virginia not properly accounted for in another revenue fund. This may seem like a shallow definition, but it is the official definition used by the Commonwealth. Although general fund revenues have comprised slightly less than half of total revenues of the Commonwealth in recent years,^{1/} these are the individual, corporate, and sales taxes that the individual citizen associates with his state government. In addition, the general fund is the focus of most of the legislative appropriation process. For these reasons, it receives the largest amount of attention in this report. Much of the revenue outside of the general fund comes from the federal government or represents state taxes earmarked for highways.

The first section of the chapter provides projections of general fund revenues for the next three biennia, 1976-78, 1978-80, and 1980-82. Combined with our expenditure projections in Chapter IV for the same period, the revenue forecasts help to answer two basic questions:

1. Will there be any need to consider increasing present taxes or imposing new ones?

^{1/} See for the last five fiscal years Report of the Comptroller to the Governor of Virginia for Fiscal Year Ended June 30, 197 . (Richmond: Department of Accounts, 197_).

2. If the answer to the first question is affirmative, then how much additional revenue will be required?

A second section develops alternative means of changing general fund taxes to provide additional revenues. The final section briefly investigates the special funds, in particular the gasoline tax and the motor vehicle sales and use tax.

The General Fund Revenue Forecast

This section presents first the short-run economic outlook and the long-run economic outlook. It then turns to the revenue forecasting methodology, the general fund revenue forecast assuming no structure or rate changes, and a brief discussion of the error range possible in the forecasts.

Short-Run Economic Outlook

Any discussion of the economic outlook through June 30, 1982, must have some underlying assumption about the resolution of the 1974-75 economic recession in the United States. This recession has been acclaimed the most severe of the post World War II recessions, which generally have been dated 1948-49, 1953-54, 1957-58, 1960-61, 1969-70, and 1974-75. The very rapid deterioration in the level of economic activity in December, 1974, and throughout the first quarter of 1975 has made the most severe recession label appropriate.

There has been a large volume of discussion among professional forecasters, government officials, businessmen, and private citizens as to the causes of the latest recession and the usefulness of comparisons between this and previous ones. The confusion over the current recession is due in part to the confused nature of the business and economic data

available when the recession was beginning, the presence of shortages of materials and order backlogs, which are characteristics of booming economic periods rather than recessionary periods, and the misleading signals given by the economy while it tried to correct for the distortions caused by wage and price controls. In retrospect it appears that although the oil embargo caused significant economic disruptions, a classical type economic slowdown or even recession would have resulted sometime during the 1974-75 period without the embargo. Chase Econometrics Associates, Inc., a leading economic forecasting service, best summarized the reasons for the 1974-75 recession in its discussion of five causal factors. Real disposable income, or money income adjusted for increases in prices, was growing very little throughout 1973 and actually declined when adjusted for farm income. This decline continued throughout 1974. As real disposable income declined, the standard of living of most Americans deteriorated. Declines over a short period can be offset by lower savings rates or increased borrowing. In the current situation, however, the length of the decline caused consumers to be unable or unwilling to maintain their previous spending patterns so that a slump in consumer spending resulted. The second factor was the oil embargo and the shock waves from it. The immediate impact was the sharp increase in the world price of oil that caused further declines in real disposable incomes in this country and abroad. The embargo also led to business interruptions because of a lack of fuel, thereby causing further shortages of raw materials, and the interdependence of various industries caused problems in one industry to be translated throughout the economy. The third factor was the removal of wage and price controls at the end of April, 1974. The controls produced distortions in the economic

system that became evident only after their removal. Price increases resulted and contributed to further declines in real disposable income. A fourth factor was the severe crop failures of 1974. While a near normal amount of rain fell in 1974, almost all of it came early in the year during the planting season with a drought during the peak growing season. Early frosts also limited what was to be a poor harvest. The final and perhaps the most important factor contributing to the recession was monetary policy overkill. The Federal Reserve's monetary policy continued to fight inflation even after the recession was well underway. This restrictive monetary policy caused the downturn to be much more severe than it would otherwise have been. Another event contributing to the severity of the recession was the business community's disbelief that a downturn was underway.

Thus, the 1974-75 recession is like previous recessions with falling real incomes causing a dampening in consumer demand with the associated buildups of business inventories and lack of confidence among consumers and businessmen. What are some factors that can cause the economy to turn around? Clearly, as the economy turned down, the demand for certain raw materials and other inputs in short supply lessened, thereby relaxing the pressures for further price increases. The result is some hope for a general lessening in the overall level of inflation that will allow consumer buying patterns to stabilize and consumer confidence to increase. In addition, as businessmen succeed in working off inventories built-up when consumer spending slumped, orders for new production will be placed that should slowly start the nation back up the economic ladder. Monetary and fiscal policies have been reoriented to provide a stimulus to economic activity in place of restrictive policies designed to fight inflation. Monetary policy has turned

stimulative, and the corporate and personal income tax cuts signed into law in March, 1975, have provided the thrust in the fiscal area. Another positive note is that it is unlikely that the combined problems of floods, drought, and early frost will strike again in 1975.

When will the upturn begin? We forecast that the economy should continue to decline through the second quarter of 1975 and begin a modest upturn during the final two quarters of the year with this upturn continuing into 1976. Of course, the economic outlook is certainly subject to dramatic change by unforeseen political events like an oil embargo or the collapse of international trade agreements.

Long-Run Economic Outlook

Once we make the ceteris paribus assumption that the short-run economic outlook is for a recovery continuing into 1976, what is the long-run projection for the level of economic activity as measured by gross national product (GNP)? Table 3.1 lists actual and projected current dollar GNP on a fiscal year basis from 1957-58 through 1981-82. The average annual increase in GNP from 1957-58 through 1973-74 was 7.2 percent. This average annual percentage increase was exceeded in 1971-72, 1972-73, and 1973-74 because of a continuation of a high level of real economic growth (i.e., increased physical volume of production) as well as a higher than average level of inflation in the latter half of that period. The 6.6 percent increase projected for 1974-75 is due only to inflation with real economic activity declining. We forecast an increase of 10.3 percent for 1975-76 and relatively large percentage increases for fiscal years 1976-77 and 1977-78. These high growth rates are the result of above normal real economic growth (5 to 6 percent per year) spurred by the recovery that is expected to carry into 1977

TABLE 3.1--CURRENT DOLLAR GROSS NATIONAL PRODUCT, ACTUAL AND PROJECTED

<u>Fiscal Year</u>	<u>Current Dollar Gross National Product</u>	
	<u>(Billions of \$'s)</u>	<u>Percent Change From Previous Year</u>
1957-58	\$ 440.2	-
1958-59	469.2	+ 6.6
1959-60	495.6	+ 5.6
1960-61	506.5	+ 2.2
1961-62	541.7	+ 6.9
1962-63	574.5	+ 6.0
1963-64	611.6	+ 6.4
1964-65	655.6	+ 7.2
1965-66	718.5	+ 9.6
1966-67	771.4	+ 7.4
1967-68	827.0	+ 7.2
1968-69	899.0	+ 8.7
1969-70	954.9	+ 6.2
1970-71	1,013.6	+ 6.1
1971-72	1,100.6	+ 8.6
1972-73	1,225.2	+11.3
1973-74	1,348.9	+10.1
	Average Annual Increase + 7.2	
<u>Projections</u>		
1974-75	1,438.6	+ 6.6
1975-76	1,587.0	+10.3
1976-77	1,797.8	+13.3
1977-78	1,997.2	+11.1
1978-79	2,169.2	+ 8.6
1979-80	2,365.7	+ 9.1
1980-81	2,592.9	+ 9.6
1981-82	2,839.0	+ 9.5

SOURCE: Various issues of the Survey of Current Business, especially the July issues which contain the annual revisions in the national income and product accounts.

combined with a continuation of above normal rates of inflation (5 to 6 percent). The boom moderates during the 1978-79 fiscal year with a return to more normal levels of real economic growth (about 4 percent annually), but higher levels of inflation continue throughout the remainder of the forecast period.

Revenue Forecasting Methodology^{1/}

The methodology utilized to make the revenue projections rests on the fundamental assumption that the Virginia economy is sufficiently broad based to respond directly to economic trends in the national economy. This assumption permits a forecast of GNP to be utilized to yield a forecast of Virginia personal income, the primary measure of economic activity for the state.^{2/} A comparison that supports this assumption is shown in Table 3.2, which presents the percentage distribution of personal income between the national and the Virginia economies by type and by industry source for calendar year 1973, the latest year available. Wages and salaries are a slightly larger percentage of

^{1/} This section is designed to give only a very general overview of the assumptions and techniques utilized to forecast general fund revenues. A more detailed methodology including the forecasting equations utilized for each revenue source is contained in the following two monographs, "General Fund Revenue Projections For Fiscal Years 1973-74, 1974-75, and 1975-76," (Richmond: Department of Taxation, April 15, 1974) and "General Fund Revenue Evaluation: October 1974," (Richmond: Department of Taxation, October 15, 1974).

^{2/} Ideally, we should utilize a measure of overall economic activity in Virginia comparable to gross national product. Gross state product estimates have not been found to be a reliable measure of Virginia economic activity nor are there projections available. One major problem for gross state product estimates is developing an estimate of imports and exports to the state. At the national level there are more controls that generate import and export data while there are no such controls at the state level. The problem is compounded because imports and exports are a larger percentage of total economic activity at the state level than at the national level.

TABLE 3.2--PERCENTAGE DISTRIBUTION OF PERSONAL INCOME PAYMENTS BY SOURCE,
ADJUSTED FOR RESIDENCY, VIRGINIA AND UNITED STATES, 1973

Type of Income	Percent of Total	
	1973 Virginia	1973 United States
Total personal income by place of residence..	100.0	100.0
Dividends, interest, and rent.....	11.8	13.8
Total labor and proprietors' income:		
By Type		
Wage and salary disbursements.....	66.4	65.6
Other labor income.....	3.5	4.3
Proprietors' income.....	6.4	9.1
Farm.....	1.6	3.6
Nonfarm.....	4.8	5.4
By Industry		
Farm.....	1.9	4.0
Nonfarm.....	74.5	75.0
Private.....	52.4	61.3
Manufacturing.....	15.3	21.0
Mining.....	0.8	0.8
Contract construction.....	5.5	5.0
Wholesale and retail trade.....	11.2	12.7
Finance, insurance, and real estate..	3.5	4.2
Transportation, communications, and public utilities.....	5.3	5.7
Services.....	10.7	11.8
Other industries.....	0.2	0.2
Government.....	22.0	13.7
Federal, civilian.....	8.5	3.3
Federal, military.....	5.8	1.8
State and local.....	7.8	8.6
Residence adjustment.....	5.7	-
Transfer payments.....	10.2	11.1
Less: personal contribution for social insurance.....	3.9	4.0

Note: Details may not add to totals due to rounding.

SOURCE: Survey of Current Business, Vol. 54, No. 8 (August, 1974),
Table 4, p. 34; and Table 44, p. 40.

personal income in Virginia than in the nation as a whole while proprietors' income is a slightly smaller percentage than the national norm. On an industry basis Virginia and the nation are quite similar with each having close to 75 percent of personal income derived from nonfarm activities. Virginia is relatively more concentrated in government activities and less concentrated in private business than is the nation. Nationally, 61.3 percent of total personal income is derived from private, nonfarm activity, while in Virginia this percentage is only 52.4. Manufacturing contributed only 15.3 percent of total personal income in Virginia while nationally the figure is 21.0 percent. The difference results from Virginia's relatively large government sector, which makes up 22.0 percent of total personal income versus only 13.7 percent in government nationally. This relatively large government sector serves to stabilize the Virginia economy. In addition, the Virginia economy is relatively less dependent on transfer payments and pays less in social insurance contributions than does the nation.

We actually forecast Virginia personal income with the GNP forecast in Table 3.1 and the average relationship between the growth in GNP and the growth in Virginia personal income over the period from 1957-58 to 1973-74. We established the relationship with ordinary least squares regression and found the following:

$$\text{(Log Virginia Personal Income)} = .594829 + 1.214466 \text{ (log GNP)} \\ (112.676)$$

Where: coefficient of determination = .9987
standard error of estimate = .0067
F - test of significance = 12,693.63
Durbin-Watson test = 1.2037
Durbin-Watson test for presence of autocorrelation
of residuals is inconclusive.

We can interpret this equation to mean that a one percent increase in GNP will yield approximately a 1.21 percent increase in Virginia personal income. Table 3.3 presents the historical Virginia personal income series along with the projections through fiscal year 1981-82.

We then used the Virginia personal income forecast as the principal independent variable to project the individual income tax, the sales tax, and the public service corporation taxes as well as the tobacco, beer, and alcoholic beverage excise taxes. Using ordinary least squares regression analysis we specified in separate equations the historical relationship between collections in each of these sources and personal income and then inserted the personal income projections. The corporate income tax is not forecast using Virginia personal income but rather utilizes the historical relationship between Virginia corporate tax collections and national corporate profits tax liability, a measure of the market rate of interest, and a proxy variable for corporate activity in Virginia, the number of new corporations in Virginia. We also found this historical relationship with ordinary least squares regression analysis and then inserted the projected values for the explanatory variables. Several of the miscellaneous taxes and other revenue sources do not respond immediately to changes in the level of economic activity. We derived the forecasts for these sources simply as a continuation of historical trends. This is accomplished by utilizing a separate regression equation for each source that makes collections a function of the qualitative variable time. When necessary, we made adjustments for changes in the tax laws.

TABLE 3.3--VIRGINIA PERSONAL INCOME, ACTUAL AND PROJECTED

<u>Fiscal Year</u>	<u>Virginia Personal Income (Millions of \$'s)</u>	<u>Percentage Increased</u>
1957-58	\$ 6,446.1	-
1958-59	6,957.0	+ 7.9
1959-60	7,287.8	+ 4.8
1960-61	7,577.9	+ 4.0
1961-62	8,228.2	+ 8.6
1962-63	8,807.6	+ 7.0
1963-64	9,522.6	+ 8.1
1964-65	10,420.1	+ 9.4
1965-66	11,386.2	+ 9.3
1966-67	12,357.4	+ 8.5
1967-68	13,627.8	+10.3
1968-69	15,070.9	+10.6
1969-70	16,504.7	+ 9.5
1970-71	17,904.0	+ 8.5
1971-72	19,768.5	+10.4
1972-73	22,116.0	+11.9
1973-74	24,615.8	+11.3
Average Annual Increase + 8.8		
<u>Projections</u>		
1974-75	26,503.5	+ 7.7
1975-76	29,859.6	+12.7
1976-77	34,742.8	+16.4
1977-78	39,476.7	+13.6
1978-79	43,642.9	+10.6
1979-80	48,489.8	+11.1
1980-81	54,202.2	+11.8
1981-82	60,512.1	+11.6

SOURCE: April and October issues of the Survey of Current Business which contain regional personal income data. Slight modifications were required to make the fiscal year data consistent with revisions of calendar year data issued in the August 1974, issue of the Survey of Current Business.

General Fund Revenue Forecast
Assuming No Structural or Rate Changes

We must view the general fund revenue forecasts beginning with 1976-77 as benchmark or planning forecasts rather than budget forecasts. They assume no changes in tax structures or rates over the forecast period. At the same time, we must remember that the standard and itemized deductions of the Virginia individual income tax conform to the federal deductions. Thus, any changes at the federal level, such as the increase in the standard deductions for 1975 only that was part of the income tax reduction package, should have an immediate impact on the state. Recognizing the potential for higher standard deductions and the fiscal problems that they could cause, the 1975 session of the General Assembly passed Senate Bill No. 645 (Chapter 46, 1975 Acts of Assembly), which freezes the Virginia deductions at the 1974 level for calendar year 1975 only. The act allows the executive and legislative branches to evaluate the effect of the change in the federal law on state revenues without a short-run fiscal crisis and to plan for offsetting changes at the state level if, as expected, the Congress makes the higher deductions effective for 1976 and beyond. The result for these long-run planning projections is that they may be somewhat inexact because they cannot anticipate a revised tax structure; however, they will capture the overall magnitudes, since the likelihood is great that the state will opt for an offset to lower revenue caused by federal action.

The projections include only three quarterly payments in 1976-77 from federal general revenue sharing because the program will lapse at the end of calendar year 1976. It is likely that the revenue

sharing program will be extended, but some consideration has been given to eliminating state governments from the program with local governments receiving all the payments. The loss of revenue sharing money, if it occurs, will cost the Commonwealth in excess of \$200 million during the period 1976-77 through 1981-82.

Table 3.4 presents the official revenue forecasts for 1974-75 and 1975-76 and the long-run projections from 1976-77 through 1981-82 by revenue category. The table shows the four major tax sources of revenue followed by the miscellaneous taxes and other revenues. It is evident from this table that the largest proportion of general fund revenue comes from the four major taxes: the corporate income tax, the individual and fiduciaries income tax, the public service corporation taxes, and the sales and use tax. Of these the individual and fiduciaries income tax and the sales and use tax produce the greatest revenues because of their broader bases and their greater responsiveness to economic growth than any other revenue sources.

Table 3.5 shows actual and projected general fund revenues on a biennial basis from 1962-64 through 1980-82. This table illustrates the vast increase in general fund revenues from the early 1960's through the 1972-74 biennium. During this twelve year period actual revenues from the major tax sources increased almost 400 percent while total general fund revenue increased almost 290 percent. Of course, during this period the state imposed the sales and use tax, raised the rates on both the corporation and individual and fiduciaries income taxes, and saw the introduction of federal general revenue sharing. During the eight year period from the end of the 1972-74 biennium until the end of the 1980-82 biennium, we forecast the major tax sources of general fund revenue to increase approximately 210 percent while total general fund revenues will grow by 172 percent.

TABLE 3.4--PROJECTED GENERAL FUND REVENUES FOR FISCAL YEARS 1974-75 THROUGH 1981-82

	Official Estimate		Long-run Projections					
	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82
MAJOR TAX SOURCES								
Corporations - Income	\$ 119,600,000	\$ 121,800,000	\$ 133,900,000	\$ 155,000,000	\$ 170,500,000	\$ 193,000,000	\$ 218,700,000	\$ 244,600,000
Individuals and Fiduciaries - Income	562,200,000	681,500,000	810,200,000	977,600,000	1,132,900,000	1,322,400,000	1,557,300,000	1,830,600,000
Public Service Corporations	58,300,000	63,700,000	79,600,000	89,700,000	98,600,000	108,900,000	121,100,000	134,500,000
State Sales and Use Tax	371,000,000	425,400,000	486,400,000	552,700,000	611,000,000	678,900,000	758,900,000	847,200,000
Total Major Tax Sources	\$1,111,100,000	\$1,292,400,000	\$1,510,100,000	\$1,775,000,000	\$2,013,000,000	\$2,303,200,000	\$2,656,000,000	\$3,056,900,000
MISCELLANEOUS TAXES AND OTHER REVENUES								
A.B.C. Profits	29,400,000	30,700,000	28,900,000	29,700,000	30,500,000	31,300,000	32,100,000	32,900,000
Alcoholic Beverages State Tax	28,700,000	30,300,000	31,200,000	33,000,000	34,500,000	36,100,000	37,900,000	39,700,000
Bank Stock	3,000,000	3,100,000	3,800,000	4,000,000	4,100,000	4,300,000	4,500,000	4,600,000
Beer and Beverage State Tax	20,000,000	21,300,000	24,200,000	26,600,000	28,600,000	30,800,000	33,400,000	36,200,000
Capital Not Otherwise Taxed	6,200,000	6,500,000	8,000,000	8,500,000	9,000,000	9,600,000	10,300,000	10,900,000
Corporate Franchise and Charters	5,800,000	6,000,000	6,500,000	6,900,000	7,300,000	7,700,000	8,200,000	8,700,000
Excess and Other Fees From Officers	2,500,000	2,700,000	3,000,000	3,100,000	3,300,000	3,500,000	3,700,000	3,900,000
Inheritance, Gift	18,600,000	19,500,000	23,100,000	24,200,000	25,300,000	26,400,000	27,500,000	28,600,000
Institutional Revenues	2,800,000	2,900,000	2,600,000	2,700,000	2,800,000	2,900,000	3,000,000	3,100,000
Insurance Companies - Premiums	48,300,000	53,200,000	57,600,000	64,000,000	71,000,000	78,700,000	87,400,000	96,900,000
Interest and Rents	17,300,000	17,800,000	19,700,000	21,500,000	22,800,000	24,200,000	25,600,000	27,100,000
Licenses and Permits	4,100,000	4,200,000	4,400,000	4,500,000	4,600,000	4,800,000	4,900,000	5,000,000
Miscellaneous Taxes and Penalties	4,000,000	4,200,000	4,600,000	4,800,000	5,000,000	5,300,000	5,500,000	5,800,000
Other Miscellaneous Revenues	7,400,000	7,100,000	7,800,000	8,500,000	9,200,000	9,900,000	10,800,000	11,700,000
Tobacco Products Tax	16,700,000	17,400,000	19,100,000	20,500,000	21,700,000	23,200,000	24,800,000	26,700,000
Transfer Per Appropriations Act	2,200,000	2,800,000	2,500,000	2,700,000	2,900,000	3,100,000	3,300,000	3,500,000
Wills, Suits, Deeds, Contracts	22,800,000	25,000,000	24,600,000	26,600,000	28,700,000	30,700,000	32,800,000	34,800,000
Total Misc. Taxes and Other Revenues	\$ 239,800,000	\$ 254,700,000	\$ 271,600,000	\$ 291,800,000	\$ 311,300,000	\$ 332,500,000	\$ 355,700,000	\$ 380,100,000
FEDERAL GENERAL REVENUE SHARING								
Federal Revenue Sharing	40,300,000	41,000,000	32,200,000	-0-	-0-	-0-	-0-	-0-
Federal Revenue Sharing Interest	1,000,000	1,100,000	1,500,000	-0-	-0-	-0-	-0-	-0-
Total Federal General Revenue Sharing	\$ 41,300,000	\$ 42,100,000	\$ 33,700,000 ^{a/}	-0-	-0-	-0-	-0-	-0-
TOTAL GENERAL FUND REVENUES	\$1,392,200,000	\$1,589,200,000	\$1,815,400,000	\$2,066,800,000	\$2,324,300,000	\$2,635,700,000	\$3,011,700,000	\$3,437,000,000

^{a/} This figure represents three payments which will be received during 1976-77. It is presumed that no further revenue sharing money will be received after 1976-77 since the present program is to expire at the end of calendar year 1976. Congress has begun consideration of extending the federal general revenue sharing program, but final passage of a bill extending the current program cannot be anticipated.

TABLE 3.5--GENERAL FUND REVENUES BIENNIAL BASIS ACTUAL 1962-64 THROUGH 1972-74 AND
PROJECTED 1974-76 THROUGH 1980-82

	Actual						Official	Long-run Projections		
	1962-64	1964-66	1966-68	1968-70	1970-72	1972-74	1974-76	1976-78	1978-80	1980-82
MAJOR TAX SOURCES										
Corporations - Income	\$ 66,142,525	\$ 87,658,331	\$ 98,176,680	\$ 134,851,250 ^{a/}	\$ 142,347,598 ^{a/}	\$ 203,024,192 ^{a/}	\$ 241,400,000	\$ 288,900,000	\$ 363,500,000	\$ 463,300,000
Individuals and Fiduciaries - Income	256,117,611 ^{c/}	306,577,074	415,019,382 ^{d/}	556,198,913 ^{e/}	678,362,436 ^{e/}	910,868,392 ^{e/}	1,243,700,000	1,787,800,000	2,453,300,000	3,387,900,000
Public Service Corporations	48,848,650	52,520,529	59,076,713	81,404,221 ^{h/}	82,471,430	101,999,493	122,000,000	169,300,000	207,500,000	255,600,000
State Sales and Use Tax	...	...	189,999,992 ^{i/}	395,308,346 ^{i/}	488,875,837	629,232,829	796,400,000	1,039,100,000	1,289,900,000	1,606,100,000
Total Major Tax Sources	\$371,108,786	\$446,755,934	\$ 762,272,767	\$1,167,762,730	\$1,392,057,301	\$1,845,124,911	\$2,403,500,000	\$3,285,100,000	\$4,316,200,000	\$5,712,900,000
MISCELLANEOUS TAXES AND OTHER REVENUES										
Total Miscellaneous Taxes and Other Revenues Including Federal General Revenue Sharing^{j/}	245,836,074	277,685,236	259,106,587	321,847,590	392,870,894	526,125,529	577,964,960	597,100,000	643,800,000	735,800,000
TOTAL GENERAL FUND REVENUES	\$616,944,860	\$724,441,170	\$1,021,379,354	\$1,489,610,320	\$1,784,928,195	\$2,371,250,440	\$2,981,464,960	\$3,882,200,000	\$4,960,000,000	\$6,448,700,000

^{a/} Includes a windfall in fiscal year 1968-69 of \$13,015,047, and a windfall in fiscal year 1969-70 of \$11,670,490 resulting from a change in law requiring corporations to pay their income tax in installments if their tax liability exceeded \$5,000. A further change requiring installment payments when tax liability exceeds \$1,000 resulted in a windfall of \$1,774,518 in fiscal year 1970-71 and an estimated windfall of \$1.7 million in fiscal year 1971-72.

^{b/} Rate increased from 5 percent to 6 percent effective January 1, 1972. Revenue impact not felt until 1972-73.

^{c/} Includes \$31,081,135 windfall due to the withholding of taxes for taxable year 1963, the collections of estimated taxes, and early payments.

^{d/} Includes \$11.5 million in revenue due to holding open books for collections from localities. Revenues were lower by \$1.1 million due to an increase in the dependent exemption of \$100.

^{e/} Includes \$29,709,290 windfall due to monthly collections of withheld income taxes in fiscal year 1968-69.

^{f/} A speed-up in the refund process resulted in a \$4.3 million one-time loss in fiscal year 1971-72.

^{g/} Effective January 1, 1972, reflects conformity to federal income tax law and the rate increase from 5 percent to 5.75 percent on taxable income over \$12,000. Revenue impact not felt until 1972-73.

^{h/} Includes \$13,412,305 windfall in fiscal year 1968-69 due to public service corporations filing declarations of estimated tax and paying the estimated tax in installments.

^{i/} The State Sales and Use Tax became effective September 1, 1966. The rate was raised from 2 percent to 3 percent on July 1, 1968.

^{j/} Detailed footnotes for the miscellaneous taxes and other revenue sources of general fund revenue are found in Table 3.2, pages 71-72 of Fiscal Prospects and Alternatives: 1974.

SOURCE: 1962-64 Biennium data to 1972-74 Biennium data: See for the last fourteen fiscal years Report of the Comptroller to the Governor of Virginia for Fiscal Year Ended June 30, 19__, (Richmond: Department of Accounts, 19__); Official Estimate: Department of Taxation; Long-run Projections by Staff.

Table 3.6 indicates more explicitly the relative importance of the major tax sources and the miscellaneous sources of general fund revenue. We expect the relative importance of the corporation income tax to lessen slightly over the forecast period as corporate profits grow at a slightly lower rate than income and sales. We project the individual income tax alone to produce over 50 percent of all general fund revenues by 1980-82. This source has been and will continue to be the most important source of general fund revenue to the Commonwealth. The four major tax sources are projected to produce 80.7 percent of total general fund revenue in 1974-76 followed by increasingly larger percentages of 84.6, 87.0, and 88.6 percent. The relative decline in importance of the miscellaneous taxes and other sources needs no further discussion except that the continuation of the present federal general revenue sharing program, which includes state governments, will increase the relative share of the miscellaneous sources.

Table 3.7 and Chart 3.1 summarize both the actual and projected dollar and percentage increases in general fund revenues from the 1962-64 biennium through the 1980-82 biennium. The projected absolute increase of \$610.2 million projected for the current biennium almost exceeds total general fund revenues in the 1962-64 biennium. This trend continues with the projected increase of \$900.7 million during the 1976-78 biennium surpassing total revenues in 1964-66 while the \$1,077.8 million increase projected for 1978-80 surpasses total revenues of the 1966-68 period. Revenues are projected to increase 30.2 percent during the 1976-78 biennium followed by increases of 27.8 percent in 1978-80 and 30.0 percent in 1980-82. These large absolute and percentage changes for the projection period are the result of substantial real economic growth and above average rates of inflation. Thus, while the

TABLE 3.6--MAJOR TAX SOURCES AND MISCELLANEOUS TAXES AND OTHER REVENUE
AS A PERCENTAGE OF TOTAL GENERAL FUND REVENUE
ACTUAL 1962-64 THROUGH 1972-74 AND PROJECTED 1974-76 THROUGH 1980-82

	Actual						Official	Long-run Projections		
	1962-64	1964-66	1966-68	1968-70	1970-72	1972-74	Estimate 1974-76	1976-78	1978-80	1980-82
MAJOR TAX SOURCES										
Corporations - Income	10.7	12.1	9.6	9.1	8.0	8.6	8.1	7.4	7.3	7.2
Individuals and Fiduciaries - Income	41.5	42.3	40.6	37.3	38.0	38.4	41.7	46.0	49.5	52.5
Public Service Corporations	7.9	7.2	5.8	5.5	4.6	4.3	4.1	4.4	4.2	4.0
State Sales and Use Tax	-	-	18.6	26.5	27.4	26.5	26.7	26.7	26.0	24.9
Total Major Tax Sources	60.2	61.7	74.6	78.4	78.0	77.8	80.7	84.6	87.0	88.6
MISCELLANEOUS TAXES AND OTHER REVENUES										
Total Miscellaneous Taxes and Other Revenues Including Federal General Revenue Sharing	39.8	38.3	25.4	21.6	22.0	22.2	19.3	15.4	13.0	11.4
TOTAL GENERAL FUND REVENUES	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: Details may not add to totals due to rounding.

SOURCE: Table 3.5

TABLE 3.7--SUMMARY OF GENERAL FUND REVENUES,
ACTUAL 1962-64 TO 1972-74 AND PROJECTED 1974-76 TO 1980-82

<u>Biennium</u>	<u>Amount</u> <u>(Millions of \$'s)</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u> <u>(Millions of \$'s)</u>	<u>Percent</u>
<u>Actual</u>			
1962-64	\$ 616.9	\$ +111.7	+22.1
1964-66	724.4	+107.5	+17.4
1966-68	1,021.4	+296.9	+41.0
1968-70	1,489.6	+468.2	+45.8
1970-72	1,784.9	+295.3	+19.8
1972-74	2,371.2	+586.3	+32.8
<u>Projected</u>			
1974-76	2,981.5 ^{a/}	+610.2	+25.7
1976-78	3,882.2	+900.7	+30.2
1978-80	4,960.0	+1,077.8	+27.8
1980-82	6,448.7	+1,488.7	+30.0

Note: Details may not add to totals due to rounding.

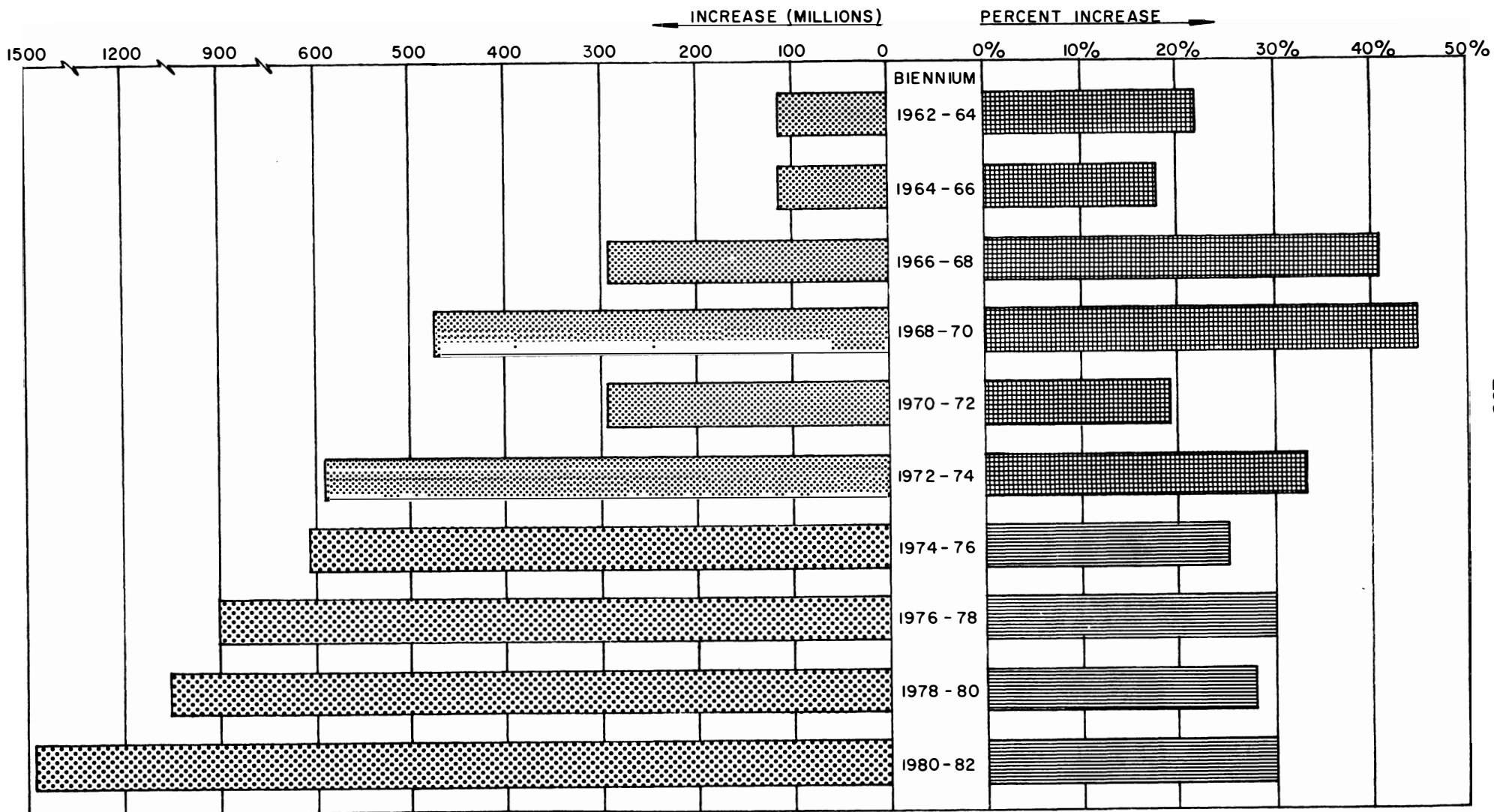
^{a/} Official estimate adopted during 1975 session of the General Assembly.

Commonwealth may receive significantly larger amounts of dollars, many of them will have to be expended solely to meet higher prices and not to purchase more real public goods and services.

Error Range

We must recognize that these long-run projections may be subject to considerable error because of unforeseen changes in the level of economic activity or changes in the various tax laws. The revenue forecasts are only as good as the projections of economic activity upon which they are based. The further into the future revenues are projected, the larger the margin of error is likely to be. An error range of \pm 4.0 percent is considered acceptable in making long-run projections of this type. The problem for policy makers is that this

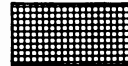
CHART 3.1
GROWTH OF GENERAL FUND REVENUES
ACTUAL AND PROJECTED 1962-64 TO 1980-82



ACTUAL



PROJECTED



ACTUAL



PROJECTED

Source: Table 3.7

± 4 percent error range yields projections for 1980-82 ranging from \$6,190.8 million to \$6,706.6 million, or a difference of \$515.8 million.

An example of an unforeseen economic factor that could produce an error in the forecasts is a downward shift in the 1.21 to 1 relationship between the growth in Virginia personal income and the growth in GNP. In Fiscal Prospects and Alternatives: 1974 this coefficient was 1.23 so there may already be some evidence of a mild slowdown of Virginia economic growth relative to national economic growth.^{1/} If this trend continued until the coefficient became, say, 1.15 the revenue impact would be dramatic. The individual income and sales taxes alone would yield forecasts for the six year period 1976-77 through 1981-82 \$632.1 million less than the forecasts already presented. The 1976-78 projection would be \$104.1 million less, the 1978-80 projection, \$193.8 million less, and the 1980-82 projection, \$334.2 million less.

^{1/} Barry E. Lipman, Benjamin A. Vorhies, et. al., Fiscal Prospects and Alternatives, 1974: A Staff Report to the Revenue Resources and Economic Study Commission, (Richmond: June, 1974), p. 79.

General Fund Revenue Alternatives

Corporate Income Tax

Introduction

In this introduction we shall attempt to provide the reader with a brief overview of the rationalization for and the economic issues involved in a corporate income tax as it exists at the federal and state levels. The remainder of this section will focus on the Virginia corporate income tax and how it compares with those in other states.

Traditionally, the corporation for legal and taxation purposes has been viewed as a separate entity with the original federal corporate tax levied as an excise tax on the privilege of doing business as a corporation. The rationale was that since the federal government granted the right to conduct business as a corporation, it had the right to impose a tax on this privilege. From the political viewpoint the decision makers (both executive and legislative) found it easy to impose a corporate tax because corporations did not vote and because individual citizens generally did not identify directly with corporation profits. Thus, the traditional reason behind the corporate tax seems to be an ex poste recognition of the existence of the corporate entity rather than an economic justification.

The more important question is what are the potential economic effects or distortions of economic activity resulting from the corporate income tax. We can separate the discussion of this question into two parts. The first involves the burden or incidence of the corporation tax while the second involves potential distorting economic effects of the tax.

Incidence of the Tax

From an economist's point of view the most controversial issue is who bears the burden of the corporate income tax. Clearly the corporation must pay its income tax bill. The broader question, though, is whether the burden of the corporate tax is shifted forward to consumers or backward to the factors of production. For analytical purposes economists have distinguished between short- and long-run shifting of the corporate income tax.

Short-run shifting infers that the after tax rate of return of the corporation is no lower than it would have been in the absence of the tax. Under this shifting argument the corporation merely acts as a tax collector for government. If shifted backward the tax is an additional expense like wages or rent that must be covered before making its profit. If the consumer bears the full burden of the tax, the corporate income tax is a hidden sales tax on the final purchaser. Short-run shifting can occur only under an imperfect market structure where firms exhibit varying degrees of control over price and output. The price and output decisions are made in a way that allows corporations to cover their full costs including their corporate income taxes while maintaining their required after tax rate of return. Many economists do not think that total short-run shifting is possible because it seems unreasonable that firms could set a price that would totally cover a tax that they must anticipate paying. Only the business operations in a given year can determine the tax owed for that year. The empirical evidence on the short-run shifting of the corporate income tax is inconclusive. There are as many different possible ways to investigate potential shifting as there are economists interested in testing it. The data are so incomplete that a definitive study of short-run shifting

is impossible. ^{1/} Thus the debate on the potential for such shifting will continue.

If the corporate income tax is somehow not shifted in the short-run, it must influence investment decisions in the long-run by reducing the rate of return on corporation equity, since a tax not borne by consumers or wage earners must be borne by suppliers of capital. The result is a lower rate of return on investment in the corporate sector than in the noncorporate sector and the potential for switching capital from one to the other.

Other Economic Effects

Any discussion of the economic effects of the corporate income tax must be overshadowed by the discussion of shifting, since the potential economic effects are quite different depending on how the tax is shifted. If the tax is borne by capital, the before tax rate of return of a particular investment project must be significantly greater than the rate required in the absence of the tax. For example, if a corporation used a decision criterion of a minimum rate of return on investment of 15 percent, the profits required to generate a 15 percent rate of return would be considerably higher with the tax than without it. A \$1,000,000 investment would require only a profit of \$150,000 in the absence of the 48 percent federal tax. To yield an after tax 15 percent rate of return would require profits of about \$290,000 or a 29 percent before tax rate of return. A firm might have several worthwhile investment projects that would yield returns in the 15 to 29 percent range; however, it would not undertake them because the potential after tax return would not meet the minimum investment criterion. Thus, the corporate tax may retard capital formation in the corporate

^{1/} For a survey of empirical studies on the short-run shifting of the corporate income tax, see William H. Oakland, "A Survey of the Recent Debate on the Short-Run Shifting of the Corporation Income Tax," in Proceedings of the National Tax Association, Vol. 62 (1969), pp. 525-547.

sector. Another potential bias of the corporate tax is the result of the treatment of debt and equity capital. Interest payments to debtors are treated as a business expense and are not taxed. Dividend payments to stockholders are considered returns to owners and come out of profits that are taxed. Except in closely held corporations, a strong argument can be made that dividends are a return for the use of funds just like interest paid to debtors. The unequal treatment of these encourages corporations to engage in debt financing since this is a cheaper source of funds.

Conclusion

The corporate income tax has been and will probably continue to be one of the most controversial sources of revenue for the federal and state governments. There are a few economic arguments to support the existence of this tax while there are a wide variety of potentially adverse economic effects and distortions resulting from it. Equity considerations are tied closely to the type and degree of tax shifting both of which are still hotly debated. Without more conclusive evidence on shifting or other distorting effects of the tax, it is likely that the tax will continue to be imposed since it is a large revenue producer at the state and federal levels.

Structure of the Corporate Tax in Virginia

The Virginia corporate income tax covers all domestic (incorporated in Virginia) and foreign (incorporated outside Virginia) corporations doing business in the state with the exception of public service corporations, insurance companies, inter-insurance exchanges, state and national banks, banking associations, any company which does business on a mutual basis, credit unions, and religious, educational, benevolent, and other corporations not organized or conducted for pecuniary profit. Those excluded are subject to other forms

of taxation or are exempt from any taxes.

The corporate tax rate was increased from 5 to 6 percent by the 1972 session of the General Assembly with a January 1, 1972, effective date. It is applied to a corporation's federal taxable income, with necessary modifications, as a result of the conformity legislation passed by the 1971 session of the General Assembly. Modifications include adding to federal taxable income (1) income taxes imposed by Virginia or any other taxing jurisdiction, since such income taxes are deductible in computing federal taxable income and (2) certain interest and dividends.

Virginia permits corporations engaged in multi-state activities that have income taxable by Virginia and out-of-state political subdivisions to allocate and apportion their Virginia taxable income through the following 3 factor formula so that different states do not impose a tax on the same income:

1. A property factor: ratio of the average real and tangible personal property value of the firm in Virginia to the firm's total average real and tangible personal property value.
2. A payroll factor: ratio of the total payroll in Virginia to the firm's total payroll.
3. A sales factor: ratio of the total sales in Virginia to the firm's total sales.

These ratios are added together and divided by the applicable number of factors to determine the portions of total taxable income subject to the Virginia tax. We must note that not all factors necessarily pertain to all corporations although this is the exception rather than the rule.

In fiscal 1973-74, the yield of the 6 percent tax was \$106.4 million, or 8.6 percent of total general fund revenues. Our projections indicate that revenues from the corporate income tax with the 6 percent rate will comprise about 7.4 percent of the general fund in the next biennium and about 7.2 percent by the 1980-82 biennium.

Interstate Comparison of the Corporate Income Tax

Table 3.8 and Chart 3.2 show the corporate income tax rates for the 45 states and the District of Columbia with a tax on corporate profits as of December 31, 1974. Most states impose a flat rate tax ranging from 4 to 12 percent, but a few have a progressive rate schedule. The table denotes whether the individual state allows the federal corporate income tax to be deducted from the tax base used to calculate the state corporate income tax. Effective tax rates are provided because they standardize the nominal rates to take account of the deductibility of the federal tax in 8 states. 1/

Virginia's effective rate is 6 percent. This compares with other states as follows:

<u>Effective Rate Compared with Virginia</u>	<u>Number of States</u>
No tax	5
Lower rate	16
Same rate	7
Higher rate	22

The median effective rate for all states with a corporate income tax is 6 percent. Virginia does appear competitive with its neighbors and major competitors, for its effective tax rate is equal to the rates of Georgia, North Carolina, South Carolina, Tennessee, and West Virginia, slightly lower than the 7 percent Maryland rate, and modestly higher than Kentucky's 5.8 percent effective rate. 2/

Other Taxes On Corporations

The corporate income tax is the most visible and well-known tax paid

1/ Those states which exempt part or all of federal tax payments require payment on a much smaller tax base. The effective tax rates for the states are therefore lower than the nominal rates. For those states not allowing the federal tax deduction, the nominal and effective rates should be equal except for those with other than a flat rate.

2/ Virginia's major competitors as defined by the Virginia Division of Industrial Development are Georgia, Kentucky, North Carolina, South Carolina, and Tennessee.

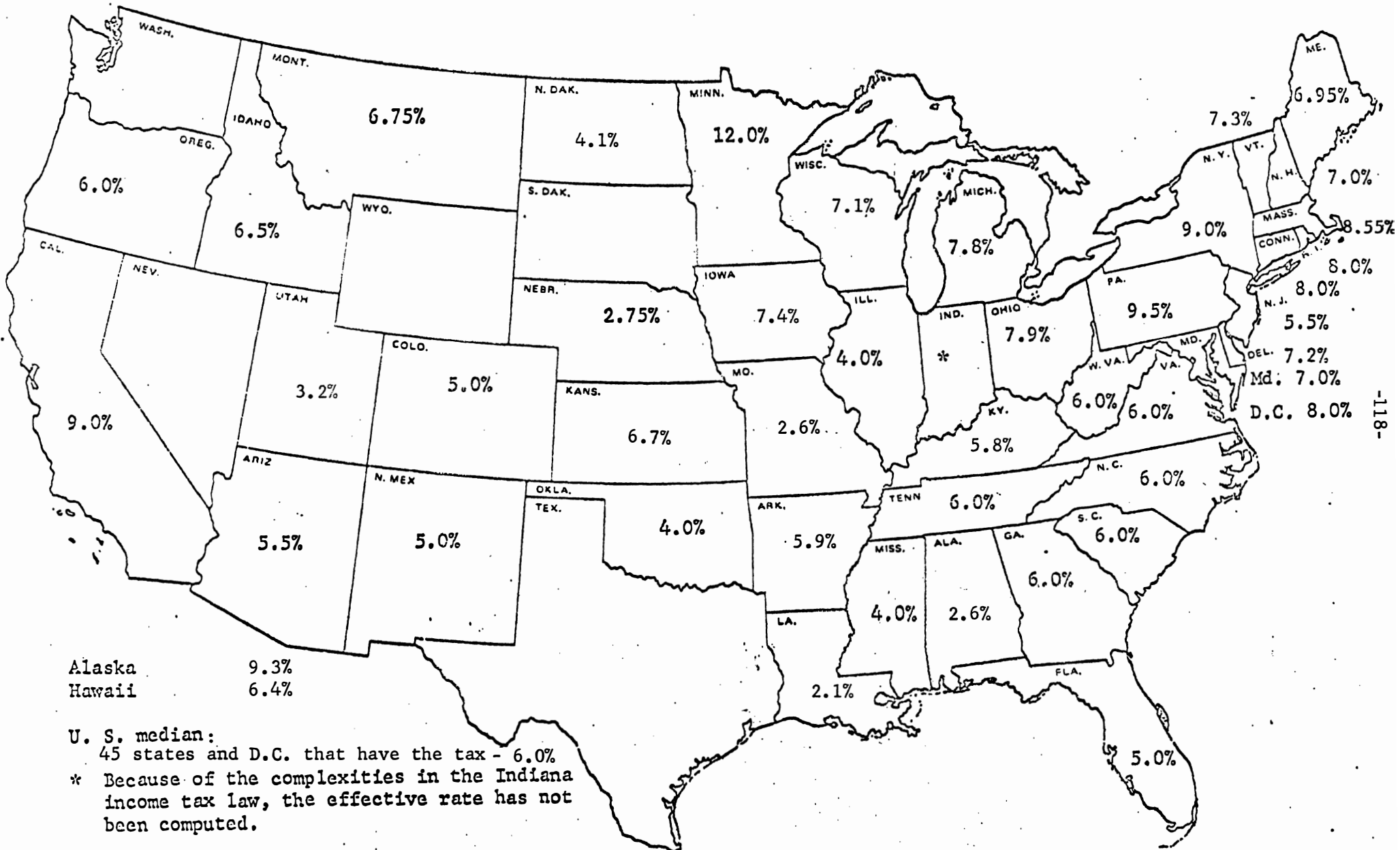
TABLE 3.8--STATE CORPORATE INCOME TAX RATES, AS OF DECEMBER 31, 1974

State	Tax Rate	Allow Deduction for Federal Income Taxes	Effective Rate ^{1/}	State	Tax Rate	Allow Deduction for Federal Income Taxes	Effective Rate ^{1/}
Alabama	5%	Yes	2.6%	Mississippi	3% on first \$5,000 4% on balance	No	4.0%
Alaska	18% of federal tax ^{2/}	No	9.3%	Missouri	5%	Yes ^{3/}	2.6%
Arizona	2.5% on first \$1,000 4% on second \$1,000 5% on third \$1,000 6.5% on fourth \$1,000 8% on fifth \$1,000 9% on sixth \$1,000 10.5% on balance	Yes ^{3/}	5.5%	Montana	6.75% ^{12/}	No	6.75%
Arkansas	1% on first \$3,000 2% on second \$3,000 3% on next \$5,000 5% on next \$14,000 6% on balance	No	5.9%	Nebraska	2.75%	No	2.75%
California	9% ^{4/}	No	9.0%	New Hampshire	7%	No	7.0%
Colorado	5%	No	5.0%	New Jersey	5.5%	No	5.5%
Connecticut	8% ^{5/}	No	8.0%	New Mexico	5%	No	5.0%
Delaware	7.2%	No	7.2%	New York	9% ^{13/}	No	9.0%
District of Columbia	8% ^{6/}	No	8.0%	North Carolina	6%	No	6.0%
Florida	5% ^{7/}	No	5.0%	North Dakota ^{14/}	3% on first \$3,000 4% on next \$5,000 5% on next \$7,000 6% on balance	Yes ^{3/}	4.1%
Georgia	6%	No	6.0%	Ohio	4% on first \$25,000 ^{15/} 8% on balance	No	7.9%
Hawaii	5.85% on first \$25,000 6.435% on balance	No	6.4%	Oklahoma	4%	No	4.0%
Idaho	6.5% plus \$10 excise tax	No	6.5%	Oregon	6%	No	6.0%
Illinois	4%	No	4.0%	Pennsylvania	9.5%	No	9.5%
Indiana	3% ^{8/}	No	... ^{9/}	Rhode Island	8% ^{16/}	No	8.0%
Iowa	6% on first \$25,000 8% on next \$75,000 10% on balance	Yes ^{10/}	7.4%	South Carolina	6%	No	6.0%
Kansas	4.5% on first \$25,000 6.75% on balance	No	6.7%	Tennessee	6%	No	6.0%
Kentucky	4% on first \$25,000 5.8% on balance	No	5.8%	Utah	6% ^{17/}	Yes ^{18/}	3.2%
Louisiana	4%	Yes	2.1%	Vermont	5% on first \$10,000 6% on next \$15,000 7% on next \$225,000 7.5% on balance	No	7.3%
Maine	5% on first \$25,000 7% on balance	No	6.95%	VIRGINIA	6%	No	6.0%
Maryland	7%	No	7.0%	West Virginia	6%	No	6.0%
Massachusetts	8.55%	No	8.55%	Wisconsin	2.3% on first \$1,000 2.8% on second \$1,000 3.4% on third \$1,000 4.5% on fourth \$1,000 5.6% on fifth \$1,000 6.8% on sixth \$1,000 7.9% on balance	Yes ^{19/}	7.1%
Michigan	7.8%	No	7.8%				
Minnesota	12% ^{11/}	No	12.0%				

TABLE 3.8--STATE CORPORATE INCOME TAX RATES, AS OF DECEMBER 31, 1974 (Continued)

- 1/ Effective rate based on a net income of \$1 million and allowance for deduction of federal income taxes when applicable.
 - 2/ Based on federal rates as of December 31, 1963, which were 30 percent on the first \$25,000 and 52 percent on all over \$25,000.
 - 3/ Specifically limited to federal tax on income taxed by the state.
 - 4/ Minimum tax \$200.
 - 5/ Plus added tax equal to amount by which 1/4 mills per \$1 of corporate excess exceeds 8 percent rate. Minimum tax \$50. Minimum tax \$100,000.
 - 6/ Minimum tax \$25.
 - 7/ Up to \$5,000 of net income is exempt.
 - 8/ Three percent rate applies to adjusted gross income. In addition, there is a supplemental corporate net income tax of 2½ percent for 1975 and 1976 and 3 percent for 1977 and thereafter.
 - 9/ Because of the complexities in the Indiana income tax law, the effective rate has not been computed.
 - 10/ Deductible up to 50 percent.
 - 11/ Minimum tax \$100.
 - 12/ Minimum tax \$50.
 - 13/ Or 1.6 mills on value of business and investment capital allocable to New York. Added tax: 0.8 mills per \$1 subsidiary capital. Minimum tax \$125.
 - 14/ Plus an additional tax of 1 percent of net income for privilege of doing business in North Dakota (federal income tax not deductible) and a Vietnam bonus surtax of 1 percent of taxable income (minimum \$10, maximum \$25).
 - 15/ Minimum tax \$50. Alternate tax, if higher, five mills on net worth.
 - 16/ Alternate tax of 40¢ per \$100 of corporate excess, whichever is larger.
 - 17/ Minimum tax \$25.
 - 18/ Amount of federal tax paid after all federal credits are deducted.
 - 19/ Only federal income tax paid on income taxable in Wisconsin; limited to 10 percent of net income before deductions for contributions and federal taxes.
- SOURCE: Prentice-Hall, Inc., State and Local Taxes: All States Unit, January 8, 1974, and April 2, 1974.

CHART 3.2--STATE CORPORATE INCOME TAX RATES, DECEMBER 31, 1974
 (Effective Rate Based on a Net Income of \$1 Million)



Alaska 9.3%
 Hawaii 6.4%

U. S. median:
 45 states and D.C. that have the tax - 6.0%
 * Because of the complexities in the Indiana income tax law, the effective rate has not been computed.

Note: Adjustments have been made for those states allowing deduction of federal income taxes. The rate shown for the U. S. is the median rate.

by the typical concern, and in Virginia as in most states it constitutes the largest single tax that a corporation pays to a state or local government. We must, however, emphasize that a corporation either operating in or contemplating relocation to a state will view its total tax liability rather than the corporate income tax alone as one of the factors affecting its location or expansion decision. To provide some perspective on the total tax liability faced by a firm in Virginia, we have drawn on information provided by the Virginia Division of Industrial Development. Table 3.9 shows the estimated state and local taxes on a hypothetical manufacturer in Virginia with a net income of \$1 million before federal income tax payments. The corporate income tax accounts for 55.6 percent of the estimated total state and local tax bill paid by the "typical" manufacturer. Various property taxes represent 33.3 percent of the tax bill and other than the income tax are the primary tax on corporations.

Although interstate comparisons of property taxes involve formidable measurement problems, a crude analysis of relative property tax revenues shows the revenues that various states collect. Table 3.10 shows per capita state and local property tax revenues for Virginia, its neighbors and major competitors. Virginia is higher than these states except for Maryland.

If we compare Virginia's total tax bill on a "typical" corporation with the tax bills that neighboring or competing states levy, we see that Virginia imposes a fairly low tax load on its corporations. Table 3.11 provides the average tax bill for a hypothetical corporation with a net income of \$1 million in Virginia and selected other states. Virginia imposes the second lowest tax load if exemptions or credits are not considered and the sixth lowest if they are taken into account. Because the New York and Massachusetts tax incentives are short-lived and because the tax bills of Kentucky and South Carolina

TABLE 3.9--ESTIMATED STATE AND LOCAL TAXES ON A HYPOTHETICAL MANUFACTURER IN VIRGINIA, 1974-75

	Assumed Values for Taxable Items	Type of Tax	Tax Rate	Assessment Ratio	Annual Tax	Percent of Total Bill
Real estate	\$ 1,140,000	Real property (L)	\$3.21 per \$100 ^{1/}	22.5% of fair market value ^{2/}	\$ 8,234	7.6
Machinery and tools:						
Original cost	4,490,000	Personal property (L)	\$4.00 per \$100 ^{2/}	15% of original cost ^{2/}	26,940	25.0
Book value	2,280,000					
Trucks & company cars	50,000	Personal property (L)	\$3.80 per \$100 ^{3/}	40% of market value ^{3/}	760	0.7
Office furniture and fixtures	100,000	Business capital (S)	30¢ per \$100	100% of book value	300	0.3
Inventory	2,150,000	Business capital (S)	30¢ per \$100	100% of book value	6,450	6.0
Receivables less payables ^{4/}	1,330,000	Business capital (S)	30¢ per \$100	100% of book value	3,990	3.7
Cash	460,000	None	No tax		-	-
Net income before federal income tax	1,000,000	Corporate income (S)	6%		60,000	55.6
Net worth	6,400,000	None	No tax		-	-
Total sales (gross receipts)	14,300,000	None	No tax		-	-
Capital stock	1,340,000	Annual registration (S)	Ranges from \$10 for stock of \$15,000 or less to \$50 for stock in excess of \$300,000.		50	0.0
Annual purchases subject to sales tax:						
Machinery and equipment	390,000	None ^{5/}	No tax		-	-
Electricity:						
Plant	87,000	None	No tax		-	-
Office	29,000	None	No tax		-	-
Fuels:						
Plant	92,000	None ^{5/}	No tax		-	-
Office	31,000	Sales and use (L), (S)	4% ^{6/}		1,240	1.1
TOTAL					\$107,964^{7/}	100.0

Note: (L) local tax; (S) state tax; figures are for a foreign corporation.

^{1/} Average tax rate and median assessment ratio for 1973 for all counties and cities in Virginia as compiled in a study by the Virginia Department of Taxation.

^{2/} Average for 1975 for all counties and cities in Virginia as estimated by Fred C. Forberg, Director of Real Estate Appraisal and Mapping, Virginia Department of Taxation.

^{3/} This is the median rate and ratio being used by counties and cities in Virginia for the 1974-75 tax year. Taxing practices vary widely throughout the state. Some communities use a percentage or all of the retail, wholesale, or loan value of the vehicle as shown in an official guidebook, while others use a percentage or all of the original cost, book value, or fair market value of the vehicle as reported by the taxpayer. We have assumed the book value shown to be approximately equal to these various values.

^{4/} Not taxed if books maintained outside Virginia.

^{5/} No tax if used directly in manufacturing tangible personal property for sale.

^{6/} Includes a 3 percent state levy and a 1 percent local levy.

^{7/} Does not include utility taxes which localities may impose.

SOURCE: Virginia Division of Industrial Development.

TABLE 3.10--STATE AND LOCAL PROPERTY TAX REVENUES
VIRGINIA AND SELECTED STATES, PER CAPITA, FISCAL YEAR 1972-73

<u>State</u>	<u>Per Capita Revenue</u>	<u>Relative to Virginia (Virginia=100)</u>
Georgia	\$126.21	97
Kentucky	77.88	60
Maryland	196.22	151
North Carolina	100.28	77
South Carolina	83.75	64
Tennessee	103.21	79
VIRGINIA	130.00	100
West Virginia	83.33	64
U. S. Average	215.78	166

SOURCE: U. S. Department of Commerce, Governmental Finances in 1972-73, GF 73, No. 5 (Washington, D. C.: U. S. Government Printing Office, 1974), p. 45.

are only moderately lower even with incentives, only Maryland, which offers a property exemption for up to 10 years, has a substantially lower tax bill for any extended length of time. This favorable tax position explains, at least in part, the high growth rate in the manufacturing sector that Virginia has achieved. Between 1963 and 1972 manufacturing employment grew by 25 percent in Virginia compared with 12 percent for the nation and 38 percent for Virginia's competitors. Value added in manufacturing gives a similar picture, for in the same time period it grew by 101 percent in Virginia as compared with 84 percent for the nation and 133 percent for Virginia's major competitors. The short-run growth trends in manufacturing employment and value added in manufacturing verify this long-run growth trend. Between 1967 and 1972 manufacturing employment grew by 11 percent in Virginia as compared with 14 percent for its major competitors while declining 2 percent in the nation. Value added in manufacturing grew during the same period by 51 percent in Virginia as compared with 35 percent for the nation and 61 percent for Virginia's major

TABLE 3.11 -- TOTAL STATE AND LOCAL TAXES IMPOSED ON A
HYPOTHETICAL MANUFACTURER, 1974-75
(assuming net income equals \$1 million)

<u>State</u>	<u>Without Exemptions or Credits</u>	<u>With Exemptions or Credits</u>
California	\$243,717 to 253,242	\$243,717 to 253,242
Georgia	139,363 or 141,753	139,363 or 141,753
Illinois	262,953	262,953
Kentucky	104,555	98,535 <u>1/</u>
Maryland	124,734	81,477 <u>2/</u>
Massachusetts	168,134	70,856 <u>3/</u>
New Jersey	154,542	154,542
New York	137,202 to 162,362	47,202 to 72,362 <u>4/</u>
North Carolina	138,899	138,899
Ohio	208,078	208,078
Pennsylvania	146,096	146,096
South Carolina	112,671	103,241 <u>5/</u>
Tennessee	108,625	108,625
West Virginia	224,354	167,054 <u>6/</u>
VIRGINIA	107,964	107,964
All State Average (using lowest tax shown)	158,793	138,574

1/ Property exemption for up to five years.

2/ Property exemption for up to ten years.

3/ Investment credit of 3 percent of investment in real estate, machinery, and office fixtures, to be applied against the corporation excise tax. Credit is good for the first year of operation; it can't be carried forward.

4/ Investment credit of 2 percent of total investment to be applied against the New York franchise (income) tax. Credit would be used-up early in the second year of operation.

5/ Property exemption, except for school purposes, for up to five successive years.

6/ Investment credit of 1 percent per year for ten years applied against the business and occupation tax.

competitors. ^{1/}

Before discussing a change in Virginia corporate tax rate, we must point out that corporations, when considering locational changes, examine not only taxes but a number of other factors. Each industry will attach a different level of importance to different factors. Some of them might be the quality of the labor force, availability and efficiency of the transportation network, proximity to raw material supplies, location of important markets, area wage rates, or the prices of basic energy sources.

Consideration of a Change in the Virginia Corporate Tax Rate

To increase the present 6 percent rate to, say, 7 percent during the 1976-78 biennium would represent a 40 percent increase in state corporate income tax liability within a period of 6 years. Such a change would be quite significant if we consider that the 5 percent rate remained unchanged for nearly 25 years. On the other hand, the full tax increase would not be paid entirely by the corporation because the state income tax is a deductible item in computing federal corporate income tax liability. A 1 percentage point increase in the tax rate would involve an effective increase of approximately one-half that amount with the other one-half borne by the federal government.

If Virginia did raise the corporate tax rate while other states did not, the state's position would deteriorate vis-a-vis neighboring or competing states. To better understand how an increase in the corporate tax rate would affect Virginia, we refer back to Table 3.11. Increasing the rate to 7 percent would boost a hypothetical Virginia manufacturer's tax bill to \$117,964, which would move Virginia from the second lowest ranked state to the fourth lowest exclusive of exemptions or credits. Virginia would rank below

^{1/} U. S. Bureau of the Census, Statistical Abstract of the United States: 1974, 95th Edition, (Washington, D.C.: Government Printing Office, 1974) pp. 730-731.

Kentucky, Tennessee, and South Carolina, three of its major competitors. If exemptions or credits were included, Virginia would slip to the seventh lowest ranked state.

As with many other policy decisions a change in the corporate tax rate must be considered in light of the trade-offs that would result. Specifically, an increase in the tax rate would lead to additional revenues in the short-term but in the long-run could hurt the chances for expanding the corporate tax base in Virginia. Thus, some major considerations that center around increasing the rate are:

1. How much growth does Virginia desire?
2. How will companies planning to relocate or expand their facilities be affected by an increase in the tax rate?
3. To what extent does Virginia desire to trade additional present revenues for the possibility of increased future revenues?

Taxation of Banks

Introduction

Under current law, Virginia taxes the shares of all state and national commercial banks at the rate of \$1 per \$100 of stock value. The state and the localities each receive a portion of total bank stock tax revenues with the counties taking up to 80 percent of revenue collections and the cities up to 40 percent. In the aggregate, the state receives approximately 45 percent of total revenue with local governments receiving the remaining 55 percent. Virginia is one of 14 states with a shares tax as the principle form of taxation. Neighboring states that have a shares tax include Kentucky, Tennessee, and West Virginia.

This section will discuss alternatives to the current bank shares tax. Included will be a description of the impact of allocating varying

ratios of the tax revenue between the state and the localities and an analysis of other forms of bank taxation.

Revisions in the Distribution of Bank Stock Tax Revenues

Table 3.12 lists various portions of total bank stock tax revenues that might be returned to county and city governments. It then compares state and local revenue collections under each alternative based on data from bank tax returns filed in fiscal year 1973-74 for tax year 1973. Since approximately 60 percent of total taxable share value was in the cities in tax year 1973, it is obvious that the same percentage share of revenues for both counties and cities results in more revenue flowing to the cities than to the counties. We must note, however, that despite the current concentration of the bank tax base within

TABLE 3.12--ALTERNATIVE LOCAL DISTRIBUTIONS OF BANK SHARES TAX REVENUES BASED ON ACTUAL COLLECTIONS FOR TAX YEAR 1973

<u>Percent of Total Revenue Retained by Locality</u>	<u>Revenue Collections by Government^{a/} (Millions)</u>		
	<u>Counties</u>	<u>Cities</u>	<u>State</u>
80	\$2.5 ^{b/}	\$3.8	\$1.5
70	2.2	3.3	2.3
60	1.9	2.8	3.1
50	1.6	2.4	3.8
40	1.3	1.9 ^{b/}	4.5

Note: Total bank stock tax collections amounted to \$7.8 million in fiscal year 1973-74; the state's share of collections was \$3.4 million.

^{a/} Details may not add to totals because of rounding.

^{b/} Amount received under current law.

SOURCE: Report of the Department of Taxation, Fiscal Year Ending June 30, 1974, (Richmond: November, 1974), p. 40.

cities, the base has been shifting away from cities to the counties in recent years.^{1/} If this trend were to continue, equal shares for cities and counties would limit the relative gain for cities.

Legislation passed at the 1975 session of the General Assembly but later vetoed by the Governor would have raised the maximum portion that cities may retain to 80 percent, the same amount that counties may retain. In 1973-74, the effect of this legislation would have been a shift of approximately \$1.9 million in revenue from the state to the cities with the amount of bank revenue flowing to cities overtaking the amount flowing to counties.

There appear to be two alternative justifications for adjusting the state/local split of bank stock tax revenues. The first is to equalize the distribution ratios for both cities and counties even though actual revenues paid to cities would currently exceed those paid to counties. The other is that the distribution ratios should reflect the present local distribution of bank stock value and should attempt to equalize the revenue paid to cities with that paid to counties. If this were to remain the objective, periodic re-examination of the ratios might be warranted to compensate for shifts in the tax base. From Table 3.12, we can see that for 1973 county/city ratios of either 80 and 50 percent or 60 and 40 percent would have equalized the local distributions of bank stock tax revenues.

Alternative Forms of Bank Taxation

There are two alternative forms of taxation for banks. One is

^{1/} In fiscal year 1969-70, approximately 71 percent of the total taxable bank stock base was found in Virginia cities.

the corporate income tax levied on other businesses, and the other is a franchise tax "measured by" income.

Under the corporate income tax, a state cannot tax interest derived from U. S. Treasury securities as well as interest derived from other federal government securities. Virginia also does not tax interest income from its own securities or those from Virginia municipalities. Since banks in Virginia derive a significant portion of their income from federal and in-state securities and since they could easily adjust their portfolios to include nontaxable instruments, the exclusion of such income from the corporate tax base would make available a wide number of means to reduce their tax liabilities. A recent study by the Federal Reserve Bank of Philadelphia indicates that banks have become increasingly proficient in reducing their tax bills.^{1/} Using the ratio of federal income tax liability to economic income as a measure of the effective tax rate on banks, the study showed that nationally the income tax burden on banks has declined from 38.3 percent in 1961 to only 16.8 percent in 1972.^{2/} If this ratio were applied to data for Virginia commercial banks, the state trend is not unlike the national trend. Between 1969 and 1973 the effective tax rate on Virginia banks declined from approximately 22.0 to 16.5 percent.^{3/}

^{1/} Donald J. Mullineaux, "The Taxman Rebuffed: Income Taxes at Commercial Banks," Business Review, (Federal Reserve Bank of Philadelphia: May, 1974), pp. 11-23.

^{2/} Economic income was defined as explicit receipts from all sources of banking activity less explicit expenses incurred in generating these receipts.

^{3/} Data Source: Federal Deposit Insurance Corporation, Bank Operating Statistics--1969, 1970, 1971, 1972, and 1973, Table C--Virginia.

Under a franchise tax "measured by" income, interest income from U. S. Treasury and other federal government securities could be taxed indirectly. However, interest income from Virginia and its municipalities would in all likelihood remain tax exempt, and bankers could still adjust the composition of their portfolios in those directions that would minimize their tax bills.

Table 3.13 compares the estimated revenue collections for tax year 1973 under either a corporate income tax or a franchise tax "measured by" income (both at the rate of 6 percent) to actual bank shares tax

TABLE 3.13--A COMPARISON OF ACTUAL REVENUE COLLECTIONS FROM BANKS TO ESTIMATED REVENUES UNDER ALTERNATIVE TAX STRUCTURES, TAX YEAR 1973

<u>Tax Structures</u>	<u>Total Revenue (millions)</u>	<u>State Revenue (millions)</u>
Bank Stock Tax ^{a/} (\$1 per \$100 stock value)	\$7.8	\$3.4
Corporate Income Tax ^{b/} (6 percent of taxable income, excluding interest on federal government securities)	1.2	1.2
Franchise Tax "Measured By" Income ^{b/} (6 percent of taxable income, in- cluding interest on federal govern- ment securities)	6.1	6.1

Note: Estimates of revenue collections in this table are based on the most reasonable of several techniques considered by the staff. Each technique relied on similar assumptions and yielded similar estimates. A description of the techniques and assumptions are available upon request from the Research Division of the Department of Taxation.

a/ Actual.

b/ Estimated.

SOURCES: Federal Deposit Insurance Corporation, Bank Operating Statistics--1973, Table C--Virginia; Report of the Department of Taxation, Fiscal Year Ending June 30, 1974, (Richmond: November, 1974), p. 40.

collections. Under the corporate income tax total revenue collections would have declined from \$7.8 million to \$1.2 million, or by an estimated \$6.6 million. Since all revenue from a corporate income tax would flow to the state, most of the net revenue loss would have been suffered by the localities, or approximately \$4.4 million. The state would have lost half that amount, or \$2.2 million.

As under the corporate income tax, all revenue from a franchise tax would also flow to the state; however, if a franchise tax had been levied on banks in 1973, total collections would have declined by a smaller amount, or \$1.7 million. State revenue would have increased by \$2.7 million, but the localities would have still lost \$4.4 million.

The tax vacuum left at the local level could be filled by imposing the tangible personal property tax on banks. Currently, the tangible personal property owned and used by a bank is considered part of its capital assets; therefore, the book value of such property is included in the stock value of the bank. Thus, if a bank's tangible personal property were subject today to the local tangible personal property tax, double taxation would occur.

Although there are no data available that would produce an estimate of the size of this additional base, it may be smaller than suspected. The 1974 session of the General Assembly amended the law to permit localities to tax the tangible personal property of banks leased to its customers or other lessees for a consideration. Since 1963, a national trend has been noted indicating that banks have found the leasing industry to be a profitable one and that they are entering

it on a progressively larger scale.^{1/} If this trend held true for Virginia, some of the tangible personal property owned by banks may already be included in the local tax base. At the same time, a bank may also find it advantageous to assume the role of lessee. If a large proportion of the banks' office furniture, equipment, and vehicles were leased from other business enterprises, this property too may already be part of the tangible personal property tax base.

Conclusion

The bank shares tax currently provides a minor but stable source of revenue to the state and the localities. Adjustments in the distribution ratios of bank shares tax revenue to localities appear subjective, depending upon whether equity in distribution ratios or equity in actual revenue between counties and cities is the desired result. With average effective income tax rates on banks declining in recent years, revenue from a corporate tax levied on income or from a franchise tax "measured by" income might not continue to grow as consistently as revenue from the bank shares tax. Furthermore, imposing a corporate franchise tax would only substitute one special business tax for another. At the local level the substitution of taxes on all tangible personal property owned by banks to compensate for declines in revenue might not provide a better revenue alternative than the current law provides.

^{1/} Steven J. Weiss and Vincent J. McGugan, "The Equipment Leasing Industry and the Emerging Role of Banking Organizations," New England Economic Review, (Federal Reserve Bank of Boston: November/December, 1973), pp. 16-17.

Capital Not Otherwise Taxed

Structure of the Tax

The state tax on capital is an ad valorem tax on all capital of any trade or business of any person, firm, or corporation located in Virginia except for the capital of a trade or business otherwise specifically taxed or exempt from taxation. The following businesses and trades are specifically exempt from the tax on capital and are otherwise taxed: banks and trust companies; cotton factors and wholesale cotton buyers; cotton and peanut dealers; credit unions; farmers and growers of nursery products; industrial loan associations; insurance companies; retail and wholesale merchants; monied capital competing with national banks; oyster packers; professions regulated by state law and professional associations; public service corporations other than motor vehicle carriers; restaurant keepers and caterers; savings and loan associations; small business investment companies; wholesale grain buyers; wholesale merchandise brokers; and industrial development corporations.^{1/} In addition, businesses with branches outside Virginia are not subject to the tax on capital employed outside the state.

Capital for the purpose of taxation under this law is defined as follows:

1. The inventory of stock on hand used in the business, whether at the place of business, in storage, or elsewhere in the state. For manufacturing firms, this includes raw materials, goods in process, and finished goods. In addition, agricultural inventories stored in excess of one year are subject to the tax for only one year.

^{1/} Commerce Clearing House, Inc., State Tax Reporter, Virginia: "Property Taxes", p. 2094.

2. The excess of bills and accounts receivable over bills and accounts payable. If bills and accounts payable exceed bills and accounts receivable, the balance cannot be credited toward an otherwise outstanding capital balance. Bills and accounts payable for the purpose of capital outlay are not deductible; in addition, receivables less payables are not taxable as capital if the company books are maintained outside of the state.
3. All other taxable personal property including all choses in action (any right which a person has to recover money or property from another in legal proceedings), equities, demands and claims, and all tangible personal property of a manufacturing, mining, radio or television broadcasting, or dairy business except machinery and tools, motor vehicles, and delivery equipment, which are taxed locally. All tangible personal property not defined as capital of a business or trade other than those specific businesses is subject to local property taxation. In addition, money on hand and on deposit, insurance policies on the life of any person and the cash surrender value of the policy, bonds of the political subdivisions of this state, notes and other evidences of debt held by a regulated investment company or a real estate trust, and shares of corporate stock are excluded from the capital tax base.

The rate of the tax on capital is 30¢ per \$100 of the book value of capital. Payment of the tax is made annually from January 1 to May 1 of each taxable year to the local commissioner of the revenue on the book value of capital as of January 1, or on the average book value of capital as of January 1 and the preceding August 1, whichever is less.

Interstate Comparison of the Tax on Capital

The states with which Virginia competes for new industry and the states where many industrial prospects are located include North Carolina, South Carolina, Tennessee, Kentucky, Georgia, Maryland, West Virginia, Pennsylvania, New York, New Jersey, Ohio, California, Massachusetts, and Illinois. As Table 3.14 shows, their taxing of business capital varies substantially. Ten of the fifteen states, including Virginia, tax inventory with three, Virginia plus Massachusetts and Maryland, levying a state tax only. California, Illinois, Ohio,

and North Carolina tax inventory at the local level at the same rate and assessment ratio as real estate while Georgia, Kentucky, and West Virginia impose both state and local taxes. For the ten states as a whole that tax inventory, 10.9 percent of the manufacturer's average total tax bill represents the inventory tax as compared to only 6.0 percent for Virginia.

Seven of the states in the table, including Virginia, tax receivables less payables. Of these, Virginia, Georgia, Kentucky, North Carolina, and Ohio levy state taxes, Illinois has a local tax, and West Virginia taxes receivables less payables at both the state and local levels. Only Illinois and West Virginia tax receivables less payables more heavily than Virginia, which imposes a tax comparable to that in Ohio and North Carolina. For the seven states as a whole

TABLE 3.14--COMPARISON OF TAXES ON INVENTORY
AND RECEIVABLES LESS PAYABLES, BY STATE, 1974

<u>State</u>	<u>Inventory</u>	<u>Receivables Less Payables</u>
California	Local tax	No tax
Georgia	State and local tax	State tax
Illinois	Local tax	Local tax
Kentucky	State and local tax	State tax
Maryland	State tax	No tax
Massachusetts	State tax	No tax
New Jersey	No tax	No tax
New York	No tax	No tax
North Carolina	Local tax	State tax
Ohio	Local tax	State tax
Pennsylvania	No tax	No tax
South Carolina	No tax	No tax
Tennessee	No tax	No tax
<u>Virginia</u>	State tax	State tax
West Virginia	State and local tax	State and local tax

SOURCE: Virginia Division of Industrial Development.

taxing receivables less payables, 1.1 percent of the manufacturer's average total tax bill represents receivables less payables versus Virginia's 3.7 percent.^{1/}

Changes in the Structure of the Tax

Historically, the tax on business capital has comprised a larger percentage of total general fund revenues than in recent years. For instance, in fiscal year 1961-62 revenues from the tax on capital not otherwise taxed were \$10,066,535, or approximately 3.9 percent of total general fund revenues of \$257,718,493. In contrast, revenues in fiscal year 1973-74 from the tax totaled \$6,568,189, or approximately 0.53 percent of general fund revenues of \$1,242,475,858.^{2/}

Over the next three biennia we project that revenues from this source will grow at an average rate of 6.4 percent per year to approximately \$10,900,000 for fiscal year 1981-82, or 0.32 percent of the general fund. Of the items subject to the capital tax, manufacturers' inventories have and will continue to generate by far the majority of the revenues.

Changes in the rate and base of the tax on capital are responsible for the decline in revenues from the tax since fiscal 1961-62.

Specifically, the Report of the Commission on State and Local Revenues and Expenditures and Related Matters to the Governor and the General Assembly in 1963 noted that Virginia's capital tax impeded the rate

^{1/} Data supplied by the Virginia Division of Industrial Development. The division uses actual state and local tax rates to estimate the average total tax bill in each state on a hypothetical manufacturer with \$1 million net income before federal income tax payments.

^{2/} The figure for fiscal year 1973-74 includes revenue from the sales and use tax enacted in 1966, the income tax rate increases effective January 1, 1972, and federal general revenue sharing that began in 1972. Revenues for fiscal years 1961-62 and 1973-74 are therefore not directly comparable.

of growth of manufacturing and other industries in Virginia by placing an unfair tax load on capital.^{1/} Consequently, the rate of the tax, already lowered from 75¢ per \$100 of book value to 65¢ per \$100 of book value effective January 1, 1963, was further reduced by the 1964 session of the General Assembly. The three-step reduction lowered the rate to 60¢ per \$100 of book value beginning January 1, 1967, 55¢ per \$100 of book value beginning January 1, 1969, and 50¢ per \$100 of book value beginning January 1, 1971. However, with the enacting of the sales and use tax in 1966, the capital tax rate was reduced to 30¢ per \$100 of book value effective January 1, 1967. In addition to the rate changes, agricultural inventories stored for more than one year before conversion to a manufactured product became subject to the tax on capital for only one year effective January 1, 1966, rather than for each successive year stored. Also, money on hand and on deposit was excluded from the capital tax base after January 1, 1965. The effects of these changes has been not only to reduce the revenues collected from the tax but also to lower the capital tax load on businesses and manufacturers, particularly the tobacco manufacturers in Virginia.

Implications of Changes in the Tax Structure

In light of the substantial reductions in the rate and base of the tax and its primary impact on manufacturers' inventories, the tax on capital as it now stands may well be more an effective hedge against an increasing local tax burden on manufacturers in Virginia

^{1/} Report of the Commission on State and Local Revenues and Expenditures and Related Matters to the Governor and the General Assembly of Virginia, (Richmond: Department of Purchases and Supply, 1963), pp. 10-13.

than an effective revenue source. Several observations lend support to this conclusion. Virginia's tax load on manufacturers' inventories is substantially below the tax liability for those states in Table 3.14 taxing inventory, or 6.0 percent of the manufacturer's estimated average total tax bill versus 10.9 percent. In addition, the tax rate on capital is lower, more uniform, and more stable in comparison to average local tax rates on manufacturer's taxable property, which have increased over the past few years. For instance, the average effective tax rate on manufacturer's machinery and tools, property which accounts for an estimated 25 percent of the manufacturer's total tax liability, has increased by 50 percent since 1971. Manufacturer's motor vehicles and delivery equipment, included in the capital tax base prior to 1974, is taxed at a median local rate of \$1.52 per \$100 of fair market value, which far exceeds the capital tax rate of 30¢ per \$100 of book value. We base these comparisons on the average of local tax rates, which can be higher or lower for individual localities.^{1/} However, it seems likely that if returned to the localities for taxation, capital would be taxed at a higher average effective tax rate in response to the need for additional local revenues.

In addition, there is a discrepancy in the taxation of tangible personal property of a manufacturer versus other businesses and trades. According to the law, tangible personal property of a manufacturing, mining, radio or television broadcasting, or dairy business, other than motor vehicles and machinery and tools, is taxed as capital

^{1/} Data supplied by the Virginia Division of Industrial Development.

whereas tangible personal property of other trades and businesses is subject to higher average local property taxation. Although this category comprises a small portion of the total tax base, it nonetheless represents a deviation, favoring manufacturing, from horizontal equity regarding the taxation of business capital.

In the final analysis, the reason for taxing manufacturing at modest, stable rates is to induce manufacturing interests to relocate or expand in Virginia rather than in other states thereby assuring long-term growth in economic activity and tax revenues at the expense of short-run revenue losses resulting from relatively lower tax rates. Although other factors, such as average hourly wage rates, energy costs, availability of resources, and transportation costs greatly affect growth, a state's overall tax structure is a significant cost factor readily available to the firm considering relocation or expansion. The discussion in the corporate tax section of the rates of growth in manufacturing employment and value added in manufacturing for Virginia, its major competitors, and the nation indicates that Virginia is competitive in attracting new industry to the state. For this reason, the state would have to carefully evaluate any proposal for change in the taxes facing businesses.

Alternatives to the Existing Tax on Capital

There appear to be three alternatives to the existing tax on capital. The first is to exempt capital from any form of taxation. Several inequities inherent in the taxation of inventories support this argument. Specifically, inventory is difficult to appraise precisely because the meaning of book value may vary from one business to the next. In addition, taxing inventory as of a specific date may

discriminate against businesses with slow inventory turnover rates as compared to those companies with rapid turnover rates that may escape taxation of a considerable portion of their inventory. Another problem is that inventory is not necessarily indicative of wealth, particularly during a recession when inventories are likely to build up, thereby resulting in heavier taxes. In any event, there are good arguments either to tax or not to tax both inventory and receivables less payables together to avoid "taxation by label," for inventories are continually converted into accounts receivables.^{1/} Of course, if the capital tax were removed, tangible personal property of a manufacturing, mining, radio or television broadcasting, or dairy business (except motor vehicles, delivery equipment, and machinery and tools already taxed at the local level) presently taxed as capital could either be taxed locally as with other businesses and trades, or both manufacturers and other businesses and trades could be exempt from any tax on tangible personal property.

Inventory and receivables less payables are not taxed in a substantial number of competitor states and states where many of Virginia's industrial prospects are located. Specifically, New Jersey, New York, Pennsylvania, South Carolina, and Tennessee do not tax inventory, and California, Maryland, Massachusetts, New Jersey, New York, Pennsylvania, South Carolina, and Tennessee do not tax receivables less payables. Eliminating the tax might well improve Virginia's competitive edge for attracting new industry relative to these and other states at the expense of initially reducing general fund revenues by \$8-\$10 million annually.

^{1/} Tax Institute of America, State and Local Taxes on Business, (Princeton, 1968), pp. 165-176.

A second alternative is to return capital to the localities for taxation. We should note, however, that if capital were no longer segregated for state taxation, tangible items such as manufacturers' inventories could justifiably be taxed locally as tangible personal property while intangibles such as receivables less payables could be exempt. In any event, it seems likely that if capital were returned to the localities, the average rate of local taxation could be substantially higher than the state capital tax rate because of local revenue demands. At the very least a local tax on capital would be less stable and less uniform than the state capital tax, in addition to fostering increased interjurisdictional competition for industry.

A final alternative to the present tax on capital is to continue to tax capital at the state level but at a different rate. If more revenue were desired, the rate of the tax could be increased accordingly. Similarly, the rate of the tax could be lowered if less revenue were desired.

Conclusions

The main argument for taxing capital at a modest, stable rate is to encourage the continued growth of manufacturing in the state.

Several questions are of interest in relation to this objective:

1. To what extent could an increase in the rate of the capital tax, which accounted for only 0.53 percent of total general fund revenues in 1973-74, affect the relatively favorable industrial climate in Virginia?
2. At what point does the tax on manufacturers' inventories become insignificant in relation to similar taxes in other states?
3. Is the tax on inventory horizontally equitable, or is it a tax on a few large industries in Virginia?

Individual and Fiduciaries Income Tax

Introduction

As seen in Table 3.6 the individual and fiduciaries income tax has been and is forecast to continue to be the single most important source of general fund revenue. Beginning with taxable year 1972 Virginia conformed in large part to the federal individual income tax structure. After discussing the present structure and rates in the remainder of this introduction, we compare the Virginia tax with the taxes in other states. In addition, we look at the individual income tax sampling methodology that the Department of Taxation currently uses to evaluate the effects of possible income tax structure and rate changes, actually evaluate the effects on income tax collections of alternative structures and rates, analyze retirement income tax relief, the Virginia dividend exclusion, capital gains treatment, discuss a credit on food for home consumption, and in the final section investigate the possible effects of inflation on the income tax base.

As a result of Senate Bill No. 645 (Chapter 46, 1975 Acts of Assembly) the present Virginia individual income tax conforms to the federal ~~maximum~~ and ~~minimum~~ standard deductions as of December 31, 1974, rather than the higher standard deductions imposed by the Tax Reduction Act of 1975 for 1975 only. The provisions of Senate Bill No. 645 are also effective for taxable year 1975 only, thereby forcing Virginia to return to conformity with existing federal tax law as of January 1, 1976. If the federal changes are not made permanent, then both the federal and Virginia standard deductions will be those in effect as of December 31, 1974, with no adverse effects on general fund revenues.

The basic elements of the present Virginia structure are as follows:

1. Exemptions: \$600 for personal, dependent, and blind with \$1,000 for persons sixty-five and over. (The federal exemption is \$750 for all classes with an additional \$30 credit in 1975 for all personal and dependent exemptions.)
2. Maximum Standard Deduction: The Virginia maximum standard deduction is 15 percent of adjusted gross income (AGI) up to \$2,000 for all taxpayers. (At the federal level the Tax Reduction Act of 1975 increased this to 16 percent up to a maximum of \$2,600 for married taxpayers and \$2,300 for single taxpayers.)
3. Minimum Standard Deduction: The minimum standard deduction or low income allowance is \$1,300 in Virginia. (The federal Tax Reduction Act of 1975 increased this at the federal level to \$1,900 for married and \$1,600 for single filers.)
4. Treatment of Married Taxpayers: Under Virginia law if a husband and wife file a joint federal income tax return, they may elect to file separate Virginia income tax returns. This treatment was permitted before conformity and was retained in the conformity legislation. In effect this is a tax reduction for married persons who both have income, since they are allowed to be taxed at a lower effective rate than those who are single or those married persons filing a joint return. (At the federal level the split income option allows married persons a tax advantage versus a single person with the same gross income.)

The present rate schedule became effective for all taxable years beginning with 1972 and marked the first change in the Virginia tax rates since 1948. This schedule is:

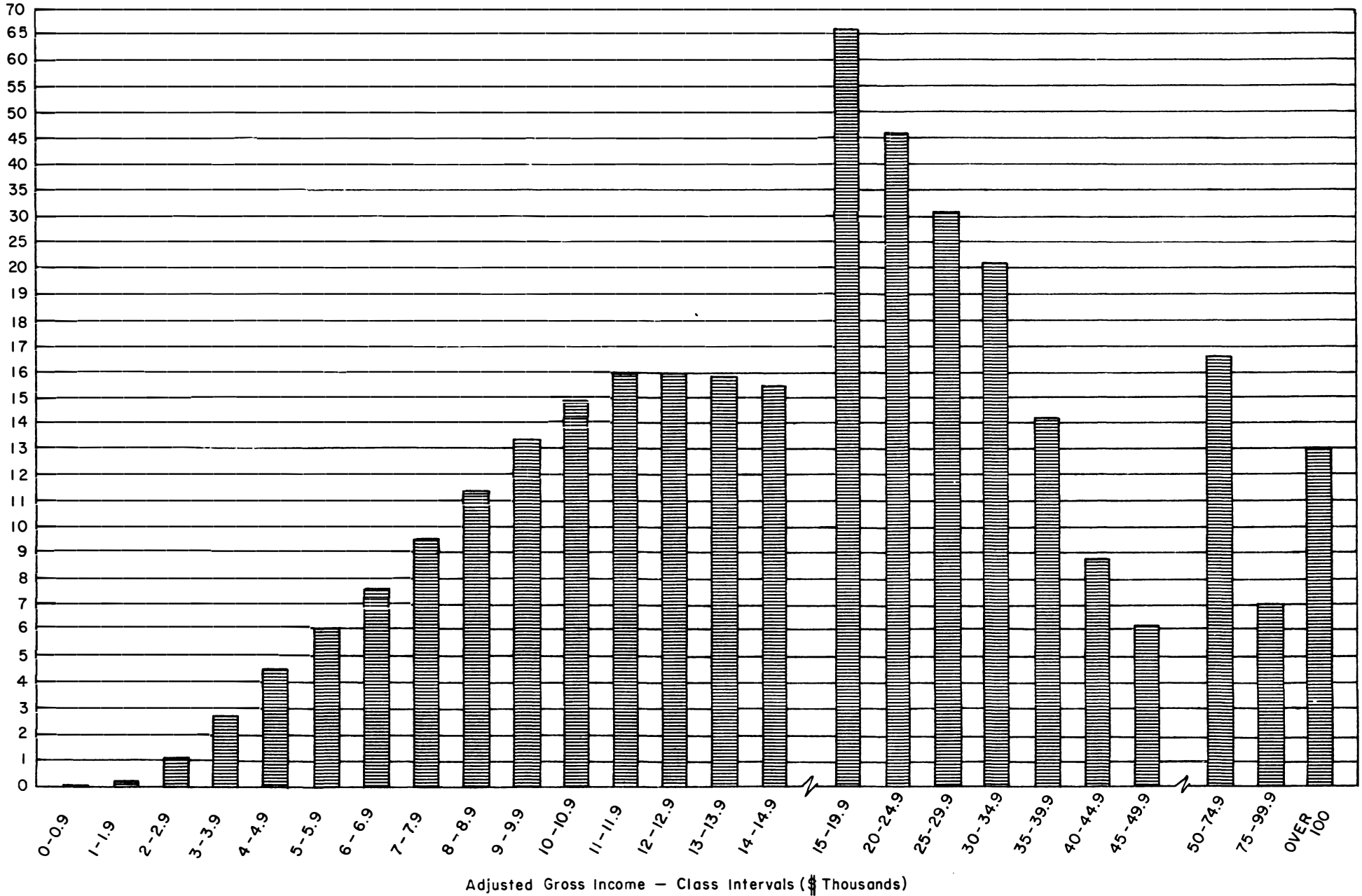
<u>Net Taxable Income</u>	<u>Rate</u>
First \$3,000	2%
\$3,001 - \$5,000	3%
\$5,001 - \$12,000	5%
Greater than \$12,000	5.75%

The 1972 change added the greater than \$12,000 bracket.

Chart 3.3 shows the distribution of tax receipts by Virginia AGI classification for taxable year 1972. Since 1972 the only major change

Total Tax
Receipts
\$ Millions

CHART 3.3
TOTAL INDIVIDUAL INCOME TAX RECEIPTS BY AGI CLASSIFICATION - TAX YEAR 1972



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Note: Structure and rates were those applicable to tax year 1972 returns.

Source: Department of Taxation Annual Report 1973-74, Table I.4, p.24.

in the Virginia income tax structure has been the increase in the exemption for age from \$600 to \$1,000 beginning with taxable year 1973. Chart 3.4 shows the total number of returns distributed by Virginia AGI class.

Comparisons With Other States

As of July 1, 1973, forty-one states plus the District of Columbia imposed an income tax on individuals.^{1/} Thirty-one states conformed the tax to some degree to the federal provisions. As explained earlier, Virginia conformed in large part to the federal individual income tax structure effective January 1, 1972. In addition to Virginia, three surrounding states, Kentucky, Maryland, and West Virginia, referred to the Internal Revenue Code in defining AGI as of July, 1973. North Carolina and the District of Columbia did not conform to the federal individual income tax structure.^{2/}

Table 3.15 compares the exemptions granted by the states and the District of Columbia for 1973, and Table 3.16 shows their standard deductions. Compared to the surrounding states and the District of Columbia, Virginia allowed the same \$600 personal and dependent exemptions as did West Virginia. The District of Columbia and North Carolina had \$1,000 personal exemptions and a \$500 and \$600 dependent exemption, respectively.^{3/} Personal and dependent exemptions were consistently higher in Maryland than in Virginia. Kentucky allowed credits in lieu of exemptions. Three neighboring states, Maryland, North

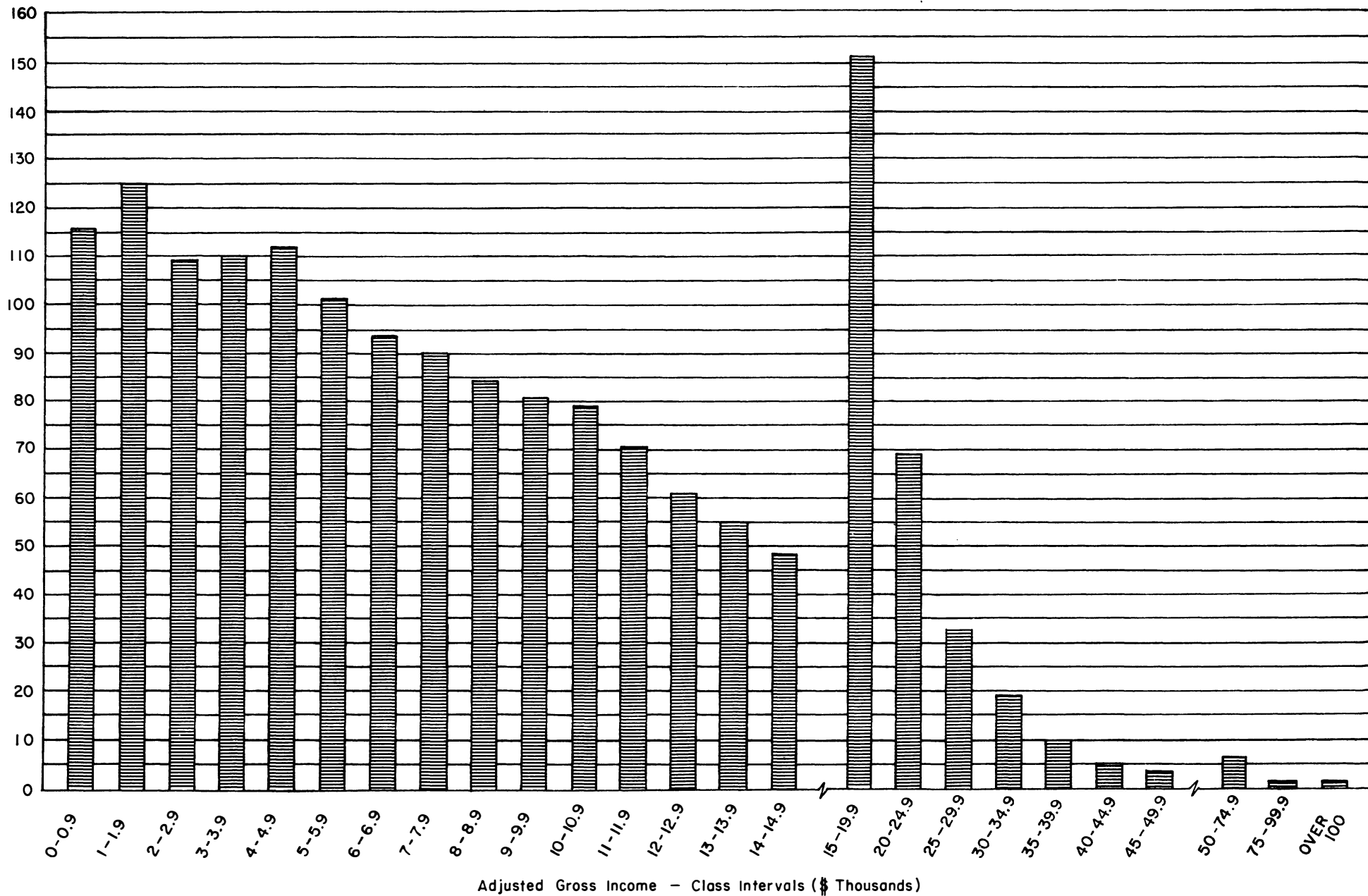
^{1/} Two additional states, Tennessee and New Hampshire, limited the tax to interest and dividends, and Connecticut taxed only capital gains.

^{2/} Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism, 1973-74 Edition, (Washington, D. C.: U. S. Government Printing Office, 1974), pp. 273-275.

^{3/} Joint returns are not permitted in North Carolina; an additional exemption of \$1,000 is allowed a married woman with a separate income.

CHART 3.4
TOTAL NUMBER OF INDIVIDUAL INCOME TAX RETURNS BY AGI CLASSIFICATION
TAX YEAR 1972

Number of
Returns
Thousands



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Source: Department of Taxation Annual Report 1973-74, Table I.3, p.24.

TABLE 3.15. -- STATE INDIVIDUAL INCOME TAXES: PERSONAL EXEMPTIONS, JULY 1, 1973

State	Personal exemption		Additional exemption on account of --		
	Single	Married (joint return)	Dependents	Age ¹	Blindness ¹
Alabama	\$1,500 ₂	\$3,000 ₂	\$300 ₂	.....₂	.....₂
Alaska					
Arizona	1,000	2,000	600	\$1,000	\$500
Arkansas ³	17.50(1,750)	35(3,200)	6(267)	.....	17.50
California ³	25(2,250)	50(4,500)	8(400)	.....	8(400)
Colorado ⁴	750	1,500	750	750	750
Delaware	600 ⁵	1,200	600	600	600
Georgia ⁶	1,500	3,000	700 ⁷	700	700
Hawaii ⁴	750	1,500	750	750 ⁸	5,000
Idaho ^{4,9}	750	1,500	750	750	750
Illinois	1,000	2,000	1,000	1,000	1,000
Indiana ⁴	1,000	2,000 ¹⁰	500	500	500
Iowa ³	15(1,500)	30(2,250)	10(370)	15	15
Kansas ⁴	600	1,200	600	600	600
Kentucky ³	20(1,000)	40(2,000)	20(1,111)	20(1,000)	20(1,000)
Louisiana ¹¹	2,500(50)	5,000(100)	400(8)	.....	1,000(20)
Maine	1,000	2,000	1,000	1,000	1,000
Maryland	800	1,600	800 ¹²	800 ¹²	800
Massachusetts ^{4,13}	2,000	2,600-4,600	600	600	2,000
Michigan ¹⁴	1,200	2,400	1,200	1,200	1,200
Minnesota ^{3,4}	21(1,057)	42(1,657)	21(553)	15	15
Mississippi	4,500	6,500	750	750	750
Missouri	1,200	2,400	400	.....	.....
Montana	600	1,200	600	600	600
Nebraska ⁴	₂	₂	₂	₂	₂
New Hampshire ¹⁶	600	600 ¹⁷	.....	.....	.....
New Jersey	650	1,300	650	650	650
New Mexico	₂	₂	₂	₂	₂
New York	650	1,300	650	650	650
North Carolina	1,000	2,000 ¹⁸	600 ¹⁹	1,000	1,000
North Dakota	750	1,800	750	750	750
Ohio ²⁰	500	1,000	500	₂₀	.....
Oklahoma	750	1,500	750	750	750
Oregon	675	1,350	675	675	675
Rhode Island	₂	₂	₂	₂	₂
South Carolina	800	1,600	800 ²¹	800	800
Tennessee ¹⁶	₂	₂	₂	₂	₂
Utah	₂	₂	₂	₂	₂
Vermont ⁴	₂	₂	₂	₂	₂
Virginia	600	1,200	600	1,000	600
West Virginia	600	1,200	600	600	600
Wisconsin ^{3,4}	15(484)	30(968)	15(443)	5	.....
Dist. of Columbia	1,000	2,000	500	500	500

See footnotes at the end of table.

TABLE 3.15. -- STATE INDIVIDUAL INCOME TAXES; PERSONAL EXEMPTIONS, JULY 1, 1973 (continued)

- ¹In most States an identical exemption is allowed for a spouse if she meets the age and blindness condition. In Massachusetts the deduction for blindness is allowed against business income only. In Hawaii the \$5,000 blindness deduction is allowed in lieu of the personal exemption.
- ²Since the State tax is based on either federal taxable income or federal tax liability, in effect, federal personal exemptions are adopted.
- ³Personal exemptions and credits for dependents are allowed in the form of tax credits which are deductible from an amount of tax. With respect to personal exemptions, the sum in parentheses is the exemption equivalent of the tax credit assuming that the exemption is deducted from the lowest brackets. With respect to the dependency exemptions; the sum in parentheses is the amount by which the first dependent raises the level at which a married person or head of family becomes taxable.
- ⁴In addition to the personal exemption deductions, a sales tax credit or cash rebate (in the case of Kansas, Minnesota and Wisconsin a property tax credit or cash rebate) is provided. See table 14E.
- ⁵An additional \$300 exemption is allowed if the taxpayer is the head of a household.
- ⁶In addition to the personal exemption deductions, low income tax credits are provided. The credits range from \$1 to \$15 for single persons with Federal adjusted gross income under \$3,015, and \$1 to \$30 for married persons filing joint returns with Federal AGI under \$6,030.
- ⁷The exemption is allowed for students regardless of age or income. For students beyond the high school level, \$1,400 per dependent and \$700 if the taxpayer is a student. A taxpayer who has used a student dependent to qualify as the head of a household is allowed only a \$700 exemption for that student dependent.
- ⁸Individuals establishing residence in Hawaii after the age of 65 are subject to tax on income from Hawaii sources only (the tax is imposed on the entire taxable income of resident individuals, estates, and trusts).
- ⁹In addition to the personal exemption deductions, a \$10 tax credit is allowed for each personal exemption.
- ¹⁰Each spouse is entitled to the lesser of \$1,000 or adjusted gross income (minimum of \$500 each).
- ¹¹The exemptions and credits for dependents are deductible from the lowest income bracket and equivalent to the tax credits shown in parentheses.
- ¹²An additional exemption of \$800 is allowed for each dependent 65 years of age or over.
- ¹³The exemptions shown are those allowed against business income, including salaries and wages: a specific exemption of \$2,000 for each taxpayer. In addition, a dependency exemption of \$600 is allowed for a dependent spouse who has income from all sources of less than \$2,000. In the case of a joint return, the exemption is the smaller of (1) \$4,000 or (2) \$2,600, plus the income of the spouse having the smaller income.
- ¹⁴Personal exemptions are increased to \$1,500 effective 1/1/74.
- ¹⁵An additional tax credit of \$20 is allowed for each taxpayer or spouse who has reached the age of 65. Additional tax credits for the blind: unmarried, \$20; married, \$25 for each spouse.
- ¹⁶The tax applies only to interest and dividends. New Hampshire also imposes a 4% commuter's income tax.
- ¹⁷An additional exemption of \$600 is allowed a married man with separate income; joint returns are not permitted.
- ¹⁸An additional exemption of \$1,000 is allowed a married woman with separate income; joint returns are not permitted.
- ¹⁹Plus an additional \$600 for each dependent who is a full-time student at an accredited university or college.
- ²⁰Maximum personal exemption is \$3,000 per return. Taxpayers 65 and over allowed a \$25 tax credit, not to exceed tax otherwise due.
- ²¹The exemption is extended to dependents over the age of 21 if they are students in an accredited school or college.

SOURCE: Commerce Clearing House, State Tax Reporter as shown in Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism, 1973-74 Edition, (Washington, D. C.: U. S. Government Printing Office, 1974), pp. 269-270.

TABLE 3.16. -- STATE INDIVIDUAL INCOME TAXES: USE OF STANDARD DEDUCTION AND OPTIONAL TAX TABLE, JULY 1, 1973

State	Percent ¹	Size of standard deduction			Optional tax table
		Single	Maximum		
			Separate return	Married Joint return	
Alabama	10	\$1,000	\$1,000	\$1,000	x
Alaska ²	3	3	3	3	x
Arizona	10	500	500	1,000	x
Arkansas	10	1,000	500	1,000	....
California	....	1,000	1,000	2,000	x
Colorado ²	10	1,000	500	1,000	x
Delaware ⁴	10	500	500	1,000	....
Georgia	3	3	3	3	....
Hawaii	10	1,000	500	1,000	x
Idaho ²	3	3	3	3	x
Illinois	....	....	....	....	....
Indiana	....	....	....	....	....
Iowa	5	250	250	250	x
Kansas ²	3	3	3	3	x
Kentucky ⁵	....	500	500	500	x
Louisiana	10	1,000	500	1,000	....
Maine	10	1,000	500	1,000	x
Maryland	10	500	500	1,000	x
Massachusetts	....	....	....	....	....
Michigan	....	....	....	....	....
Minnesota	10	1,000	1,000	1,000	x
Mississippi	15	750	750	1,500	....
Missouri ²	3	3	3	3	x
Montana	10	500	500	1,000	....
Nebraska ²	3	3	3	3	x
New Jersey ^{2,6}	15	2,000	7	2,000	....
New Mexico ²	3	3	3	3	....
New York ²	15	2,000	7	2,000	x
North Carolina	10	500	500	8	....
North Dakota ²	3	3	3	3	....
Ohio	....	....	....	....	....
Oklahoma	15	2,000	1,000	2,000	x
Oregon ²	3	3	3	3	x
Pennsylvania	....	....	....	....	....
Rhode Island	3	3	3	3	....
South Carolina	10	500	500	1,000	x
Utah ²	3	3	3	3	x
Vermont ²	10	1,000	500	1,000	x
Virginia ²	3	3	3	3	....
West Virginia	10	1,000	7	1,000	x
Wisconsin ²	15	2,000	9	2,000	x
District of Columbia	10	1,000	500	1,000	x

See footnotes on following page.

TABLE 3.16. -- STATE INDIVIDUAL INCOME TAXES: USE OF STANDARD DEDUCTION AND
OPTIONAL TAX TABLE, JULY 1, 1973 (Continued)

Note: Excludes New Hampshire and Tennessee where the tax applies to interest and dividends only, and Connecticut where tax applies to capital gains.

¹ Amount of standard deduction is generally based on gross income after business expenses. The detailed provisions vary.

² A low income allowance is provided.

³ Since the State uses either the Federal tax base or Federal tax liability in computing the State tax, in effect, the Federal standard deduction is adapted.

⁴ In lieu of all other deductions except Federal income taxes up to \$300 for individuals and \$600 for married couples filing joint return.

⁵ In lieu of other deductions except Federal income taxes, a standard deduction of \$500 may be taken if adjusted gross income is at least \$8,000. If adjusted gross income is less than \$8,000, taxpayers may use optional tax table.

⁶ The deduction shown is for the New Jersey-New York commuter's tax. No standard deduction is provided under the New Jersey-Pennsylvania commuter's tax.

⁷ The standard deduction allowed a married couple may be taken by either or divided between them in such proportion as they may elect.

⁸ An additional \$500 is allowed a married woman with separate income; joint returns are not permitted.

⁹ The combined total deduction for married persons who both have income may not exceed \$2,000 nor may either spouse claim more than 15% of their own total incomes.

SOURCE: Commerce Clearing House, State Tax Reporter as shown in Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism, 1973-74 Edition, (Washington, D. C.: U. S. Government Printing Office, 1974), pp. 271-272.

Carolina, and West Virginia, as well as the District of Columbia, had a 10 percent standard deduction, with varying maximum ceilings, compared to 15 percent, or a maximum of \$2,000, in Virginia. Virginia allows a minimum standard deduction of \$1,300.^{1/}

The present rate schedule in Virginia is compared to those in the other states in appendix Table A.2. The majority of the states had rate schedules with more than two brackets below \$5,000 and/or with several brackets above \$5,000. Their marginal rates typically rise from 1 or 2 percent on the first \$1,000 or \$2,000 of net taxable income through four or five brackets to 7 or 8 percent on net taxable income between \$10,000 and \$15,000. These schedules therefore are more progressive than the present one in Virginia. Among contiguous states, Maryland had three \$1,000 brackets to \$3,000 and a 5 percent rate on net taxable income over \$3,000; however, Kentucky, North Carolina, West Virginia, and the District of Columbia had more progressive rate schedules than the present one in Virginia. Tennessee taxed only interest and dividends as explained in an earlier footnote.

The burden of Virginia's income tax can be compared to the burden in other states on a national and regional basis. In 1972 and 1973 the burden of our state income tax was greater than the national average burden of state and local income taxes but less than the average burden for the states and District of Columbia that imposed an individual income tax, according to three overall measures given in Table 3.17. At the regional level, effective tax rates for selected taxpayers at different levels of income for Virginia and contiguous states would best illustrate the comparative burden. If the comparisons were

^{1/} In addition to Virginia, eleven states, Alaska, Georgia, Idaho, Kansas, Missouri, Nebraska, New Mexico, North Dakota, Oregon, Rhode Island, and Utah, used the federal maximum standard deduction as of July 1, 1973. Of these, all except Georgia and Rhode Island also had the minimum standard deduction.

TABLE 3.17 -- STATE AND LOCAL INDIVIDUAL INCOME TAX BURDEN, 1972-73

Area	State and Local Individual Income Tax Receipts in Fiscal Year 1972-73		
	Per Capita in 1973	Per \$1,000 of Personal Income in 1973	Per \$1,000 of Federal AGI in 1970
Virginia	\$91.87	\$18.80	\$31.52
U. S. Average (incl. D. C.)	85.63	16.99	28.57
Average of States and the District of Columbia that Impose an Individual Income Tax	96.95	19.11	31.88

SOURCES: Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism, 1973-74 Edition, (Washington, D. C.: U. S. Government Printing Office, 1974), pp. 281-282; Kenneth E. Quindry, State and Local Revenue Potential, 1973, SREB Research, (Atlanta, Georgia: Southern Regional Educational Board, 1974), pp. 42-43, 52-53, 73.

made for 1973 reflecting the conformity changes and the rate increase in the Virginia individual income tax law, it would show that the effective rates of the Virginia tax were lower than the effective rates in the District of Columbia, Maryland, and North Carolina for both individuals and families, and only moderately higher than the effective rates in West Virginia. By April, 1975, the surrounding states had made no substantial changes in their individual income taxes; as a result, the findings based on the 1973 comparison still apply.^{1/}

^{1/} Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism, 1973-74 Edition, (Washington, D. C.: U. S. Government Printing Office, 1974), pp. 260-271.

Income Tax Sampling Methodology

Each year the number of individual income tax returns processed increases at both the federal and state levels. During 1972 there were over 77.0 million individual income tax returns processed by the Internal Revenue Service. In Virginia the number of returns processed by the Department of Taxation was approximately 1.6 million. In order for the Department of Taxation to provide tax policy information to the executive branch it has been necessary to use the entire file of tax returns to evaluate proposals such as the conformity legislation. This is a cumbersome and time consuming process even though each year's tax file is computerized. With the passage of the conformity legislation more of a demand for this type of tax policy information has been created, since many proposed changes in the federal income tax law affect Virginia income tax collections. In order to more efficiently provide tax policy information and expand the type of information readily obtainable, the Department of Taxation in cooperation with the Statistics Research Division of the Research Triangle Institute has developed an individual income tax sampling methodology that will enable the department to evaluate the revenue impact of many types of structural changes as well as different rate schedules. The discussion in this section on the revenue impacts of alternative structures and rates relies on the Department of Taxation's 1972 individual income tax sample. We should point out that the design and use of the sample in no way compromises the confidentiality of any individual's income tax return.

Statisticians refer to the sampling methodology utilized as "optimum systematic stratified sampling with replication." This sampling design is much more statistically sound than a simple random selection of tax returns. In this sample the total population is divided into mutually exclusive and

exhaustive subsets or "strata" on the basis of Virginia AGI, blindness, and age (sixty-five and over). The sample design is "optimum" in the sense that it yields estimates of nearly maximum precision or minimum expected error given either a fixed sample size or cost of selection. A "systematic" sample is one in which sample units are selected sequentially in constant intervals after a randomly selected starting point. A sample is "replicated" when it consists of several subsamples each of which is representative of the total population. What this statistical jargon tells us is that the sample yields a highly reliable estimate of the revenue effects of structural or rate changes in the tax law with a relatively minimum amount of resources having to be expended.

The sample is particularly useful for evaluating the revenue gain or loss of a change in the Virginia exemptions, minimum and maximum standard deductions, the marginal rates and/or rate brackets, and limited changes in the definition of Virginia AGI. The sample is designed to provide information on these very broad issues that affect the total population of taxpayers or a significant portion of the population already represented in the sample. The sample as it currently exists has several limitations. It cannot provide estimates on a locality basis and therefore it is not useful for evaluating the revenue potential of any type of local individual income tax. Locality sampling was omitted from the sample design since it was the opinion of Research Triangle Institute that reliable locality data could not be provided using this methodology. In addition stratification by other subpopulations, such as taxpayers claiming retirement income exclusions, is not possible since the master file is not categorized on this basis.

The Department of Taxation currently has taxable year 1971 and taxable year 1972 samples with the taxable year 1973 sample expected to be operational by August, 1975. The actual number of scientifically selected returns in the sample for each of these years is approximately 200,000 with

each divided into 50 replicates. Each of the 50 replicates will provide a sound estimate of the revenue impact of potential structural or rate changes with the overall estimate being the average of the 50 independent subsamples. In actual practice it has been determined that for a reliable estimate to be derived not all 50 replicates need to be utilized, since the additional reliability or added precision of the estimate is low compared to the additional cost involved to produce the additional replicates. For example, the precision or the range of potential error around the estimate of revenue derived under a new structure with 20 replicates may be \pm \$2.0 million and \pm 0.5 percent while the range of error using all 50 replicates may be only \pm \$1.5 million and \pm 0.4 percent. The added degree of precision in this case is not worth the extra expense of utilizing the additional 30 replicates.

Alternative Virginia Structures and Rates

We divide our analysis of alternative changes in the Virginia individual income tax into the following parts: (1) a discussion of rate changes under the current law that would raise additional general fund revenues; (2) a discussion of rates to offset the revenue loss resulting from a permanent increase in the minimum and maximum standard deductions as set out in the Tax Reduction Act of 1975, President Ford's tax reduction proposal of January, 1975, or the Congressional House Ways and Means Committee tax reduction proposal of 1975; and (3) a discussion of rate changes to raise additional revenues within each of the structures provided by the alternative tax reduction plans. This complex presentation is necessary because, as previously noted, the Tax Reduction Act of 1975 increased the minimum and maximum standard deductions only for 1975 while Virginia maintained its standard deductions at their 1974 levels for the year. If the federal changes are allowed to expire at the end of the year, Virginia will once again conform to the federal standard deductions in 1976 and could look to the individual income tax solely for additional revenues.

If, as seems most likely, Congress extends the tax reduction to 1976 and beyond, it would probably take one of the forms that we shall discuss and would require an income tax rate hike or other action by the General Assembly to avoid a permanent loss in revenues while continuing conformity. Only then could the individual income tax be viewed as a source of additional revenue.^{1/}

We must reiterate here that all estimates of revenue impacts in this discussion are based on the Department of Taxation's 1972 individual income tax sample. In every case, we use 20 replicates from the sample and attain at least a precision level of \pm \$2.2 million and \pm 0.52 percent for the revenue estimate of an alternative structure or rate schedule.

Alternative Revenue Raising Rate Schedules Under the Present Structure

If Congress allows the increases in the standard deductions mandated by the Tax Reduction Act of 1975 to expire at the end of the year and if additional revenues from the individual income tax are required, what are the alternatives available to the policy makers? Without dramatically altering the definition of Virginia AGI, the only major policy option available is to change the rate schedule.^{2/} Table 3.18 shows the present

^{1/} We think that from among the many options available the Tax Reduction Act of 1975, President Ford's plan, and the House Ways and Means Committee proposal provide reasonable alternatives for a discussion of long-term conformity to the federal structure. We do not consider any proposals that would further deconformity. The 1975 solution of freezing the standard deduction at the 1974 level should be viewed only as a short-run solution to a temporary increase. One major problem with this solution is that under the Virginia law the taxpayer must use either the itemized or standard deduction claimed on his federal return. Since the maximum amounts of standard deduction are now lower in Virginia than at the federal level, a taxpayer may desire to use the standard deduction at the federal level and itemize deductions for state purposes but will be unable to do so.

^{2/} One relatively straightforward structural change that could raise \$10 to \$15 million per year in additional revenues would be to tax long-term capital gains at 100 percent rather than to continue conforming to the federal treatment that permits 50 percent of these gains to be excluded from AGI. This is discussed in more detail in the next portion of the individual income tax section.

TABLE 3.18 -- FOUR ALTERNATIVE RATE SCHEDULES
TO PRODUCE ADDITIONAL REVENUES USING THE PRESENT
VIRGINIA INCOME TAX STRUCTURE

Present Rate Schedule

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	5%
over - \$12,000	5.75%

Alternative Rate Schedules

Schedule A

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	5%
\$12,001 - \$25,000	7%
\$25,001 - \$50,000	8%
over - \$50,000	9%

Schedule B

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
over - \$ 5,000	6%

Schedule C

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$10,000	5%
\$10,001 - \$20,000	7%
\$20,001 - \$30,000	8%
\$30,001 - \$50,000	9%
over - \$50,000	10%

Schedule D

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$10,000	6%
\$10,001 - \$15,000	7%
\$15,001 - \$20,000	8%
over - \$20,000	9%

rate schedule and four alternative rate schedules chosen from an infinite number of possible options.

Rate Schedule A of Table 3.18 produces a 7.1 percent increase in revenue, or \$26.1 million in 1972, with the entire increase coming from taxpayers above \$12,000 of net taxable income (NTI).^{1/} The NTI brackets and rates are the same up to \$12,000 as those in the present schedule with increased marginal rates on all NTI over \$12,000 and the over \$50,000 bracket being taxed at a 9 percent rate. This schedule adds a greater degree of progression to the income tax and thus more closely conforms to the ability-to-pay theory of taxation.^{2/}

Schedule B raises 8.5 percent in additional revenue, or \$31.3 million in 1972, as compared to the present rate schedule. This schedule increases the tax burden on all NTI over \$5,000. It has the disadvantage of raising the tax burden most in the \$5,000 to \$12,000 bracket where the statutory rate increases an entire percentage point while increasing only one-fourth of a percentage point on NTI over \$12,000.

Rate Schedule C generates 11 percent, or \$40.5 million in 1972, more than the current rate schedule. The rates are the same as those in the present schedule only up to \$10,000. They increase substantially on all NTI over \$10,000 and reach 10 percent on NTI above \$50,000.

Schedule D raises 18.9 percent in additional revenue, \$69.2 million in 1972, versus the present rate schedule. This schedule increases the tax rate significantly on all NTI above \$5,000 with a maximum of 9 percent on

^{1/} Net taxable income is the taxpayer's income upon which he is actually taxed. It is derived from AGI by subtracting his exemptions, deductions, and exclusions.

^{2/} The ability-to-pay theory of taxation involves both horizontal and vertical equity. For a brief explanation of the theory, see the next portion of the individual income tax section.

NTI above \$20,000.

The four schedules taken together indicate that in order to raise significant revenues while keeping the current rates in the lower brackets requires rates in the upper brackets that approach 10 percent. Alternatively, if there is a willingness to adopt a schedule counter to the ability-to-pay theory of taxation, significant revenues can be raised by increasing rates in the lower NTI brackets.

The following table compares the present rate schedule with Schedules A through D using three hypothetical NTI levels:^{1/}

Rate Schedule	Present Virginia Income Tax Structure		
	Tax Liability \$6,000 NTI	Tax Liability \$14,000 NTI	Tax Liability \$32,000 NTI
Present	\$170	\$585	\$1,620
A	170	610	1,940
B	180	660	1,740
C	170	650	2,050
D	180	700	2,250

It is not our intention to imply that these NTI's are representative of a typical taxpayer or group of taxpayers; we use them solely to compare tax liabilities under the alternative rate schedules given relatively low, medium, and high NTI levels.^{1/} The table shows that at the \$6,000 NTI level there is only a \$10 difference in tax liability between the five rate schedules. This difference becomes much larger for a \$14,000 NTI and reaches \$630 for the \$32,000 NTI category.

The Potential Effects of the Alternative Tax Reduction Proposals on Virginia Taxpayers and the General Fund

If Congress continues the higher standard deductions under the Tax

^{1/} No table showing NTI by AGI classes is presented in this report. This information is available from the Research Division of the Department of Taxation for taxable year 1972 for the present structure and for each of the three alternative federal tax reduction proposals.

Reduction Act of 1975 into 1976 and beyond, lower and middle income taxpayers will benefit, and the state will have to offset a significant drop in general fund revenues. Federal adoption of the standard deduction set forth in either President Ford's tax reduction proposal or the House Ways and Means Committee proposal will have the same basic impact on taxpayers and the general fund.^{1/} Table 3.19 compares the standard deduction provisions of the Tax Reduction Act of 1975 and the two other proposals with the 1974 standard deduction provisions. The Tax Reduction Act of 1975 provides for an increase of \$600 in the minimum standard deduction or low income allowance for married joint filers and a \$300 increase for single filers. The increases in the maximum standard deduction are the same as for the low income allowance. The maximum percentage standard deduction increases 1 percentage point to 16 percent. President Ford's plan did not distinguish between the minimum and maximum standard deduction but gave a flat \$2,600 deduction to married filers and a \$2,000 deduction to single filers. No maximum percentage deduction was required. The original House Ways and Means Committee plan raised the low income allowance for married persons to \$2,500 while increasing it to only \$1,900 for single filers. The maximum standard deduction under this proposal would have increased 50 percent for married joint filers and 25 percent for single filers, and the maximum percentage would have been 16 percent.

Table 3.20 compares the NTI and tax liability under the present Virginia structure and rates with those under the three alternative federal tax relief proposals and existing state rates using AGI's of \$5,000, \$10,000, \$15,000, and \$20,000. In calculating NTI from AGI in this table, we assumed that the standard deduction was claimed at all AGI levels and

^{1/} We have not looked at conformity to the \$750 personal, dependent, age, and blind exemptions. The result of such a move would be additional tax relief for taxpayers and a revenue decline of \$20 to \$25 million per year.

TABLE 3.19--STANDARD DEDUCTION PROVISIONS OF THE TAX REDUCTION ACT OF 1975, PRESIDENT FORD'S JANUARY, 1975 PLAN, AND THE HOUSE WAYS AND MEANS COMMITTEE PLAN OF 1975 COMPARED TO THE 1974 STANDARD DEDUCTION

	Minimum Standard Deduction (Low Income Allowance)			Percentage	Maximum Standard Deduction		
	Married Joint	Married Separate	Single		Married Joint	Married Separate	Single
1974 Provisions ^{a/}	\$1,300	\$ 650	\$1,300	15%	\$2,000	\$1,000	\$2,000
Tax Reduction Act of 1975 Provisions	1,900	950	1,600	16%	2,600	1,300	2,300
President Ford's January, 1975 Plan ^{b/}	2,600	1,300	2,000	--	2,600	1,300	2,000
House Ways and Means Committee Plan of 1975	2,500	1,250	1,900	16%	3,000	1,500	2,500

^{a/} The 1974 federal provisions here are those that were in effect in Virginia for taxable year 1974 and continue to be in effect for taxable year 1975 under the provisions of Senate Bill No. 645 passed during the 1975 Session of the General Assembly.

^{b/} President Ford's proposal gave each married taxpayer a flat \$2,600 standard deduction and each single taxpayer a flat \$2,000 standard deduction. There was no difference between the minimum and maximum values nor was a maximum percentage deduction required.

TABLE 3.20--COMPARISON OF NET TAXABLE INCOME AND TAX LIABILITY UNDER THE PRESENT VIRGINIA STRUCTURE AND UNDER THREE ALTERNATIVE FEDERAL STRUCTURES^{a/}

Adjusted Gross Income Level	Virginia Net Taxable Income Under Structure Provided by: ^{b/}				Tax Liability Under Present Virginia Rate Schedule Under:			
	Present Virginia Structure	Tax Reduction Act of 1975	President Ford's Plan	House Ways and Means Committee Plan	Present Virginia Structure	Tax Reduction Act of 1975	President Ford's Plan	House Ways and Means Committee Plan
Single								
\$ 5,000	\$ 3,100	\$ 2,800	\$ 2,400	\$ 2,500	\$ 63	\$ 56	\$ 48	\$ 50
10,000	7,900	7,800	7,400	7,500	265	260	240	245
15,000	12,400	12,100	12,400	12,000	493	476*	493	470
20,000	17,400	17,100	17,400	16,900	781*	763*	781*	752*
Married Joint, No Dependents^{c/}								
\$ 5,000	\$ 2,500	\$ 1,900	\$ 1,200	\$ 1,300	\$ 50	\$ 38	\$ 24	\$ 26
10,000	7,300	6,900	6,200	6,300	235	215	180	185
15,000	11,800	11,400	11,200	11,300	460	440	430	435
20,000	16,800	16,200	16,200	15,800	746	712*	712*	689*
Married Joint, Two Dependents^{c/}								
\$ 5,000	\$ 1,300	\$ 700	\$ 0	\$ 100	\$ 26	\$ 14	\$ 0	\$ 2
10,000	6,100	5,700	5,000	5,100	175	155	120	125
15,000	10,600	10,200	10,000	10,100	400	380	370	375
20,000	15,600	15,000	15,000	14,600	677	643*	643*	620*

* Rounded to nearest dollar.

^{a/} It is assumed in this table that all taxpayers claim the standard deduction, since itemized deductions are unaffected by these tax relief proposals.

^{b/} It is assumed in calculating net taxable income that only personal deductions are claimed and no Virginia dividends or retirement income exclusions are claimed.

^{c/} It is assumed that the adjusted gross income is earned by one family member so that the family files a married joint return.

that there would be no blindness or age exemptions.

For single filers President Ford's plan would grant the most relief in the under \$10,000 AGI categories while providing no relief to the taxpayers with \$15,000 and \$20,000 of AGI. The Tax Reduction Act and Ways and Means proposal would spread the tax relief among all four AGI categories.

For married filers all three alternative structures would grant some type of tax relief at all AGI levels. Under the Ford plan Virginia married taxpayers with two dependents would pay no tax if they had an AGI of \$5,000 or less while under the Ways and Means plan and Tax Reduction Act this family would be liable to Virginia for \$2 and \$14, respectively.

Each of these three structures would reduce total NTI available for Virginia tax purposes. The Tax Reduction Act of 1975 would have lowered total NTI for Virginia tax purposes by 3.3 percent in 1972, the Ford proposal by 7.2 percent, and the Ways and Means proposal, by 6.9 percent. Under each one NTI would be lowered in every marginal rate bracket, since the standard deduction can apply to any taxpayer and since in 1972 59 percent of all Virginia taxpayers with AGI at all levels claimed the standard deduction. With the present rate schedule the Tax Reduction Act of 1975 would have caused an estimated 3 percent drop in Virginia revenues in 1972 while President Ford's and the Ways and Means proposals would have lowered revenues by approximately 6.2 percent. The estimated revenue loss by NTI bracket in 1972 for each of the three plans is shown in the following table:

Net Taxable Income Bracket	Revenue Loss Under		
	Tax Reduction Act of 1975 (Millions)	President Ford's Proposal (Millions)	House Ways and Means Proposal (Millions)
\$ 0-\$ 3,000	\$- 3.1	\$- 7.4	\$- 6.5
\$3,000-\$ 5,000	- 2.4	- 5.3	- 5.0
\$5,000-\$12,000	- 4.3	- 9.2	- 9.4
Over -\$12,000	- 1.2	- 1.0	- 2.0
Total	\$-11.0	\$-22.9	\$-22.9

Alternative Rate Schedules to Offset the Revenue Loss Under Each Tax Reduction Plan

Table 3.21 presents rate schedules designed to offset the revenue loss associated with each of the three tax reduction proposals. Schedules E through H just replace the 3 percent in revenues lost under the Tax Reduction Act of 1975 while Schedule I offsets the 6.2 percent revenue loss under either the Ford or the Ways and Means plans. There are a wide variety of schedules that could offset the loss under each of these plans, but these five are representative of the types of rate changes required.

Schedule E raises the required 3 percent in revenue by lowering the NTI taxed at the 2 percent rate from \$3,000 to \$2,000. Under the present rate schedule all taxpayers pay \$60 on NTI up to \$3,000. Schedule E makes the amount paid \$70 and distributes the burden among all taxpayers with NTI above \$2,000 by requiring them to pay up to an additional \$10 in Virginia income taxes. This method of raising the additional revenue lessens the progressivity of the income tax. Schedule F offsets the 3 percent revenue loss with a 1 percentage point increase on all NTI above \$12,000. This change requires higher income taxpayers to bear the entire burden of the tax increase, although this rate schedule does not recognize any difference in the ability to pay taxes between a taxpayer with a \$12,000 NTI and one with a \$50,000 NTI, since each pays 6.75 percent. Rate Schedule G also produces revenue adequate to offset the revenue loss if the 1975 Act becomes permanent. Schedule G is

TABLE 3.21 -- RATE SCHEDULES TO OFFSET THE REVENUE LOSS FROM
THREE ALTERNATIVE FEDERAL INCOME TAX LAW CHANGES:
TAX REDUCTION ACT OF 1975, PRESIDENT FORD'S PLAN, HOUSE WAYS AND MEANS COMMITTEE PLAN

Present Rate Schedule

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	5%
over - \$12,000	5.75%

Alternative Rate Schedules to Offset Revenue Loss
From Tax Reduction Act of 1975

Schedule E

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 2,000	2%
\$ 2,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	5%
over - \$12,000	5.75%

Schedule F

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	5%
over - \$12,000	6.75%

Schedule G

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	5%
\$12,001 - \$20,000	6%
\$20,001 - \$30,000	7%
over - \$30,000	8%

Schedule H

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$10,000	5%
\$10,001 - \$25,000	6%
\$25,001 - \$50,000	7%
over - \$50,000	8%

Alternative Rate Schedule to Offset Revenue Loss From
President Ford's Plan or the House
Ways and Means Committee Plan

Schedule I

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	5%
\$12,001 - \$20,000	7%
\$20,001 - \$30,000	8%
over - \$30,000	9%

the same as the present schedule up to \$12,000 NTI and raises the rate in the \$12,000 to \$20,000 NTI range only from 5.75 to 6 percent. Under this schedule taxpayers with greater than \$20,000 of NTI make up almost all of the 3 percent revenue loss. Schedule H retains the current brackets up to \$10,000 NTI while imposing a 6 percent rate on NTI between \$10,000 and \$25,000. When compared to the present rate schedule, a taxpayer under \$25,000 NTI would pay up to \$52.50 more in Virginia taxes with the remaining loss being recovered through the higher marginal rates on NTI greater than \$25,000.

Because both the Ford plan and the Ways and Means plan produce a revenue loss more than double that caused by the Tax Reduction Act of 1975, any rate schedule designed to offset their impact must have more revenue raising potential than Schedules E through H. Schedule I keeps the present schedule up through \$12,000 NTI. However, it increases taxes in the \$12,000 to \$20,000 NTI range by a maximum of \$100 by raising the rate to 7 percent and produces the remaining revenue with 8 and 9 percent rates from taxpayers with NTI in excess of \$20,000.

Alternative Rate Schedules to Raise Additional Revenues with Each Tax Reduction Plan

We assume here that it is necessary to consider raising additional revenues from the individual income tax while at the same time conforming to one of the three federal tax reduction plans. Because a rate schedule would have to offset a 3 to 6.2 percent decline in revenues before generating any extra revenues, it would have to contain higher marginal rates and/or be significantly more progressive than any rate schedule already provided. Table 3.22 lists along with the present rate schedule four representative rate schedules to raise additional revenues under the Tax Reduction Act of 1975 and four typical ones to raise additional revenues under the Ford or Ways

TABLE 3.22 -- RATE SCHEDULES TO RAISE ADDITIONAL INDIVIDUAL INCOME TAX REVENUES GIVEN THE TAX REDUCTION ACT OF 1975 STRUCTURE, PRESIDENT FORD'S PLAN AND THE HOUSE WAYS AND MEANS COMMITTEE PLAN

Present Rate Schedule

<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	5%
over - \$12,000	5.75%

Alternative Rate Schedules to Raise Additional Revenue Under Tax Reduction Act of 1975 Structure

<u>Schedule J</u>		<u>Schedule K</u>	
<u>Net Taxable Income</u>	<u>Rate</u>	<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%	\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%	\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	5%	\$ 5,001 - \$10,000	6%
\$12,001 - \$20,000	7%	\$10,001 - \$25,000	7%
\$20,001 - \$30,000	8%	\$25,001 - \$50,000	8%
over - \$30,000	9%	over - \$50,000	9%

<u>Schedule L</u>		<u>Schedule M</u>	
<u>Net Taxable Income</u>	<u>Rate</u>	<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%	\$ 0 - \$ 2,000	2%
\$ 3,001 - \$ 5,000	3%	\$ 2,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	6%	\$ 5,001 - \$12,000	6%
over - \$12,000	8%	over - \$12,000	8%

Alternative Rate Schedules to Raise Additional Revenue Under President Ford's or the House Ways and Means Committee Plan

<u>Schedule N</u>		<u>Schedule O</u>	
<u>Net Taxable Income</u>	<u>Rate</u>	<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 3,000	2%	\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%	\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$12,000	6%	\$ 5,001 - \$10,000	6%
\$12,001 - \$20,000	7%	\$10,001 - \$15,000	7%
\$20,001 - \$30,000	8%	\$15,001 - \$20,000	8%
over - \$30,000	9%	over - \$20,000	9%

<u>Schedule P</u>		<u>Schedule Q</u>	
<u>Net Taxable Income</u>	<u>Rate</u>	<u>Net Taxable Income</u>	<u>Rate</u>
\$ 0 - \$ 2,000	2%	\$ 0 - \$ 3,000	3%
\$ 2,001 - \$ 5,000	3%	\$ 3,001 - \$ 5,000	4%
\$ 5,001 - \$10,000	6%	\$ 5,001 - \$12,000	6%
\$10,001 - \$20,000	7%	over - \$12,000	6.75%
\$20,001 - \$30,000	8%		
\$30,001 - \$50,000	9%		
over - \$50,000	10%		

and Means proposals.

In addition to offsetting the 3.0 percent revenue loss from the standard deduction increase, Schedule J produces a 5.2 percent increase in revenues, or \$18.9 million in 1972, over the present structure and rate schedule. Schedule J has the same NTI brackets as Schedule G in Table 3.21 but has higher rates in all NTI brackets above \$12,000. Schedule K raises revenues by 12.5 percent, or \$45.6 million in 1972. This schedule has the same NTI brackets as Schedule H in Table 3.21, but all NTI brackets above \$5,000 have higher rates.

Schedule L retains the present Virginia NTI brackets, but increases the rate in the upper two brackets. This schedule generates 13.5 percent, \$49.5 million in 1972, in additional revenues and is similar to Schedule F in Table 3.21.

Schedule M raises 16.7 percent in additional revenues, or \$62.3 million in 1972. This schedule is similar to Schedule E of Table 3.21 in that it lowers the first NTI bracket to \$2,000, thereby raising the tax paid under \$5,000 of NTI by a maximum of \$10. This schedule also raises the rate 1 percentage point in the \$5,000 to \$12,000 NTI bracket for a maximum increase of \$70. All NTI over \$12,000 is taxed 2.25 percentage points higher than under either the current rate schedule or Schedule E.

Since the plans offered by President Ford and the House Ways and Means Committee both have similar effects on Virginia revenues, we use the same four rate schedules for each plan. Under either plan Schedule N produces approximately 8.9 percent, \$32.5 million in 1972, in additional revenues. This schedule has the same NTI brackets as Schedules G and J but necessarily has higher rates.

Schedule O produces approximately 11.9 percent, \$43.5 million in 1972, in additional revenues under both plans. Compared to the present schedule, Schedule O keeps the present brackets and rates up to \$5,000,

raises the tax paid a maximum \$90 between \$5,000 and \$12,000 of NTI, and generates the remaining additional revenues from taxpayers with NTI over \$12,000.

Schedule P produces a revenue increase under both alternative plans of approximately 13.5 percent, or \$49.5 million in 1972. This schedule is quite progressive with a 10 percent rate on NTI above \$50,000 but also raises the tax paid by low NTI groups by lowering the 2 percent bracket from \$3,000 to \$2,000.

Schedule Q raises approximately 20.1 percent, \$73.6 million in 1972, in additional revenues under both the Ford and Ways and Means plans. This schedule is a powerful revenue producer since it keeps the present NTI brackets and raises each marginal rate 1 percentage point. As Schedule E, it definitely leads to a less progressive income tax.

Summary

We have discussed how to raise additional individual income tax revenues under the present income tax structure, the revenue loss under three alternative changes in the federal law, rate schedules to just offset the revenue loss from these changes, and rates to produce additional revenues within these three alternative structures. Table 3.18 shows four rate schedules that would produce varying amounts of additional revenue under the present structure:

<u>Rate Schedule</u>	<u>Change in Revenue</u>	
	<u>Percent</u>	<u>Amount in 1972 (Millions)</u>
A	+ 7.1	+\$26.1
B	+ 8.5	+31.3
C	+11.0	+40.5
D	+18.9	+69.2

These schedules are generally more progressive than the traditional schedule used in Virginia and thus more closely conform to the ability-to-pay theory of taxation. Schedule B, however, raises 8.5 percent in additional revenue by

using the preconformity NTI brackets while raising the marginal rate to 6 percent on all NTI over \$5,000.

Schedules E through H in Table 3.21 would offset the 3.0 percent revenue loss caused by the Tax Reduction Act of 1975. Schedules E and F offset this loss by using the more traditional Virginia brackets and rates whereas Schedules G and H use a more progressive rate schedule. Schedule I in Table 3.21 would make up the 6.2 percent decrease in revenue caused by both President Ford's and the House Ways and Means Committee's plans with a more progressive rate schedule.

Schedules J through M in Table 3.22 would offset the 3.0 percent revenue loss of the Tax Reduction Act of 1975 while also raising additional revenue:

<u>Rate Schedule</u>	<u>Change in Revenue</u>	
	<u>Percent</u>	<u>Amount in 1972 (Millions)</u>
J	+ 5.2	\$+18.9
K	+12.5	+45.6
L	+13.5	+49.5
M	+16.7	+62.3

Schedules J and K add more progression to the rate schedule and Schedules L and M use the more traditional Virginia brackets and rates.

Schedules N through Q in the same table would eliminate the 6.2 percent loss under both the Ford and Ways and Means plans while generating differing amounts of extra revenue:

<u>Rate Schedule</u>	<u>Change in Revenue</u>	
	<u>Percent</u>	<u>Amount in 1972 (Millions)</u>
N	+ 8.9	\$+32.5
O	+11.9	+43.5
P	+13.5	+49.5
Q	+20.1	+73.6

These four schedules of necessity have to deviate significantly from the traditional Virginia NTI brackets or marginal rates to raise significant additional revenues, since a 6.2 percent revenue loss must be offset before any additional revenues are produced.

Additional Structural Changes

There are several additional structural changes with equity as well as revenue effects that deserve analysis. They are retirement income tax relief, the elimination of the Virginia dividend exclusion, and the taxation of 100 percent of capital gains.

Retirement Income Tax Relief

Introduction--Under current law Virginia grants a variety of exclusions to retired persons and their survivors as its vehicle for retirement income tax relief. The exclusion of any kind of income from taxation reduces the tax base and therefore the revenues from the tax. When the exclusions vary between different classes of taxpayers who may have identical incomes, the inequities coupled with the revenue loss make the provisions of the law particularly controversial. This section will discuss the current provisions for tax relief to retirees and offer alternatives that could improve the equity of the relief.

The Current Law--The current law, enacted by the 1974 session of the General Assembly, became effective for the 1974 tax year. It provides the following maximum exclusions to retirees and their survivors:

1. A \$3,000 exclusion for federal civil service retirees and a \$1,500 exclusion for their surviving spouses (after cost recovery).
2. A \$2,000 exclusion for military retirees age sixty and over and a \$1,500 exclusion for their surviving spouses (with no age restriction for surviving spouses and no cost recovery provision for either group).

3. A \$2,000 exclusion for retirees from private industry and a \$1,000 exclusion for their surviving spouses (after cost recovery).

An annuitant whose AGI exceeds \$12,000 must reduce his maximum exclusion by one dollar for every dollar of AGI that exceeds that amount. The current law also provides that benefits received by Virginia Supplemental Retirement System (VSRS) retirees and their survivors be totally excludable.

Under these provisions the tax treatment accorded to each class of retirees is inconsistent. Federal civil service retirees receive an exclusion of up to \$3,000, but military and private retirees only receive up to \$2,000. A further lack of uniformity exists in that no age restriction is placed upon any class of annuitants other than military retirees. An example of how different provisions for different groups violate the concept of horizontal equity can be demonstrated by considering four single men over age sixty (but less than sixty-five) each with pension income of \$10,000, itemized deductions of \$2,000, and a personal exemption of \$600.^{1/} Based on the current tax rate schedule, their state income tax liabilities would be as follows:

<u>Retiree</u>	<u>Virginia Income Tax Liability</u>
Federal civil service	\$102
Military	140
Private	140
VSRS	None

The treatment accorded surviving spouses also displays a lack of

^{1/} Horizontal equity refers to that portion of the generally accepted ability-to-pay theory of taxation that calls for individuals with the same income to pay the same tax.

uniformity. The survivors of military and civil service retirees receive maximum exclusions of \$1,500, but the survivors of retirees from the private sector only receive a maximum of \$1,000.

The income constraint limiting the relief to low and middle income retirees and surviving spouses for all classes but VSRS does ensure some degree of adherence to the concept of vertical equity.^{1/} For the example just shown, the tax liabilities of the federal civil service, military, and private industry retirees would equalize at \$493 as pension income reached \$15,000 and the exclusions disappeared. The VSRS retiree would, however, continue to have no tax liability.

Alternatives to the Current Retirement Income Exclusions--We can approach the question of how best to provide tax relief to retirees and their survivors in several different ways, depending upon which approach to horizontal equity we choose to accept. One approach would be to consider nontaxable forms of retirement benefits, such as social security and railroad retirement, as part of the individual's total retirement income and to adjust any tax relief to account for these benefits. The other approach would be to disregard nontaxable benefits and to provide tax relief only on the basis of other, taxable forms of retirement income. We can use either of these with the exclusion concept of tax relief or the credit concept, since the only difference between the two is that an exclusion reduces taxable income while a credit is a direct reduction of tax liability. The alternatives presented here will deal with both approaches to horizontal equity.

^{1/} Vertical equity is the other half of the ability-to-pay theory of taxation, which says that persons with higher incomes should pay a higher tax.

The federal government grants relief in the form of a retirement income tax credit that employs the first approach to horizontal equity. The intent of the Congress when it enacted the retirement income credit in 1954 was to provide comparable tax relief for recipients of nontaxable social security and railroad retirement benefits and for annuitants who received other forms of retirement income; prior to 1954 retirement income derived from other plans had been fully taxable.^{1/} To do this, the base of the credit was set at an amount equal to the maximum social security benefit. This amount was then subject to reduction by actual social security or railroad retirement benefits that the individual received. A further dollar for dollar reduction in the base of the credit was required for retirees under age seventy-five with earned income in excess of the amount that social security regulations had set as the limit for meeting the requirements of its test of retirement. No reduction for earned income was required after the individual reached age seventy-five, once again conforming to social security treatment. For individuals under the age of sixty-five, retirement income was defined as any pension or annuity income (other than military pension income) received from public retirement systems. For retirees age sixty-five and over, retirement income included any taxable pension or annuity as well as income from interest, dividends, and rents. If total retirement income was less when compared to the maximum social security benefits after downward adjustments, it became the base for the credit. The amount of the credit was then calculated at the first marginal income tax rate.

^{1/} Joseph A. Pechman, Federal Tax Policy, (Washington: The Brookings Institution, September, 1966), pp. 85-86.

When the credit concept was adopted by the federal government in 1954, the maximum social security benefit was \$1,200, the earned income constraint was \$900, and the first \$2,000 of taxable income was subject to a tax of 20 percent. Since its enactment the credit has been modified several times. First, retirement income was redefined for individuals under age sixty-five to include military pensions. In 1956, the earned income restriction was eliminated after age seventy-two instead of age seventy-five. For persons over age sixty-five but under age seventy-two the earned income restriction was increased from \$900 to \$1,200, but for persons under age sixty-five it remained at \$900. Similar changes had been enacted in social security regulations in 1954 but after the legislation providing the retirement income credit had been passed by Congress. The base of the retirement income credit was increased in 1962 from \$1,200 to \$1,524, the maximum social security benefits payable at that time. The earned income restriction was further modified to conform to existing social security regulations for persons between the ages of sixty-two and seventy-two so that a reduction in the credit base of only \$1 for every \$2 of earned income between \$1,200 and \$1,700 was required; earned income in excess of \$1,700 reduced the credit base dollar for dollar. For individuals under age sixty-two, the \$900 constraint applied with a dollar for dollar reduction in the credit base for earned income over that amount. In 1965, when federal income tax rates were reduced, the credit was also reduced from 20 to 15 percent so that relief would be at the average of marginal rates applicable to the first \$2,000 of taxable income. Included in the same bill that reduced the credit were provisions to increase by 50 percent the maximum credit for married taxpayers who file joint returns. This increase was intended to

compensate for the 50 percent supplementary social security received by a husband on behalf of his wife.^{1/} Since 1962, maximum social security benefits have more than doubled and the earned income restriction for recipients of these benefits has also increased; however, the credit base has never been changed to conform to these provisions.^{2/}

Maryland grants tax relief to retirees in the form of an exclusion based on social security and railroad retirement benefits and subject to reduction for actual benefits received. Each year Maryland obtains the statewide averages of these benefits for the prior year, averages them together, and rounds the figure to the nearest \$100. The maximum exclusion for the current tax year is then set equal to this average. An individual must reduce his exclusion by the amounts of social security and/or railroad retirement benefits received during the year, since these forms of income are already nontaxable. Tax relief is only provided to persons age sixty-five and over with the exception that it is also provided to disabled persons regardless of age. Thus, the Maryland exclusion is much the same as the base of the federal retirement income credit. The maximum retirement income exclusion without any downward adjustments for Maryland retirees and survivors amounted to \$2,300 for the 1974 tax year.

The second approach to horizontal equity, which makes no allowance for nontaxable forms of income, can be taken with a sliding scale credit. Individuals within the same AGI classes would receive equal credits,

^{1/} Joseph A. Pechman, Federal Tax Policy, pp. 86-87.

^{2/} The current maximum annual social security payment is \$3,796. A retiree can earn up to \$2,520 per year with no reduction in benefits; for each \$2 of earnings above this limit, social security benefits are reduced \$1. Individuals who are age seventy-two and over can continue to earn an unlimited amount of income without reduction in social security benefits.

but, as income increased, the credit would be reduced in order to provide greater adherence to the concept of vertical equity. Two examples of a state sliding scale retirement income credit are shown below:

<u>Example 1</u>		<u>Example 2</u>	
<u>AGI Class</u>	<u>Credit</u>	<u>AGI Class</u>	<u>Credit</u>
\$ 4,999 or less	\$100	\$ 4,999 or less	\$60
\$ 5,000-\$ 9,999	60	\$ 5,000-\$ 9,999	40
\$10,000-\$14,999	40	\$10,000-\$14,999	20
\$15,000 and over	0	\$15,000 and over	0

The criterion for eligibility could be the receipt of a taxable pension or annuity as reported on the federal return. The credit could apply to retirees from all sectors, including VSRS, and would be based solely on the size of AGI without regard for pension size or for social security benefits. On the other hand, relief could also be extended to those who have other forms of taxable retirement income in lieu of a pension (e.g., interest, dividends, and rents).

Another alternative that makes no provision for social security benefits would be a modification of the current law to provide equal exclusions to the various sectors. The current \$3,000 exclusion for federal civil service retirees could be reduced to the same level of \$2,000 that applies to the military and private sectors. Conversely, the \$2,000 exclusion provided for retirees from these two sectors could be increased to \$3,000, or a compromise exclusion could be provided at \$2,500 for the three sectors.

Tax Relief in Other States--When compared to the income tax relief granted to retirees in neighboring states, Virginia's current provisions are generally more generous. North Carolina and Kentucky both offer

partial exclusions, and only West Virginia extends more relief than the Commonwealth. West Virginia taxpayers who are age sixty-five and over receive a \$4,000 exclusion for retirement benefits from any source and a total exclusion for state pensions. As mentioned earlier, Maryland also utilizes the retirement income exclusion concept of tax relief but bases it on the annual statewide average of social security and railroad retirement benefits paid. The maximum exclusion for 1974 was \$2,300, which was then subject to reduction for actual social security and railroad retirement benefits that the individual received.

Several states provide income tax relief patterned after the federal retirement income credit. They include California, Indiana, and Oregon. It is worth noting that although these three states use the same base for the credit as used for federal tax purposes, they offer only a portion of the federal relief by basing their credit on their state individual income tax rates. California limits the tax credit to 1 percent of the credit base instead of the 15 percent granted by the federal government. A 1 percent credit is consistent with the California rate schedule, since the first \$2,000 of California taxable income is subject to that rate. Indiana grants a state retirement income credit equal to two-fifteenths of the allowable federal credit. Two-fifteenths is equivalent to relief at a tax rate of 2 percent, which is the flat state individual income tax rate in Indiana.

Oregon applies a variation of the federal concept. A retirement income credit equal to 25 percent of the permissible federal credit may be claimed. This amount is also consistent with the notion that relief should be granted at the first bracket rate, since the first \$500 of Oregon taxable income is subject to a 4 percent tax rate. In addition to the credit, retirees receive a variety of exclusions but with a

number of restrictions placed on eligibility for them. Payments received by retirees from the Oregon public retirement fund are totally excludable.

The Equity and Revenue Impact of Alternative Forms of Tax Relief--We

can view any variation of the credit concept or exclusion concept of tax relief as a "tax expenditure" because the decision to reduce the taxes of retirees is no different than the decision to create a government program that would provide financial assistance to them. However, the government program appears explicitly on the expenditure side while the tax expenditure does not appear anywhere and is thus subject to less scrutiny from policy makers and the general public. A tax expenditure does not provide relief to those persons with too little income to file a tax return, but a program can be designed to include benefits for these persons. Finally, revenues available for appropriation are reduced whether relief is granted in the form of a tax break or a special government program.^{1/} We estimate that the cost to the state of the current retirement income exclusions is from \$9 to \$11 million per year in individual income tax revenues.

If Virginia were to use the credit concept of tax relief patterned after the federal provisions, there would be more equity than the present law provides. As shown earlier, the current law violates the concept of horizontal equity. It grants different retirement income exclusions to different classes resulting in retirees and survivors with equal annuities paying unequal taxes. In addition, two individuals may have equal retirement income, but one may have a double tax break, since part

^{1/} Edward M. Fried, Alice M. Rivlin, Charles L. Schultze and Nancy H. Teeters, Setting National Priorities: The 1974 Budget, (Washington: The Brookings Institution, 1973), pp. 49-57.

of his income may be in the form of nontaxable social security and part may be excludable pension income. The livelihood of the other individual may depend solely on other taxable forms of retirement income, such as interest, dividends, rent, or even limited earnings. The current law also does not prohibit individuals with more than one kind of pension from claiming more than one exclusion.

At the same time, the present law does not totally meet the test of vertical equity although it does impose an income constraint on tax relief. Without a requirement in the law to account for social security and railroad retirement benefits as well as other kinds of income, one retiree may have total income higher than that of another but may pay a lower tax. We can show how this might occur if we consider two individuals who are both single and over age sixty-five; one is retired from military service, and the other is not under a pension plan. Assume that the first individual receives total income of \$8,000 consisting of a \$6,000 pension and \$2,000 in social security. Assume that the second individual has total income of \$6,500 of which he earns \$5,000 from part-time employment, receives \$1,500 from rental property, and because of his earnings is ineligible for social security. Under provisions of the current law the first retiree would have a Virginia income tax liability of \$22; however, the second individual, with less income, would be required to pay \$195.^{1/} Finally, because of the progressive nature of the individual income tax rate schedule, the current law enables a retiree whose total income places him in one of the higher marginal brackets to receive more relief than one who is in a lower bracket.

^{1/} These tax liabilities are based on the minimum standard deduction of \$1,300, a personal exemption of \$600, and the \$1,000 exemption for age.

Adoption of the basic framework of the current federal retirement income credit with the base equal to current maximum social security benefits but periodically modified to reflect increases in benefits would restore horizontal equity. The greatest tax relief would go to those retirees who received little or no social security benefits. In particular, federal civil service employees do not contribute to the social security system, and those civil service retirees ineligible for social security would benefit.^{1/} However, the same tax relief would be granted to all retirees when social security payments were equivalent. Another asset would be that other forms of retirement income would be included in the calculation base for the credit. The potential to claim more than one exclusion would also be eliminated.

The federal credit concept would also enhance vertical equity. There would be a reduction in the amount of the credit as social security and railroad retirement payments to the individual increased. The degree of tax relief would be unaffected by the progressive income tax rate schedule, since the credit would be granted at the first marginal rate. Furthermore, the federal credit concept would eliminate the age discrimination in the present law; at the same time it would increase relief as age advances because of the progressive decline and final disappearance of the earned income restrictions.

The total cost for Virginia of the full federal retirement income credit, which is currently granted at the marginal rate of 15 percent, is estimated at approximately \$4 million per year, or less than half

^{1/} A recent study indicates that about 2 out of 5 civil service retirees do receive social security benefits because of limited employment outside the federal government. See U. S. Civil Service Commission Committee on Post Office and Civil Service, Survey of Income of Civil Service Annuitants, (Washington: U. S. Government Printing Office, September, 1973), p. 7.

the current cost of tax relief.^{1/} There are no data available to develop estimates of the cost of a Virginia credit based on current maximum social security benefits and granted at the first marginal tax rate of 2 percent. However, because of the increased number of individuals who would become eligible for tax relief, the total cost of the credit would probably exceed \$4 million per year and might possibly reach the cost of the current law.^{2/}

The second alternative, which would provide a retirement income exclusion based on the statewide average of actual social security and railroad retirement benefits, would also improve equity. Since the exclusion would be reduced for actual social security or railroad retirement benefits received by the taxpayer, much of the same enhancement of horizontal and vertical equity would occur as for the credit concept. The Maryland plan does not provide for retirement income other than pensions and annuities, but if Virginia were to adopt this exclusion concept, it could define retirement income to include interest, dividends, rent, and earned income. The exclusion concept would still enable taxpayers to take advantage of the progressive income tax rate schedule, but tax relief could be limited to taxpayers age sixty-five and over, thereby eliminating the current age discrimination. Estimates of the cost of the Maryland plan for Virginia range from \$3 to \$4 million per year; if retirement income were

^{1/} Estimates of the cost of the retirement income credit for Virginia are based on an Internal Revenue Service sample of federal individual income tax returns filed by Virginians for the 1970 and 1972 tax years. Excessive sampling variability within AGI classes was noted in some instances.

^{2/} Approximately 20,000 Virginians were eligible for the federal retirement income credit in 1972. We estimate that about 170,000 retirees and survivors are eligible for the current retirement income exclusions.

defined to include other taxable forms of income, the total cost might increase substantially because of the increased number of taxpayers who could take advantage of the tax break. The data are not, however, available to make such an estimate.

The sliding scale credit concept would treat the pension and annuity income of all retirees and survivors the same. Although it would better conform to the notions of horizontal and vertical equity than current law by granting equal relief to taxpayers within the same AGI classes and by reducing tax relief as AGI increases, it would still make no provision for nontaxable forms of income. If receipt of a pension or annuity determined eligibility, the cost of the first example of a sliding scale credit would be approximately \$6 million per year, and the cost of the second would be approximately \$4 million. If the eligibility criterion were expanded to include other forms of taxable retirement income, the cost could rise substantially.^{1/}

The final alternative, which would equalize the present exclusions for all classes of retirees, would better relate to the concept of horizontal equity than current law. If the \$12,000 income constraint were retained, the same degree of adherence to the notion of vertical equity in the existing law would be continued. There would still be no comparability of relief between those with and without social security, and the potential to have double exclusions and to take advantage of the progressive rate schedule would still be present.

^{1/} The methodologies used to estimate the cost of the Maryland plan and the sliding scale credit are available upon request from the Research Division of the Department of Taxation.

Unless the exclusions were extended to retired persons with other taxable forms of income, both concepts of equity would suffer even more. Finally, unless the age constraint on military retirees were removed, or imposed upon all retirees, age discrimination would continue in the law. Table 3.23 shows the estimated costs of various exclusions by class of annuitant, with and without an age constraint for retirees, but with continuation of the current AGI constraint.^{1/} These estimates are based on the assumption that exclusions would be granted only for taxable pension and annuity income and not for other taxable forms of income, but again their total cost could increase substantially because of the added number of eligible individuals.

Conclusion--Tax relief can be granted to retirees and survivors in various forms. Before Virginia decides which of these forms is most acceptable in terms of both equity and cost, it should decide which notion of horizontal equity that it wishes to achieve. Unless provisions for tax relief conform consistently to one of the approaches outlined in this section, the tax treatment of retirees and survivors will continue to differ significantly between classes.

Elimination of the Virginia Dividend Exclusion

At the present time the dividends paid by Virginia corporations are excluded from income taxation. There are, however, four types of corporations and associations that are not subject to the state

^{1/} We estimate the cost of eliminating the AGI constraint to be from \$2.0 to \$3.0 million, assuming continuation of the current exclusions to all sectors. If all retirees received maximum exclusions of \$2,000 with no age restrictions, we estimate the cost of eliminating the AGI constraint to be as much as \$4.0 million more than the amounts shown in Table 3.23; if each retiree were to receive a \$3,000 exclusion with no age restriction, we estimate the cost to be as much as \$5.5 million more than the amounts shown in the table.

TABLE 3.23--ESTIMATED COST BY SECTOR OF VARIOUS RETIREMENT
INCOME EXCLUSIONS, ASSUMING \$12,000 AGI CONSTRAINT (MILLIONS)^{a/}

	Retirees					
	Age 60 Constraint			Without Age Constraint		
	\$2,000	\$2,500	\$3,000	\$2,000	\$2,500	\$3,000
Civil Service	\$1.8-\$2.2	\$2.6	\$2.8-\$ 3.4	\$1.8-\$2.2	\$ 2.6	\$ 2.8-\$ 3.4*
Military	0.5- 0.7*	0.8	0.9- 1.1	2.6- 3.2	3.7	4.0- 5.0
Private	<u>3.1- 3.9</u>	<u>4.3</u>	<u>4.5- 5.7</u>	<u>3.1- 3.9*</u>	<u>4.3</u>	<u>4.5- 5.7</u>
Total	\$5.4-\$6.8	\$7.7	\$8.2-\$10.2	\$7.5-\$9.3	\$10.6	\$11.3-\$14.1

	Survivors (Without Age Constraint)				
	\$1,000	\$1,500	\$2,000	\$2,500	\$3,000
Civil Service	\$0.4	\$0.6-\$0.7*	\$0.8	\$1.0	\$1.2-\$1.4
Military	0.2	0.3- 0.4*	0.4	0.5	0.6- 0.8
Private ^{b/}	- *	-	-	-	-
Total	\$0.6	\$0.9-\$1.1	\$1.2	\$1.5	\$1.8-\$2.2

Note: An explanation of the methodology used to develop these estimates is available from the Research Division of the Department of Taxation.

* Current provisions.

^{a/} We estimate the cost of fully excluding VSRS benefits to be from \$1.4 to \$1.8 million per year, which must be added to the total cost of any of the alternative plans outlined here. Data are not available to make estimates of the cost of extending partial exclusions to VSRS annuitants; however, if the same treatment were applied to VSRS annuitants as those from other sectors, the cost would be reduced.

^{b/} The number of survivors from the private sector is indeterminable from total private annuitants. The cost of relief to private survivors is therefore included in the cost to private retirees.

corporation income tax, and the dividends paid by them are not deductible by the recipients:

1. Public service corporations
2. Insurance companies
3. Reciprocal or inter-insurance exchanges
4. Credit unions

National banks wherever located and state banks and trust companies in Virginia are not subject to the state corporation income tax, but the dividends paid by them are fully deductible by the recipients. For the most part, therefore, the question of exclusion is confined to dividends paid out of earnings and profits of corporations engaged in manufacturing, mining, merchandising, business service, and farming.

During preconformity (all taxable years beginning before January 1, 1972), Virginia law provided that if only part of the income were assessable - that portion derived from business within the state - then only the corresponding part of the dividends would be deductible. For example, if 40 percent of a corporation's income were taxable by Virginia, 40 percent of its dividends would be deductible on the Virginia individual income tax. The varying percentages of different corporations made this a complicated procedure. Conformity attempted to simplify this procedure. If less than 50 percent of the corporation's net income is taxable by Virginia, then no portion of the dividends paid by the corporation to Virginia residents is deductible. On the other hand, if 50 percent or more of the corporation's income is taxable in Virginia, then all of the dividends paid by the corporation to Virginia residents are deductible.

There are arguments for continuing the present treatment. The exclusion of dividends may attract additional investment in Virginia corporations and thus encourage their development and growth. The

present treatment of Virginia corporate dividends may also prevent double taxation. That is, if a tax is paid by a corporation on its profits and if a stockholder is taxed again when the profits are distributed to him in the form of dividends, the original income is taxed twice. There is substantial controversy over the double taxation of dividends. If the burden of the corporation tax is perfectly shifted away from capital to consumers or wage earners, then dividend income is actually not taxed twice under the current law. The corporation when making its payment is simply carrying out its designated function as a tax collecting agency with actual profits and dividends no lower than they would be if the tax were not imposed. If the burden of the corporate tax is borne by capital, the double taxation argument is valid. When business managers are questioned about shifting, they feel that the corporate tax is shifted through their pricing policies. Economists, however, disagree over the evidence supporting the shifting of this tax.^{1/} Thus the double taxation argument supporting the dividend exclusion is open to question.

On the other hand, there are reasons to change the treatment of dividends paid by Virginia corporations. The exclusion represents a departure from the state's conformity to federal income tax law and appears to violate the notion of horizontal equity, which calls for individuals with the same income to pay the same tax. Moreover, the \$100 dividend exclusion already granted under conformity probably mitigates any adverse effects of double taxation for the average taxpayer.

Another argument for elimination is that this form of tax relief

^{1/} See the discussion of the shifting arguments in the earlier section on the corporate income tax.

is so limited that it provides little additional incentive to invest in Virginia corporations. This view has support from the Division of Industrial Development. The division thinks that eliminating the exclusion would have little effect on the ability of manufacturers to raise capital and generally would create no serious problems affecting Virginia's competitive position in attracting new industry.^{1/}

A final reason is that exclusion of Virginia corporate dividends costs the state \$3 to \$5 million annually.^{2/} This loss can be viewed as a tax expenditure. Its objectives and effects are similar to actual expenditures for a program in the budget. Both reduce revenues available for other purposes; however, the program would explicitly appear on the expenditure side while the tax expenditure does not appear anywhere. As a result, the executive branch, the legislature, and the public can subject this tax expenditure to less critical analysis than an explicit expenditure. Two other differences between the dividend exclusion and an explicit expenditure are that the exclusion is automatically more beneficial to high than to low income taxpayers because of the progressive rate schedule and that it provides no benefits to persons too poor to pay the income tax.

Elimination of the present Virginia dividend exclusion could be used to meet any demands for more revenue, for such a step would yield the state \$3 to \$5 million annually. The commission did

^{1/} The letter from the Division of Industrial Development with these views and other comments on the taxation of dividends is on file with the staff of the commission and has been published in Senate Document No. 13, the report of the commission to the 1975 session of the General Assembly.

^{2/} This estimate relies on data made available by the Internal Revenue Service in Statistics of Income - 1971, Individual Income Tax Returns (Washington: Government Printing Office, 1973).

recommend to the 1974 session of the General Assembly elimination of the exclusion in Senate Bill No. 61, which was carried over to the 1975 session of the General Assembly and was then defeated. Senate Bill No. 61 did reflect the desire of the commission to retain the exclusion from individual income taxation of the dividends paid by national banks and state banks and trust companies. At the same time, we must indicate that most of the reasons for doing away with the Virginia corporate dividend exclusion also apply to the bank dividend exclusion.

Taxation of 100 Percent of Capital Gains

We can define capital gains as gains that result from the sale of assets other than those held in the ordinary conduct of business. Inventory gains made by a department store or gains from appreciation in the value of securities held by a security dealer are viewed as ordinary income. On the other hand, gains from the sale of securities held by an investor or of a house by a homeowner are given preferential capital gains treatment. Under the federal provisions to which Virginia has conformed since 1972, this treatment extends to the sale of assets held over six months and reduces it by 50 percent for purposes of taxation. Prior to conformity, Virginia did not distinguish between capital gains and ordinary income in determining taxable income.

What are the arguments favoring the continuation of this preferential treatment? One is that capital gains are discontinuous and volatile so that they would be subject to more tax under a progressive rate schedule than would an equal amount of income received in a steady flow. Another is that capital gains are not expected

as regular income but are windfalls that accrue without intention. A third is that taxing capital gains at 100 percent would decrease the effective rate of return on investments, thereby reducing the amount of investment and ultimately the level of economic activity. Finally, full taxation of capital gains would go against the conformity structure that Virginia, along with thirty other states, has adopted. Conformity, by making the Virginia individual income tax very similar to the federal income tax, has led to greater simplicity for the taxpayer, better reporting of income tax data, and more efficient administration of the tax.

What reasons are there to oppose favored treatment? If capital gains are discontinuous and volatile, the way to meet the problem is through adequate averaging provisions. Some gains may be windfalls, and others may not; in neither case does it seem valid to apply an expectation criterion to determine income. Every capital gain produces an increase in an individual's wealth and taxable capacity. Not to treat capital gains as ordinary income violates the notions of horizontal and vertical equity. The preferred treatment appears to create a strong incentive to take capital income in the form of capital gains rather than profits, dividends, or interest, especially as income and the marginal tax rate increase. In the early 1970's, the latest period for which data are available, approximately one-half of all capital gains in Virginia and at the national level were found among persons with AGI's over \$50,000. The result is not only different tax liabilities at given levels of income but an offset to the progressivity of the individual income tax. Of course, the top marginal rate in Virginia is 5.75 percent as compared to the top federal rate of 70 percent; taxation of all capital gains

at this lower state rate would probably not deter capital investment. A final argument against special treatment is that it is a tax expenditure costing the state \$10 to \$15 million annually.^{1/} The state could use these monies to meet any future demands for more revenue.^{2/}

Personal Income Tax Credit on Food for Home Consumption

If some allowance is to be made for the sales tax paid on food for home consumption, an alternative to exemption is an income tax credit. As Table 3.24 shows, at the close of 1973, 16 states and the District of Columbia used some form of the tax credit device. Of these, Colorado, Nebraska, and the District of Columbia granted a personal income tax credit to compensate for a sales tax on food. The credit was granted on all resident income tax returns; in addition, refunds were made to those without a tax liability. The credit, as these areas used it, was calculated by the number of personal (exclusive of those for age and blindness) exemptions per tax return times the credit. Nebraska had a \$10 credit, Colorado a \$7 credit, and the District of Columbia, a credit ranging from \$2 to \$6 per personal exemption, depending on the taxpayer's income bracket, for those with income below \$6,000. Two states - Hawaii and Massachusetts - give the credits for consumer type taxes. Hawaii gave an additional credit for drug and medical expenses. Vermont allowed a credit for sales taxes paid based on income and the number of personal exemptions. In addition, Idaho

^{1/} This estimate relies on data from the 1971 state individual income tax file and from special computer printouts for 1972 federal tax returns made available by the Internal Revenue Service.

^{2/} For more on the subject, including a discussion of the taxation of unrealized capital gains, see Richard A. Musgrave and Peggy B. Musgrave, Public Finance in Theory and Practice (New York: McGraw-Hill, Inc., 1973), pp. 226-231.

TABLE 3.24 - STATE USE OF A PERSONAL INCOME TAX CREDIT-REBATE TO MINIMIZE OR OFFSET THE REGRESSIVITY OF SALES AND PROPERTY TAXES¹

State	Type of credit	Year adopted	Amount of credit	Law	Administrative Procedure
Arizona	For senior citizen property tax relief (homeowners and renters)	1973	Varies based on income. Income ceiling—single \$3,500; married \$5,000 (value of property may not exceed \$5,000)	Chap. 182 (H.B. 2311, Laws 1973)	The State Tax Commission shall make available suitable forms with instructions for claimants, including a form which may be included with or as a part of the individual income tax blank. If allowable claim exceeds income tax liability, a refund will be granted.
Arkansas	For senior citizen homestead relief	1973	Varies based on income. Up to \$400 if income was \$1,500 or less; up to \$175 if income was between \$4,500 and \$5,500	Act 63 (H.B. 10, Laws 1973)	The Department of Finance and Administration shall make available suitable forms with instructions for claimants. If allowable claim exceeds income tax liability, a refund will be granted.
California	Tax relief for renters	1972	Varies based on income. Credit ranges from \$25 for individuals with A.G.I. under \$5,000 to \$45 with A.G.I. of \$8,000 and over	Ch. 1406 (S.B. 90, Laws 1972)	Credit to be claimed on returns in such form as the Franchise Tax Board may prescribe. If credit exceeds tax liability, a refund will be allowed.
Colorado	For sales tax paid on food	1965	\$7 per personal exemption (exclusive of age and blindness)	Chap. 138, Art. 1 (Secs. 138-1-18 & 138-1-19 added by H.B. 1119, Laws 1965, effective 6/1/65)	Credit to be claimed on income tax returns. For resident individuals without taxable income a refund will be granted on such forms or returns for refund as prescribed by the Director of Revenue.
	For senior citizen property tax relief (homeowners and renters)	1971	Varies with income up to \$6,300; limited to 50 percent of property tax or \$270	Chap. 138, Art. 1 (Secs. 138-1-20 & 138-1-21 added by H.B. 1040, Laws 1971, effective 7/1/71)	Credit claimed on income tax returns or, for those having no taxable income, on forms prescribed by the Department of Revenue.
Hawaii	For consumer-type taxes	1965	Varies based on income ²	Chap. 121 (Secs. 121-12-1 & 121-1-12-2 added by Act 155, Laws 1965)	The Director of Taxation shall prepare and prescribe the appropriate form or forms to be used by taxpayers in filing claims for tax credits. The form shall be made an integral

See footnotes at the end of table.

TABLE 3.24 - STATE USE OF A PERSONAL INCOME TAX CREDIT-REBATE TO MINIMIZE OR OFFSET THE REGRESSIVITY OF SALES AND PROPERTY TAXES¹ (Cont'd)

State	Type of credit	Year adopted	Amount of credit	Law	Administrative Procedure
Hawaii (Continued)	For drug or medical expenses	1970	Varies based on income	Act 180, Laws 1970; sec. 235-56	part of the individual net income tax return. In the event the tax credits exceed the amount of the income tax payments due, the excess of credits over payments due shall be refunded to the taxpayer.
	For household rent	1970	do	Act 180, Laws 1970	
Idaho	For sales taxes paid	1965 and 1969	\$10 credit per personal exemption (rebate applicable to taxpayers 65 and over only)	Chap. 195, Laws 1965; Chap. 456, Laws 1969; Sec. 63-3024(d)	Credit (or rebate if credit exceeds tax liability) to be claimed on income tax returns. For resident individuals (65 and over) without taxable income a refund will be granted on such forms or returns for refund as prescribed by the State Tax Commission.
Indiana	Homestead relief for senior citizens and disabled persons	1973	Varies based on income and amount of property tax ³	H.B. 1144, Laws 1973	The Indiana Department of State Revenue shall make available suitable forms with instructions for claimants. If credit exceeds income tax due a refund will be granted.
Kansas	Homestead relief for senior citizens and disabled persons	1970 and 1972	Varies, based on income and amount of property tax	Chap. 403 (H.B. 1253, Laws 1970); Chap. 383 (S.B. 474, Laws 1972)	Tax credit (or rebate if credit exceeds tax liability). The Department of Revenue shall make available suitable forms with instructions for claimants, including a form which may be included with or a part of the individual income tax blank.
Massachusetts	For consumer-type taxes	1968	\$4 for taxpayer, \$4 for spouse, if any, and \$8 for each qualified dependent ⁴	Chap. 62 (Sec. 6b added by ch. 14, Acts 1968)	Credit to be claimed on income tax returns. If credit exceeds income tax due a refund will be granted.
Michigan	Property tax relief for all homeowners and renters	1973	Credit equal to 60% of excess taxes (100% for elderly). Excess taxes = homestead taxes (or tax equivalent for renters) in excess of 3.5% of total household income (various lower percentages for elderly with income below \$6,000). Maximum relief \$500 ⁵	Act 20 (H.B. 4207, Laws 1973)	The revenue division of the department of treasury shall provide forms for claiming the credit, which forms shall be a component part of the State income tax returns. If credit exceeds tax liability a refund will be allowed.

See footnotes at the end of table.

TABLE 3.24 - STATE USE OF A PERSONAL INCOME TAX CREDIT-REBATE TO MINIMIZE OR OFFSET THE REGRESSIVITY OF SALES AND PROPERTY TAXES¹ (Cont'd)

State	Type of credit	Year adopted	Amount of credit	Law	Administrative Procedure
Minnesota	For senior citizen homestead relief ⁶	1967	Credit ranges from \$1 to \$720 based on household income up to \$5,999 and amount of property tax or equivalent rent up to \$800 (20% of rent = tax equivalent)	Chap. 290 (Secs. 290.0601 to 290.0617 added by Ch. 32, Art. VI, Laws 1967, Rev. 1973)	Tax credit or refund to be claimed on income tax return. Department of Taxation shall make available a separate schedule for information necessary to administration of this section and the schedule shall be attached and filed with the income tax return. Cash refund granted if property tax credit exceeds State personal income tax liability.
	Tax relief for renters	1967	10% of the total amount paid by claimant as rent, not to exceed \$120	Chap. 290 (Secs. 290.981 to 290.992 added by Ch. 32, Art. XVII, Laws 1967, Rev. 1973)	Same as above.
Missouri	Homestead tax relief for senior citizens	1973	Credit is based on amount by which property taxes or rent equivalent exceed varying percentages of income, ranging from 3% if income is not over \$3,000 to 4% if income is between \$4,501 and \$7,500. Not more than \$400 tax considered for relief. (18% of rent = tax equivalent)	H.B. 149, 417, 425, 471 and 47, Laws 1973	Credit to be claimed on income tax returns. If allowable credit exceeds the income tax reduced by other credits, then the excess shall be considered an overpayment of the income tax.
Nebraska	For sales tax paid food	1967	\$10 per personal exemption (exclusive of age and blindness)	H.B. 377, Laws 1967 Rev. 1972	Credit to be claimed on income tax returns. Refund will be allowed to the extent that credit exceeds income tax payable but no refund will be made for less than \$2.
New Mexico	For all State-local taxes	1972	Credit varies from 0 to \$133 based on modified gross income up to \$6,000 and total number of personal exemp-	Chap. 20, Laws 1972; Chap. 336, Laws 1973	Credit to be claimed on income tax returns. If the tax credit exceeds the taxpayer's income tax liability, the excess shall be refunded to the taxpayer.

See footnotes at the end of table.

TABLE 3.24 - STATE USE OF A PERSONAL INCOME TAX CREDIT-REBATE TO MINIMIZE OR OFFSET THE REGRESSIVITY OF SALES AND PROPERTY TAXES¹ (Cont'd)

State	Type of credit	Year adopted	Amount of credit	Law	Administrative Procedure
New Mexico (Continued) . . .			tions taken for federal income tax purposes plus an additional exemption for each person 65 and over		
Vermont	For sales tax paid	1969	Varies, based on income and number of personal exemptions (other than age and blindness) ⁸	H.B. 125, Laws 1969; Chap. 152, Sec. 5829	Credit to be claimed on income tax returns. Credits properly claimed by resident individuals who have no income or no income subject to Vermont tax will be allowed the full amount of the credit as a refund.
	For property tax relief	1973	Equal to the amount by which property taxes or rent constituting property taxes on their households exceeds varying percents of the individuals total household income. Maximum credit \$500. (20% of rent = tax equivalent)	H.B. 222, Laws 1969; Chap. 139, Sec. 59C1; Chap. 81 (H.B. 155; Laws 1973)	The credit may not exceed the property tax, but if income tax liability is less than the credit the difference between the liability and the credit will be refunded.
Wisconsin	For homestead tax relief	1963; 1973	Varies, based on income and amount of property tax or rental payment (25% of rent = tax equivalent)	Chap. 71 (Sec. 71.09 (7) added by Ch. 566 (A.B. 301), Ch. 580 (A.B. 907) repealed & recreated Sec. 71.09(7) Chap. 90, Laws 1973	Tax credit or refund to be claimed on income tax return. The Department of Taxation shall make available a separate schedule which shall call for the information necessary to administering this section and such schedule shall be attached to and filed with the Wisconsin income tax form. Cash refund granted if property tax credit exceeds State personal income tax due.
Washington, D.C.	For sales tax paid on food	1969	Varies, based on income ⁹ (credit applicable to low income taxpayers only)	P.L. 91-106 (H.R. 12982)	Tax credit or refund to be claimed on income tax return.

See footnotes at the end of table.

TABLE 3.24 - STATE USE OF A PERSONAL INCOME TAX CREDIT-REBATE TO MINIMIZE OR OFFSET
THE REGRESSIVITY OF SALES AND PROPERTY TAXES¹ (Cont'd)

- ¹ If a taxpayer has no State personal income tax liability or a tax liability insufficient to absorb the entire credit (a negative tax credit situation) he is entitled to the appropriate cash refund. If the taxpayer's State personal liability is equal to or greater than the tax credit, his personal income tax liability is reduced by the amount of the credit (a positive tax credit situation).
- ² The credits for consumer-type taxes are based on "modified adjusted gross income" (regular taxable income plus exempt income such as social security benefits, life insurance proceeds, etc.) and range from \$21 per qualified exemption for taxpayers having a modified adjusted gross income of less than \$1,000 to \$1 per exemption where such income is between \$8,000 and \$9,999.
- ³ Ranges from 75% of property tax or rent constituting property tax for income below \$500 to 10% for incomes between \$4,000 and \$4,999. Maximum amount of property tax considered for relief is \$500. Twenty percent of rent equals property tax equivalent.
- ⁴ Credits are only allowed if total taxable income of taxpayer and spouse, if any, does not exceed \$5,000 for the taxable year.
- ⁵ Seventeen percent of gross rent is deemed to be property tax.
- ⁶ All homeowners residing in their own homes are allowed a direct reduction of their property taxes due by means of the Homestead Property Tax Credit. This credit amounts to 35 percent of the tax levy, excluding the amount levied for bonded indebtedness, to a maximum credit \$250. Senior citizen homeowners also receive this credit. Local governments are reimbursed for their tax loss from the state property tax relief fund.
- ⁷ Elderly may choose this relief or senior citizen relief but not both.
- ⁸ Ranges from \$12 to \$21 for taxpayers having less than \$1,000 total household income to \$0 to \$36 for those having between \$6,000 and \$6,999 income, based on number of personal exemptions.
- ⁹ Low income taxpayers (AGI not over \$6,000) are allowed a credit ranging from \$2 to \$6 per personal exemption, depending upon the taxpayer's income bracket.

SOURCE: Commerce Clearing House, State Tax Reporter as shown in Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism, 1973-74 Edition, (Washington, D. C.: U. S. Government Printing Office, 1974), pp. 276-280.

granted a \$10 tax credit against sales taxes paid for each personal exemption, and New Mexico granted a sliding scale credit against all state and local taxes based on modified gross income up to \$6,000 and the total number of personal exemptions. Finally the tax credit mechanism was used in Arizona, Arkansas, Colorado, Indiana, Kansas, Minnesota, and Missouri for senior citizen homestead relief. Similarly, California, Hawaii, and Minnesota granted a tax credit for homeowners as well as renters. For summary information on the tax credit plans used by the 16 states and the District of Columbia, see Table 3.24.

Since 1973, a number of states have either implemented new tax credits or extended or repealed existing ones. Michigan provided a tax credit for sales taxes paid on food and prescription drugs for taxable year 1974 only, Oklahoma now allows a credit for homestead taxes for senior citizens and disabled persons, and the District of Columbia provides an income tax credit for real property tax relief. In addition, Colorado increased and extended to disabled persons its credit for property tax relief and enacted a one time increase in the food sales tax credit from \$7 to \$21 applicable to 1973 income taxes. Nebraska increased its credit for sales taxes paid on food from \$10 to \$13, and Idaho permanently extended to \$15 a temporary increase in its sales tax credit. New Mexico extended its sliding scale credit for all state and local taxes paid to taxpayers with modified gross incomes less than \$7,000 and enacted a credit for sales taxes paid on medicine and medical and dental services. Hawaii repealed its tax credit for drug or medical expenses.^{1/}

A tax credit has several advantages over exemptions. It eliminates any administrative costs and difficulties of exempting food for home consumption from the sales tax. In addition, if there were a desire to provide benefits

^{1/} Commerce Clearing House, Inc., State Tax Review, January 15, 1975, Vol. 36, No. 2, pp. 5-12; Federation of Tax Administrators, Tax Administrators News, May, 1975, Vol. 39, No. 5, pp. 49-50.

to a specific group, such as residents of low income persons, a tax credit could be devised to benefit only those persons, but a food exemption would apply to all residents and nonresidents. Since any tax credit system would at least exclude nonresidents, the revenue losses caused by it could not exceed and would probably be less than those caused by a food exemption. Finally, food consumption differs by income level, family size, age, distribution, marital status, tastes, and other less obvious factors. As a result, outlays for food for home consumption are a crude measure for designing a specific pattern of tax distribution. A tax credit can be designed to provide a constant amount of relief regardless of income or can be made to vary by income class and perhaps other designated policy variables.^{1/}

One drawback of a credit is that administrative procedures would have to be adopted to avoid its abuse. Another drawback of a credit is that increases in the cost of living are not accounted for unless the law is periodically amended to raise the amount of the credit. A third potential problem is that the number of income tax returns filed in Virginia would increase by an estimated 200,000 to 300,000, since any resident citizen would qualify for the tax credit regardless of his income.^{2/}

The following analysis gives an estimate of the impact of an income tax credit for Virginia. If the credit is to compensate in full for consumer purchases of food for home use, then an estimate of the amount of this consumption is required. In tax year 1972, an estimated \$62.4 million in sales tax receipts would have been collected from purchases of food for home consumption

^{1/} For more on the subject of a tax credit versus the exemption of food for home consumption, see James A. Papke, "New Perspectives in Retail Sales Taxation," in Proceedings of the National Tax Association, Vol. 58 (1965) pp. 258-270.

^{2/} The tax credit would be computed against state income tax liability. Those residents qualifying for relief whose tax liability is less than the credit or who do not have to pay any tax would receive a cash payment from the state up to the dollar amount of the credit.

taxed at the state rate of 3 percent. The civilian resident population of the state in 1972 is estimated to have been 4,612,000.^{1/} If we divide the sales tax receipts for food for home consumption by the civilian resident population, the tax credit per person would be \$13.54, or a rounded figure of \$13.50. An estimated 4,451,000 people ^{2/} would have applied for the credit, costing the state \$60.1 million in revenue. If, on the other hand, the state were to grant a \$10 credit, the cost would have dropped to \$44.5 million.^{3/}

An income tax credit for the sales tax on food would mean a revenue loss slightly less than direct exemption of the sales tax on food. Nonresidents would not qualify for the credit, and not all residents would apply. If the credit were below the exact resident per capita food consumption amount - at \$10 for example - not all food consumption would be exempt. People consuming luxury

^{1/} U. S. Bureau of the Census, "Estimates of the Population of States: July 1, 1972 and 1973," Series P-25, No. 508 (Washington: U. S. Government Printing Office, November, 1973), p. 2.

^{2/} The 4,451,000 was derived by first taking the total of 1,636,741 returns and eliminating the estimated 47,000 nonresident returns. The 1,589,741 resident returns were then increased by 15 percent to 1,828,202 to reflect the additional returns from low income Virginia residents with no tax liability who would have qualified for the credit. The difference of 238,461 returns was multiplied by 2.0 (an estimate of the average number of personal and dependent exemptions per return for low income persons) and added to the number of returns with tax liability, 1,589,741, multiplied by 2.5 (the average number of personal and dependent exemptions per return for 1972). The 15 percent estimate was obtained as a high estimate of increased returns incurred by Colorado, Nebraska, and Indiana when they implemented the tax credit. See John F. Due, "The New State Sales Taxes, 1961-68," National Tax Journal, Vol. 21 No. 3, (Washington: September, 1968), p. 270.

^{3/} If the credit were to compensate for food and nonprescription drugs, it would be \$15 per person based on 1972 tax receipts.

$$\frac{\$62.4 \text{ million (food)} + \$4.5 \text{ million (nonprescription drugs)}}{4,612,000} = \$14.50$$

The revenue loss would have been \$64.5 million.

foods would therefore have only a portion of their food budget excluded from the tax.

Another possible option is to base the credit on income level.^{1/} For example, the \$13.50 credit might be restricted to returns with less than \$7,000 of AGI. In 1972 we estimate that this would have cost \$23.2 million - not quite two-fifths of the cost for a credit not restricted by income. If on the other hand, the credit were restricted to returns with less than \$10,000 of AGI, the cost to the state in 1972 would have been approximately \$32.1 million, or about half the cost for a credit not restricted by income.^{2/} An argument against basing the credit on income level is that such a procedure arbitrarily chooses who shall and who shall not receive sales tax relief. For instance, a family or person whose AGI rose from \$6,999 to \$7,000 under the first proposal or from \$9,999 to \$10,000 under the second would not receive the \$13.50 credit.

^{1/} In 1973 the credit was tied to income in Arizona, Arkansas, California, Colorado, Hawaii, Indiana, Kansas, Minnesota, Missouri, New Mexico, Vermont, Wisconsin, and Washington, D. C. For detailed information, see Table 3.24.

^{2/} Based on the following estimates of number of exemptions:

<u>Adjusted Gross Income</u>	<u>Number of Exemptions</u> ^{a/}
None	476,922
\$ 0 - \$ 999	143,487
\$1,000 - \$1,999	151,943
\$2,000 - \$2,999	153,038
\$3,000 - \$3,999	176,855
\$4,000 - \$4,999	200,074
\$5,000 - \$5,999	203,536
\$6,000 - \$6,999	210,674
\$7,000 - \$7,999	216,890
\$8,000 - \$8,999	219,625
\$9,000 - \$9,999	225,430

^{a/} Excludes exemptions reported on separate returns since it was assumed the combined AGI of both husband and wife would exceed \$7,000 and \$10,000, respectively. The number of exemptions has not been reduced to account for nonresident returns, since a breakdown of such returns by AGI class is not available; as a result, the cost of credit alternatives based on these data is slightly overstated.

An alternative that would temper the impact of such a change in income is a variable, vanishing, or sliding scale credit. The credit could be \$13.50 for persons with an AGI less than \$1,000 and could decline in \$2 increments for each \$1,000 rise in AGI until it reached \$1.50 for the \$6,000 - \$6,999 AGI class and disappeared for an AGI of \$7,000 or greater. In 1972, we estimate that the revenue cost of this option would have been \$15.0 million. An argument against a variable credit based on restricted AGI intervals is that inflation could erode the relative position of those who would benefit from the tax credit. A better proposal might be to broaden the AGI intervals by including higher income levels in order to offset the nominal growth in income caused by inflation. For instance, a \$13.50 credit could be given to those with AGI less than \$1,000, declining to \$11.50 for the \$1,000 to \$1,999 income class. The credit could then decline in \$2 increments for each \$2,000 rise in AGI until it reached \$3.50 for the \$8,000 to \$9,999 AGI class and disappeared for AGI of \$10,000 or more. For 1972 we estimate that the revenue cost of this option would have been \$20.2 million.^{1/}

Summary

Through either an income tax credit or exemption from the sales tax on food for home consumption, the state would lose substantial revenue.^{2/} The income tax credit would apply only to residents and could be designed to provide a lower loss of revenue. A credit geared below a certain level of income would be less costly than a general credit but would give tax relief only to low or middle income residents. In order to keep up with inflation, the tax credit,

^{1/} For more on this question and other equity implications of a tax credit, see James A. Papke and Timothy G. Shahen, "Optimal Consumption - Base Taxes: The Equity Effects of Tax Credits," National Tax Journal, Vol. 25, No. 3, (Washington: September, 1972), pp. 479-487.

^{2/} If the state also provided relief for the 1 percent local option sales tax, the revenue loss would increase by one-third.

any income constraint, and any bracketing under a vanishing credit would have to be reviewed regularly.

Individual Income Taxes and Inflation

Introduction

In an era of inflation a progressive individual income tax (whether federal or state) becomes a mechanism for raising the effective tax rate of all taxpayers without any type of legislative action. This occurs even if the real purchasing power of taxpayers' inflated incomes is constant, because with fixed rate brackets, fixed personal exemptions, and fixed standard deductions, inflation raises taxpayers' incomes into higher marginal rate brackets with the associated higher tax liabilities. The effect of inflation on tax liability is more clearly illustrated with an example. Assume a taxpayer with a base period AGI of \$5,000 and a second period where 50 percent inflation has occurred (i. e. incomes are 50 percent higher as are prices of everything purchased). The following table details the calculation of his tax liability in the base period and the 50 percent inflation period:

	<u>Base Period</u>	<u>50 Percent Inflation Period</u>
Adjusted Gross Income	\$5,000	\$7,500
Less: Personal Exemption	600	600
Less: Standard Deduction	<u>1,300</u>	<u>1,300</u>
Net Taxable Income	\$3,100	\$5,600
Current Dollar Tax Liability	63	150
Tax Liability Adjusted for Inflation	63	100
Net Real Purchasing Power Gain by Government	...	37
Effective Rate (percent)	1.26	2.0

The AGI in the inflation period is \$7,500 versus the \$5,000 in the base period, but the personal exemption and standard deduction remain fixed. NTI increases from \$3,100 to \$5,600 with the current dollar tax liability increasing from \$63

to \$150 and the effective rate rising from 1.26 to 2.0 percent. Deflating the \$150 to base period dollars yields \$100 in base period dollars or a gain of \$37 in base period dollars by government. The progressive structure and fixed dollar personal exemption and standard deduction coupled with inflation have lowered the taxpayers real after tax income by \$37 and raised government's share of the total purchasing power. This purchasing power transfer necessarily tends to expand the role of government in the economy without any type of active legislative debate.

Empirical Studies of Inflation and Taxation

Using national data Charles Goetz and Warren Weber found that between 1954 and 1970 inflation raised tax rates on real incomes for many taxpayers, but especially those with low incomes or larger families.^{1/} Real disposable incomes declined at all real AGI levels from 1954 to 1963 as inflation forced nominal incomes into higher marginal tax brackets. The Kennedy-Johnson tax cut increased real disposable incomes above their 1954 levels for all real AGI levels studied. The effects of inflation during the latter half of the 1960's caused the gains in real incomes from the Kennedy-Johnson tax cut to be almost completely eroded by 1970.

Using 1970 Internal Revenue Service data James Buchanan and James Dean found that a 10 percent general inflation would have raised federal personal income tax collections by 14 percent. Alternatively, a 10 percent rate of inflation raised real income tax collections by roughly 4 percent or shifted 4 percent of total purchasing power to government,^{2/}

^{1/} Charles J. Goetz and Warren Weber, "Intertemporal Changes in Real Federal Income Tax Rates, 1954-70," National Tax Journal, Vol. 24, No. 1, (Lancaster: March, 1971), pp. 51-63.

^{2/} James M. Buchanan and James M. Dean, "Inflation and Real Rates of Income Tax," presented at 1974 Annual Meeting of the National Tax Association held in St. Louis, p. 5.

Taking the income distribution of taxes as given, George M. Von Furstenberg found that at given levels of real income the elasticity of the average federal tax rate with respect to inflation was .60.^{1/} This implies that taxes are raised by 16 percent after one year of 10 percent inflation. He also found that inflation has lowered the progressivity of the tax structure. This occurred because itemized deductions, normally only claimed by the higher income taxpayers, have kept up with inflation while the standard deduction has changed only slowly.

No study of the effect of inflation on Virginia income taxes has been conducted. It is safe to assume that inflation has affected Virginia income tax collections significantly. The percentage of Virginia AGI in the \$0-\$3,000 bracket has declined from 65 percent of total AGI in 1960 to 38 percent in 1973, the latest year available. The percentage of AGI in the over \$5,000 bracket rose from 21 percent in 1960 to over 43 percent in 1973. Presumably, a substantial amount of this shift can be attributable to real economic growth in Virginia, although some part of it can be attributed to inflation. The result has almost certainly been a shift in real purchasing power from the private to the public sector in the state.

Suggested Solutions

Several countries have adopted ways of correcting for inflation that generally have taken the form of indexing. Exemptions and rate brackets are increased annually by a factor that satisfactorily measures the degree of inflation that occurred within that year. This method would not completely offset the effect of inflation since capital gains adjustments are generally imperfect under these types of systems, but this form of inflation adjustment may be preferable to none at all. Proposals to adopt this type of indexing at the federal level were introduced by Senator William Buckley in 1974, but to date no significant action has been taken on this proposal.

^{1/} George M. Von Furstenberg, "Individual Income Taxation and Inflation," National Tax Journal, Vol. 28, No. 1, (Washington: March, 1975), pp. 117-125.

Public Service Corporation Taxes

In Fiscal Prospects and Alternatives: 1974 there were two basic recommendations for further study of the taxation of public service corporations:^{1/}

1. Compare state and local taxes paid by public service corporations and other industries in Virginia.
2. Investigate thoroughly the issue of the taxation of trucks versus the taxation of other modes of transportation.

Acting on these recommendations, the Revenue Resources and Economic Commission has employed a consortium of economists from Virginia Commonwealth University headed by Dr. William F. Hellmuth, chairman of the economics department, to carry out the study and report by September, 1975. Dr. Larry G. Beall and Dr. George W. Jennings will concentrate on the relative taxation of public service corporations. Their work will include analyses of the tax burdens on various classes (e.g., electrical and telephone) and sizes of public service corporations and on public service corporations and other industries in Virginia and other states. Their central issue will at all times be the equity of the tax structure faced by the public utilities as compared to the structure faced by other businesses. Dr. Charles J. Gallagher and Dr. George E. Hoffer will perform the study on the various modes of transportation. Their efforts will encompass an intensive review of the relative taxation of railroads and trucks for Virginia and several other states, an analysis of the taxation of airlines, freight forwarders, inland waterway operators, and passenger motor carriers, a look at reciprocity agreement for truckers, and making alternative recommendations for change.

^{1/} Barry E. Lipman, Benjamin A. Vorhies, et. al., Fiscal Prospects and Alternatives, 1974: A Staff Report to the Revenue Resources and Economic Study Commission, (Richmond: June, 1974), pp. 93-94.

The Sales and Use Tax

Introduction

The state sales and use tax, which became effective September 1, 1966, covers the sale, rental, lease, and storage for either use or consumption of tangible personal property at the level of final consumption. Exempted from the base are public utility, professional and non-professional services, as well as sales of automobiles, gasoline, liquor, prescription medicine, and real property. The present state tax rate is 3 percent (increased from 2 percent on July 1, 1968). In addition, there is a 1 percent local option tax that all of Virginia's localities have adopted.

In fiscal year 1973-74 revenues from the sales and use tax, exclusive of the revenues from the local option, were \$337,175,387 or 27.1 percent of total general fund revenues. If the present trend continues the revenues from the sales and use tax will gradually decline in importance relative to the other components of the general fund through the remainder of the decade.

After a background discussion and comparison of the sales and use tax with those of other states and an analysis of the Virginia sales and use tax base, this section will focus on two major issues: (1) modification of the present base and (2) a modification in the rate of tax. Possible modifications of the base include the exemption of food and/or nonprescription drugs, which would lower revenues, and the extension of coverage to services, which would increase revenues. An increase in the rate may be either an increase in the state rate, which would increase state revenues, or an increase in the permitted local option rate, which would increase local revenues.

Comparison with Other States

A summary of sales and use taxes levied throughout the United States is presented in Table 3.25. As of January 1, 1975, 45 states and the District of Columbia levied a general state sales tax; in addition, 25 states have localities imposing their own sales tax either in addition to or in lieu of the state sales tax. The table indicates that the state tax rates range from 2 percent to 6 percent and that localities impose rates varying from 0.5 percent to 5 percent. Identifying the top local rate as 5 percent may be misleading because it is levied by only a few localities in Alaska. This high rate appears to be, at least in some measure, in lieu of a state sales tax. Table 3.26 presents a frequency distribution of combined state and local tax rates. Virginia is included in the 4 percent group, which also includes Maryland and North Carolina. Two other neighbors, Kentucky and the District of Columbia, levy rates of 5 percent while Tennessee imposes a rate of 5.25 percent. Among bordering states this leaves only West Virginia (3 percent) with a lower sales tax rate.

Two important points must be emphasized when considering combined state and local sales tax rates. First, the combined state and local rates reflect the maximum rate imposed by any locality in a state. Second, not all localities in a state may impose the tax, and, if they do, their rates may be lower than the maximum. At one extreme is Virginia with a uniform rate levied by all localities, and at the other is Louisiana's various local taxing jurisdictions imposing rates of 0, .5, .75, 1, 1.25, 1.5, 2, and 3 percent. Moreover, in some cases different taxing jurisdictions within a state apply the tax rate to a different set of goods and services.

TABLE 3.25--STATE AND LOCAL SALES TAXES, JANUARY 1, 1975 - SUMMARY TABLE
(Percentage Rate)

State	State Rate	Local Rate (Max.)	Food Exempt	Drug Exempt	Income Tax Credit	State	State Rate	Local Rate (Max.)	Food Exempt	Drug Exempt	Income Tax Credit
Alabama	4	3				Missouri	3	1			
Alaska		5				Nebraska	2.5	1		X	X
Arizona	4	2		X		Nevada	2	1.5		X	
Arkansas	3	1				New Jersey	5		X	X	
California	4.75	1.25	X	X	X	New Mexico	4	.5			
Colorado	3	4		X		New York	4	4	X	X	
Connecticut	6		X	X		North Carolina	3	1		X	
Dist. of Columbia	5		(2%)	X	X	North Dakota	4		X	X	
Florida	4		X	X		Ohio	4	.5	X	X	
Georgia	3					Oklahoma	2	2			
Hawaii	4				X	Pennsylvania	6		X	X	
Idaho	3			X	X	Rhode Island	5		X	X	
Illinois	4	1				South Carolina	4				
Indiana	4		X	X		South Dakota	4	1.5		X	
Iowa	3		X	X		Tennessee	3.5	1.75			
Kansas	3	.5				Texas	4	1	X	X	
Kentucky	5		X			Utah	4	.5			X
Louisiana	3	3	X	X		Vermont	3		X	X	X
Maine	5		X	X		Virginia	3	1		X	
Maryland	4		X	X		Washington	4.5	.5		X	
Massachusetts	3		X	X	X	West Virginia	3			X	
Michigan	4		X	X		Wisconsin	4		X	X	
Minnesota	4	1	X	X		Wyoming	3	1			
Mississippi	5										

SOURCES: Commerce Clearing House, Inc., All State Sales Tax Reporter, Volume 1. Commerce Clearing House, Inc., "State Tax Review," (January 15, 1974 and January 15, 1975 issues).

TABLE 3.26--FREQUENCY DISTRIBUTION OF COMBINED STATE AND LOCAL
GENERAL SALES TAX RATES, AS OF JANUARY 1, 1975

3%	3.5%	4%	4.5%	5%	6%	7% and Over
Georgia	Kansas	Arkansas	New Mexico	Alaska	Arizona	Alabama (7%)
Idaho	Nebraska	Florida	Ohio	District of Columbia	California	Colorado (7%)
Iowa	Nevada	Hawaii	Utah	Illinois	Connecticut	New York (8%)
Massachusetts		Indiana		Kentucky	Louisiana	
Vermont		Maryland		Maine	Pennsylvania	
West Virginia		Michigan		Minnesota		
		Missouri		Mississippi		
		North Carolina		New Jersey		
		North Dakota		Rhode Island		
		Oklahoma		South Dakota (5.5%)		
		South Carolina		Tennessee (5.25%)		
		Virginia		Texas		
		Wisconsin		Washington		
		Wyoming				
<u>6</u>	<u>3</u>	<u>14</u>	<u>3</u>	<u>13</u>	<u>5</u>	<u>3</u>

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Note: The combined state and local rates reflect the maximum rate used by any locality in the state. Not all localities impose taxes and should they do so, their rates may be lower than the maximum.

The U. S. median for the 46 states and D. C. which have the tax is 4.5 percent.

SOURCE: Table 3.25.

Also shown in Table 3.25 are the states exempting food products from the sales tax base or allowing an income tax credit to compensate consumers for sales taxes paid. As of January 1, 1975, 21 states and the District of Columbia exempted food or at least taxed it at a lower rate (an increase from 17 states and D. C. in 1973), and 7 states and the District of Columbia granted relief through a tax credit (an increase of one state since 1973). Thirty states and the District exempted prescription drugs from the sales tax (an increase of 4 states since 1973). We shall discuss the theoretical and empirical aspects of food and drug exemptions in a subsequent part of this section.

In an examination of any state tax, it is important to investigate how the taxing effort of one state compares with that of other states. Two measures generally used are tax receipts per capita and tax receipts per \$1,000 of personal income. Estimates of the state and local sales tax efforts of Virginia and bordering states in fiscal year 1972-73 are shown in the following table:^{1/}

<u>State</u>	<u>Receipts in Fiscal Year 1972-73</u>	
	<u>Per Capita</u>	<u>Per \$1,000 of Personal Income</u>
District of Columbia	\$130.29	\$20.74
Kentucky	94.76	26.60
Maryland	80.02	16.45
North Carolina	84.26	22.43
Tennessee	128.24	35.76
<u>Virginia</u>	80.75	18.97
West Virginia	136.90	38.36
U. S. Average (Incl. D. C.)	109.56	24.58

^{1/} SOURCE: U. S. Bureau of the Census, Governmental Finances in 1972-73, GF73, No. 5 (Washington: Government Printing Office, 1974), pp. 31-33.

These data indicate that Virginia's sales tax effort is low whether compared with the U. S. average or with that of bordering states. These measures, however, do not take account of income tax credits for sales taxes paid, which lessens the impact of the tax in the District of Columbia.

The Virginia Sales and Use Tax Base

There has been a great deal of discussion in Virginia concerning the sales and use tax base. Many suggestions have been made to extend the base or to exempt selected products from the sales tax in the interests of equity, efficiency, etc. A more thorough knowledge of the Virginia sales tax base might aid their discussion.

Table 3.27 presents the composition of the Virginia sales and use tax base in calendar year 1974 by the broad business classification groups used by the Department of Taxation. The classification groups closely resemble the federal government's Standard Industrial Classification (SIC) codes that are the basis of Virginia's collection data. The table clearly shows that the largest major source of sales tax revenue is the food group. This group encompasses almost one-third of the base and consists not only of food products for home consumption and other goods sold in grocery stores but also products sold in bakeries, taverns, and restaurants. The next major component of the base is the general merchandise group (20.6 percent). This group includes taxable products sold by department stores, dry goods stores, and drugstores. These two major categories alone account for over one-half of the sales tax base.

The next major component is the miscellaneous and unidentifiable group. This group accounts for 12.2 percent of the tax base and includes, among other things, book stores, florists, jewelers, and sporting goods

stores. The lumber, building material, and supply group comprises 11.6 percent of the tax base. The other remaining categories are substantially smaller and make up the rest of the 22.7 percent of the base.

TABLE 3.27--COMPOSITION OF THE VIRGINIA SALES AND USE
TAX BASE BY BUSINESS CLASSIFICATION CODE, 1974

<u>Group</u>	<u>Percent of Total</u>
Apparel	4.3%
Automotive	5.5
Food	32.9
Furniture etc.	5.7
General Merchandise	20.6
Lumber, Building Material	11.6
Fuel	2.3
Machinery, Equipment	2.6
Hotels, Motels	2.3
Miscellaneous and Unidentifiable	12.2
Total	100.0

SOURCE: Virginia Department of Taxation, Taxable Sales, 1974, (Richmond, 1975).

Although this analysis has shown the components of the sales and use tax base, it has not illustrated how comprehensive or how broad based the tax is. For this we must utilize a different approach.

The sales and use tax bases of different states have many similarities but at the same time many significant differences. The treatment of food products for home consumption, services, drugs, clothing, manufacturing machinery, rentals, printing, automobiles, alcoholic beverages, and lodgings varies among the states. As a result, we can only begin to compare the comprehensiveness of the base by simply listing what is included and what is excluded. In addition, the base

cannot be measured by simply examining total sales tax collections because different states have different tax rates and different levels of economic activity.

A better measure of the comprehensiveness of the base would involve an attempt to measure what percentage of consumption is covered by the sales and use tax. To measure the sales tax base we must take actual sales tax collections and adjust this figure by the state's sales tax rate to derive taxable sales. A measure of overall consumption is more difficult to obtain; however, one good proxy for consumption is disposable personal income, or income left after the exclusion of taxes unrelated to expenditures. This proxy gives the income that consumers can spend at their discretion. The ratio of taxable sales/ disposable personal income gives the percentage of all consumption goods taxed. The higher this ratio, the greater is the coverage of the sales tax base.

Table 3.28 presents this information for Virginia and for the surrounding states. It shows that in 1973 Virginia's taxable sales encompassed 49 percent of Virginia's total disposable personal income. In effect, this meant that almost one-half of all final sales of goods and services in Virginia were subject to the general sales tax. We must note that the taxable sales exclude the bases of other selective sales or gross receipts taxes. In Virginia this means the basis of taxes on motor fuels, automobiles, alcoholic beverages, and public utilities. The table reveals that the coverage of the sales tax in Virginia is relatively limited when compared to the surrounding states. This situation exists because Virginia excludes more items from the sales tax than do neighboring states, even though the excluded items may be taxed in another form. For example, the District of Columbia

taxes a broad range of services as well as alcoholic beverages. In Tennessee, the tax applies to motor vehicles, all drugs including prescriptions, a broad range of services, and utilities. For the selected states, the average coverage was 56.9 percent, and the two most comprehensive were Tennessee at 77.4 percent and the District of Columbia at 67.9 percent.

TABLE 3.28--COVERAGE OF THE SALES AND USE TAX
IN VIRGINIA AND NEIGHBORING STATES, 1973

<u>State</u>	<u>Taxable Sales</u> <u>Disposable Personal Income</u>
District of Columbia	67.9%
Kentucky	54.4
Maryland	43.8
North Carolina	63.0
Tennessee	77.4
<u>Virginia</u>	49.0
West Virginia	51.4
Total	56.9%

SOURCE: U. S. Bureau of the Census, State Tax Collections in 1974, GF74, No. 1 (Washington: Government Printing Office, 1974). Income data from U. S. Department of Commerce, Division of Economic Analysis, Regional Income Section.

This table indicates that Virginia's sales and use tax base is not as comprehensive as most of our surrounding states. Many students of the sales tax argue that an all inclusive tax base leads to a more equitable tax, for then the tax base faced by consumers at all income levels would be the same. The concept of having a broad sales tax base is similar to the rationale for taxing all income under an income tax. In terms of equity, there are few reasons why certain products or services should escape taxation. The main criticism directed against

the sales tax has been that it imposes a relatively larger burden on lower income people because the tax base generally consists of necessities, such as food and clothing, while many other items, such as services and automobiles, generally purchased by more affluent citizens, are excluded.

Modification of the Sales and Use Tax Base

Exemption of Food and Nonprescription Drugs

A large and growing number of states exempt food and/or drugs from the sales tax base or grant an income tax credit for the sales tax paid on these items. These modifications in the sales and use tax base are an attempt to reduce the possible regressivity of the sales tax.

The term regressive refers to a tax whose effective rate measured against income decreases as income increases. It has generally been observed that lower income persons spend a greater proportion of their income on consumer items, particularly on food and the other goods subject to the typical broad based sales tax, than those with higher incomes. Because they spend a greater proportion of their income on items included in the tax base, they pay a greater proportion of their income in sales taxes. This situation arises even though the tax rate is the same regardless of income. Thus, if the sales tax were passed on to the consumer, the tax would be regressive.

Many economists argue that the sales tax is passed along to consumers and is regressive. On the other hand, another group argues that the tax is shifted backward onto the owners of the factors of production; if it were, the tax would not be regressive. This controversy has not yet been resolved, although the case for forward shifting and regressivity

does have more proponents. One reason for this controversy is that the typical general sales tax encompasses hundreds of products. It is difficult enough to calculate the degree of shifting for a particular product let alone to make such a determination for all products.

Even if we assume that the sales tax is regressive, there is no basis for claiming such taxes are undesirable unless a specific value judgment is made to the effect that we wish lower income people to pay a lower percentage of their income than higher income people in sales taxes. One reason why the possible regressiveness of the tax is not viewed with serious alarm is that it is one of many state, local and federal taxes. Since some of these taxes are presumably progressive, they can offset the possible regressivity of the sales tax. As a noted expert on sales taxation points out, the regressiveness "...of the tax is not so much an argument against use of the sales tax, but against excessive reliance upon it as an element in the overall tax structure."^{1/} Another is that any tax represents only half of a fiscal operation. Investigating who receives the benefits when the tax revenues are spent would be necessary before criticizing a tax as regressive.^{2/}

A large number of states have attempted to lessen any possible regressivity in the sales tax by exempting food products for home consumption from the sales tax base. As of January 1, 1975, 21 states and the District of Columbia granted this exemption. If we assume forward shifting, exempting food from the tax base would decrease the

^{1/} John F. Due, Sales Taxation, (Urbana, Illinois: University of Illinois Press, 1957), p. 37.

^{2/} James M. Buchanan, The Public Finances (Homewood: Richard D. Irwin, Inc., 1965), pp. 466-67.

tax on all consumers but it would especially alleviate the burden of those at the lower income levels because they spend a greater proportion of their income on food.

Of course, the cost of such an exemption would be the associated loss of revenue. We estimate that in fiscal year 1973-74 an exemption of food for home consumption would have reduced both state and local option sales tax revenues by almost 24 percent. To the state this would have meant a decline in revenues of \$80.6 million, and for the localities the decrease would have been \$27.0 million. As we showed in the previous section, food products are the largest component of the sales and use tax base. The large revenue loss reflects this significance.

Another issue that the opponents of food exemption emphasize is the problems of enforcement and administration that would arise from this exemption policy. It is true that this exemption would increase the workload of both the Department of Taxation and the vendor and could cause some enforcement problems because of the many products that could be classified either food or non-food products. In an effort to examine the validity and seriousness of these problems, we have surveyed the experience of the District of Columbia, Indiana, Kentucky, Louisiana, North Dakota, and Vermont, all of which recently exempted food from the sales tax base. The general consensus of the 6 states is that the sales tax with an exemption of food is an administratively feasible tax. Most of the six indicated that the transition from the broad based sales tax to a tax with this exemption proceeded smoothly. In most cases, states felt that their taxation departments would experience problems of major proportions in implementing and administering

the exemption, but in fact, the resulting problems were minor.^{1/} One final comment concerns the growing number of states exempting food products. If the problems of exemption were as large as some believe, there would almost certainly be a number of states discontinuing their exemption of food products. This has not been the case.

These same problems also apply to the exemption of nonprescription drugs. The exemption of medicine may be desirable in terms of social policy; however, to extend the exemption beyond prescription drugs raises difficulties because of the lack of differentiation between medicine and related nonprescriptions products. This problem is magnified because many nonprescription drugs are handled not only by drugstores but also by supermarkets, variety stores, and others resulting in the involvement of a number of retailers in a relatively small exemption. The exemption of nonprescription drugs would cause a 1.6 percent decline in state and local sales tax revenues. In fiscal year 1973-74, we estimate the exemption of nonprescription drugs would have caused a \$5.4 million decline in state revenues and a \$1.8 million decline in local revenues.

An alternative method that could be used to accomplish the same purpose as the exemption (i.e., refunding the approximate amount of sales tax paid on food products for home consumption) is an individual income tax credit. A credit against individual income tax liability could be more efficient and flexible than an exemption. For example, a credit would alleviate the administrative problems while at the same time permit relief to vary over time and income level. Specifically,

^{1/} The staff of the Revenue Resources and Economic Commission has on file the responses of the six states and a brief memorandum outlining the results of this inquiry.

a credit could be designed so that it would benefit lower income consumers more than those at upper income levels. The credit philosophy of relief would in most cases result in a lower revenue loss than a food exemption. A more thorough discussion of the tax credit is presented in an earlier section on the individual income tax.

Extension of Coverage to Services

There are several logical arguments for expanding the sales and use tax base to include services. Perhaps the major argument is the underlying philosophy of the sales tax--to cover as broad a base of consumption as feasible. There is no inherent feature of most services that precludes their inclusion, and as we shall see later a large number of states tax at least some services.

Second, as personal income rises, expenditures on services tend to increase as a percentage of personal income and, therefore, at a rate faster than expenditures on commodities. Because this extension of the tax base would be borne to a greater extent by higher income groups, it would reduce any regressiveness in the tax while making the revenue from the tax more responsive to economic activity.

A final argument for taxing services is that a number of services are rendered in conjunction with the sale of tangible personal property which is presently taxed. The compliance and administration could be made much simpler if the entire charge were taxable than if a separation between the nontaxable service component and the taxable commodity component is necessary.

There are also several valid arguments against the extension of coverage to the service component of consumption. The most fundamental reason is simplicity. The taxation of services would require a detailed enumeration of the specific categories because of the large variety of

services and because of the desire to exclude certain services from the tax base (e.g., medical services, professional services, bank finance charges on financial service, etc.). Although there is no basic reason why any one of these items or others should be excluded from the tax base, there are some philosophical issues that usually preclude their taxation. Even when the remaining categories are enumerated, they may be difficult to interpret and cause some administrative problems. A potential gain in revenue, therefore, could be partially offset by increased administrative costs.

The second major reason is that the extension of the sales tax to services tends to discriminate against the in-state service firm, especially those near the border, and against the nonvertically integrated firm. The discrimination against the in-state firm occurs because use taxes can very rarely be charged on out-of-state purchases of services. An exception would be rental of equipment from an out-of-state firm for use in the state. Nonvertically integrated firms face discrimination since they often must purchase business services from other companies. For example, a small company using a taxable telephone answering service may be at a competition disadvantage as compared to one handling this service internally because employer-employee related services are not taxable.

A final reason for concern in extending coverage to services is that such a change may not relieve regressiveness in the tax as much as desired. Many personal services, such as haircuts, dry cleaning, and health services, must be used by low and moderate income groups as well as by the wealthy. Restaurant meals and hotel accommodations are already taxed, and such luxury services as cruises are beyond our taxing jurisdiction.

The strengths of these arguments have affected different states in different ways. Appendix Table A.3 shows the wide differences in the way states treat services. All of the 45 states and the District of Columbia with sales taxes make provision for taxing meals; however, their similarity of treatment in regard to taxing services ends at this point. Forty states (including Virginia) and the District of Columbia tax transient lodgings. As for public utility services, 29 states and the District tax telephone and telegraph services, 32 and the District tax gas and electricity, and 18 and the District tax water. Nine states tax intrastate transportation of persons and property.

Even more illustrative of the differences among the states are the listings in the final column of the other services and businesses subject to the sales tax. Although the list is brief, a comparison of Virginia's treatment relative to other states reinforces our previous discussion of Virginia's relatively modest sales tax base. For example, a total of 18 states tax the service component of repair charges. These states include New Jersey, New York, Pennsylvania, West Virginia, and Wisconsin. In addition to this extension to repair services, 14 states tax installation services. Thus, even though states have different tax bases and different philosophies toward the taxation of services, a large number of states tax some types of services. Another relatively common area included in the base is laundry, dry cleaning, and related services. At least 13 states and the District extend the sales tax to this type of service. The lease or rental of tangible personal property is also a commonly taxed service.

At the other extreme only one state, South Dakota, taxes professional services and it exempts persons engaged in the healing arts

or veterinarians. Virginia does not extend the state sales tax to professions although many localities do impose a license tax on the gross receipts of many professionals and other occupations.

In summary, the states are consistent in their coverage of retail sales of tangible personal property except for food and nonprescription drugs. Although many states tax a number of services, there exists a clear lack of uniformity as far as selected services are concerned with most states including different services in the tax base.

As an aid in examining the possibility of extending the sales and use tax base to some services, we provide Appendix Table A.4. The table presents a general examination of possible services that could be taxed, administrative and equity considerations, and potential revenue yield. The first column lists general categories of services with examples. The second column states whether or not the service category is subject to other sales or gross receipts taxes in Virginia. In the third column, possible tax administration problems are mentioned. In the fourth column, any questions about possible taxpayer inequities are raised, and in the fifth column rough estimates of the potential annual revenue from each category are provided. These estimates range from low (less than \$200,000) to good (\$200,000 to \$3 million) to very good (over \$4 million).^{1/} The revenue estimates reflect net increases. We have tried to deduct from the estimates sales taxes presently paid by services on goods (e.g., plastic bags for dry cleaning) used in

^{1/} Estimates based on per capita sales tax collections for fiscal year 1969-70 by Iowa for each category times the 1970 population of Virginia.

SOURCES: Iowa Department of Revenue, Retail Sales and Use Tax - Annual Report, Fiscal Year Ending June 30, 1970 (Des Moines: December, 1970); Iowa and Virginia 1970 populations: U. S. Department of Commerce, Bureau of the Census, 1970 Census of Population - Final Population Counts, PC(VI)-17 and PC(VI)-48.

production, since they would no longer be defined as the final level of production. For services establishments, such as auto repair shops, which already collect the sales tax on parts, we have counted only the additional revenue from taxing services.

An examination of the table shows that many services subject to the sales tax in other states are subject to a local gross receipts tax in Virginia. If the sales tax were extended to these services, the tax rates for some of them might become excessively high because of widely varying gross receipts taxes among and within localities. An argument can be made for extending the tax base to some selected services while eliminating the local gross receipts tax. Of course, some of the sales tax revenues would flow back to the localities to compensate them for their loss of license tax revenues. (See the discussion in Chapter VI on license taxation for a more thorough analysis of these issues.)

Although the taxation of some services could lead to problems in the areas of administration and enforcement, it is possible to select a large number of services that could expand the sales tax base and substantially increase state and local sales tax revenues while still not causing undue enforcement problems. One set of services that could be included in the sales tax base are listed in Table 3.29. This set includes those services most commonly taxed in other states-- repair services and selected personal services.

The repair services in this package include automobile repair, shoe repair, appliance repair, building maintenance and repair, and miscellaneous repair services (watch repair, electrical repair shops, reupholsters, locksmiths, etc.). Personal services include laundry and dry cleaning, auto parking, auto rental and leasing, beauty and

TABLE 3.29--ESTIMATED INCREASE IN SALES TAX BASE FROM
TAXING SELECTED SERVICES, FISCAL YEAR 1973-74

	1972 Sales (Census)	1973-74 Sales ^{a/}	Amount That Would Become Taxable	
			Ratio of Total Sales	Total, 1973-74
Auto Parking SIC 752	\$ 7,758,000	\$ 9,120,000	.87 ^{b/}	\$ 7,930,000
Auto Rental and Leasing SIC 751	55,289,000	64,970,000	.87 ^{b/}	56,520,000
Auto Repair Shops SIC 753	151,560,000	178,080,000	.62 ^{b/}	110,410,000
Auto Services Except Repair SIC 754	10,555,000	12,400,000	.87 ^{b/}	10,790,000
Beauty & Barber Shops SIC 723 & 724	85,990,000	101,040,000	.96 ^{b/}	97,000,000
Laundry, Dry Cleaning, and Services SIC 721	129,606,000	152,290,000	.96 ^{b/}	146,200,000
Motion Pictures SIC 78	159,198,000	187,060,000	.92 ^{b/}	172,100,000
Amusements, Recreation Services (Except Motion Pictures) SIC 79				
Miscellaneous Personal Services SIC 729	20,388,000	23,960,000	.80 ^{b/}	19,170,000
Miscellaneous Repair Services (Elec. Repair Shops, Watch Repair, Reupholsterers, Lock- smiths, Lawnmower Repair, Etc.) SIC 76	117,488,000	138,050,000	.73 ^{b/}	100,780,000
Services to Dwellings and Other Buildings SIC 734	43,945,000	51,640,000	.96 ^{b/}	49,570,000
Shoe Repair SIC 725	4,167,000	4,900,000	.80 ^{b/}	3,920,000
Department Stores SIC 531	1,090,044,000	1,280,800,000	.05 ^{c/}	64,040,000
Automotive Dealers SIC 55 ex 554	2,104,066,000	2,472,300,000	.07 ^{c/}	173,060,000
Gasoline Service Stations SIC 554	805,628,000	946,610,000	.07 ^{c/}	66,260,000
Apparel and Accessory Stores SIC 56	491,117,000	577,060,000	.05 ^{c/}	28,850,000
Household Appliance, Radio, Television, and Music Stores SIC 572, 573	155,031,000	182,160,000	.05 ^{c/}	9,110,000
Total	\$5,431,830,000	\$6,382,440,000	...	\$1,115,700,000

^{a/} Estimated by multiplying 1972 sales by 1.175, the ratio of fiscal 1973-74 Virginia personal income to 1972 Virginia personal income.

^{b/} Based on 1970 Internal Revenue Service national data for proprietorships and partnerships. Ratio derived by $\frac{BR - MP}{BR}$, where BR = business receipts and MP = merchandise purchased. In some cases IRS industry definitions differed slightly from the standard Industrial Classification (SIC) code.

^{c/} Sales of retail stores which also provide services. Ratio of services to total sales for automotive dealers and gasoline service stations was obtained by taking the median of figures from several automotive dealers on percentage of total sales accounted for by service. Assuming the remaining establishments would have a lower ratio of service sales to total sales, a 5 percent ratio was applied to them.

SOURCES: U. S. Bureau of the Census, 1972 Census of Selected Service Industries, Virginia, SC 72-A-47 and 1972 Census of Retail Trade, Virginia, RC72-A-47 (Washington, D. C.: Government Printing Office, 1974). Table 1 in both volumes; U. S. Treasury Department, Internal Revenue Service, Statistics of Income: 1970 Business Income Tax Returns (Washington, D. C.: Government Printing Office, 1973), Tables 2.2 and 3.2.

barber shops, amusements and movies, and miscellaneous personal services (health clubs, dress suit rental, clothing rental).

We estimate that the inclusion of these services would have added \$1.1 billion to Virginia's sales and use tax base in 1973-74, a 10 percent expansion of the base. The taxation of these services would have led to an additional \$32.5 million to the state and \$11.2 million to the localities for fiscal year 1973-74.

This proposed list of taxable services does not extend to personal services rendered by professional people. The taxation of such services would raise some administrative problems because the tax would be collected from a large number of individuals rather than businesses. In addition, the taxation of these services could lead to philosophical objections resulting from the additional taxation of medical, dental, hospital and related services, legal services, and the like.

The listings provided are broad categories and are not exhaustive. We have on file a more complete list of services that would be included under the categories. These services in general would not cause an unusual amount of administrative problems. Repair services would not cause significant problems because they are purchased in conjunction with the sale of tangible personal property presently taxed. Thus, the same dealer would collect and pay the tax. The same situation holds for dealers of personal services although not to the same extent. For example, at present the owner of a barber shop only has a very small portion of his sales subject to the sales tax (e.g., hair grooming products, shaving products, etc.). If the sales tax were extended to services, the owner would file a return based on a major proportion of his sales. Of course, there would be some services (e.g., auto parking) that would require a dealer to register and file a return when in the past it was not necessary.

Revenue Estimate

Change in Base

It is important to note that any change in the sales and use tax base will affect revenues at the local as well as at the state level. Therefore, this discussion will include the impact on local revenues and state revenues. The aggregate revenues at the local level will be affected in the same proportion as those at the state level; however, specific localities will be affected in different degrees.

The exemption of food products for home consumption from the tax base would have resulted in a 23.9 percent decline in the base and consequently in sales and use tax revenues. In 1973-74, the revenue loss for the state would have been \$80.6 million at the present 3 percent rate (see Table 3.30). At the local level this loss would have amounted to \$27.0 million. This estimate is based on the Department of Taxation's Taxable Sales publication during 1973-74 which reports quarterly sales of products subject to the sales and use tax by various classification codes.^{1/}

The exemption of both food and nonprescription drugs would have reduced the tax base by an additional 1.6 percent and would have lead to an additional decrease in state revenues of \$5.4 million for a total decline of \$86.0 million in 1973-74. The revenue decline at the local level would have been \$1.8 million for a total decline in 1973-74 of \$28.8 million.

^{1/} All sales of bakeries, confectioners, dairies, fruit and vegetable stands, grocery stores were counted as food sales. This is an oversimplification because a portion of their sales represent non-food items. On the other hand, a portion of the sales of drugstores, delicatessens, and other stores represent food sales that would be exempt.

TABLE 3.30--ESTIMATED SALES AND USE TAX REVENUES FROM ALTERNATIVE RATES AND BASES, FISCAL YEAR 1973-74 (millions of dollars)

	State		Local	
	Revenues	Change From Present	Revenues	Change From Present
Present Sales and Use Tax	\$337.2	...	\$113.0	...
<u>Present Rate</u>				
Present Base, Food Exempt	256.6	\$ -80.6	86.0	\$ -27.0
Present Base, Food and Non-prescription Drugs Exempt	251.2	-86.0	84.2	-28.8
Present Base, Plus Selected Services	369.7	+32.5	124.2	+11.2
Present Base, Plus Selected Services, Food and Nonprescription Drugs Exempt	283.7	-53.5	95.4	-17.6
<u>State Rate of 4 Percent</u>				
Present Base	449.6	+112.4	...	...
Present Base, Food Exempt	342.1	+4.9	...	...
Present Base, Food and Non-prescription Drugs Exempt	334.9	-2.3	...	...
Present Base, Plus Selected Services	492.9	+155.7	...	...
Present Base, Plus Selected Services, Food and Nonprescription Drugs Exempt	378.3	+41.1	...	...
<u>Local Rate of 2 Percent</u>				
Present Base	...	...	226.0	+113.0
Present Base, Food Exempt	...	...	172.0	+54.0
Present Base, Food and Non-prescription Drugs Exempt	...	...	168.4	+57.6
Present Base, Plus Selected Services	...	...	248.4	+135.4
Present Base, Plus Selected Services, Food and Nonprescription Drugs Exempt	...	...	190.8	+77.8

Note: The estimates for food and nonprescription drugs were based on actual taxable sales as reported by the Department of Taxation for fiscal year 1973-74. The estimates for selected services came from Table 3.29.

The second major modification of the base that we have discussed is an extension of the sales tax to certain services, notably repair services and selected personal services. Table 3.30 shows that in fiscal year 1973-74 this extension of the tax base would have led to an increase of \$32.5 million in state revenues. Of course, the extension of the base would also have increased local revenues by \$11.2 million. This revenue impact is based on the estimates of taxable services developed in Table 3.29.

The combination of all these modifications would have resulted in a \$53.5 million decline in state revenues in fiscal year 1973-74. At the local level the decline would have been \$17.6 million.

Change in Rate

The current sales and use tax structure provided revenues of \$337.2 million to the state in fiscal year 1973-74. An increase in the state tax rate of 1 percentage point would have led to increased revenues of \$112.4 million (see Table 3.30). An increase of 1 percentage point in the permitted local option would benefit localities directly and would have led to increased revenues of approximately \$113.0 million in 1973-74.

Finally, the table presents the impact of changing the tax rate and the tax base. Specifically, it examines the possibility of increasing the state rate to 4 percent or the local option rate to 2 percent

and/or exempting food and nonprescription drugs and taxing selected services.^{1/}

^{1/} This discrepancy in state and local revenues results from the state allowing the dealer a discount of 3 percent of state collections to pay for the administrative costs of collecting the tax but not compensating him for the collection of the local sales and use tax. At the same time, state collections are one month ahead of local option revenues received by the cities and counties. We should also note that any change in state sales tax revenues would affect the localities because one-third of this revenue is distributed to localities on the basis of school-age population.

Actually, the additional revenues at both the state or local level might be slightly less than the indicated amounts because the increase in the sales tax rate would increase prices which in turn might decrease sales. For a more complete discussion see Ann F. Friedlaender, Gerald J. Swanson and John F. Due, "Estimating Sales Tax Revenue Changes in Response to Changes in Personal Income and Sales Tax Rates," National Tax Journal, Vol. 26, No. 1 (Washington: March, 1973), pp. 103-110.

Inheritance and Gift Taxation

Present Structure and Revenues of the Virginia Inheritance Tax

The Virginia inheritance tax applies to the beneficiary shares of estates of residents and of nonresidents who come under its coverage. Estates consist of real and personal property. The tax levied depends on the share of the net estate (gross estate minus deductions and exemptions) received by the beneficiary and on the class of the beneficiary. There are three classes of beneficiaries.

Class A beneficiaries consist of the wife, husband, parents, grandparents, children, and all other lineally related persons. The first \$5,000 of the inheritance received by each beneficiary is exempt from taxation and amounts above that are taxable as follows:

Over \$5,000 to \$50,000	1 percent
Over \$50,000 to \$100,000	2 percent
Over \$100,000 to \$500,000	3 percent
Over \$500,000 to \$1,000,000	4 percent
Over \$1,000,000	5 percent

Class B beneficiaries are brothers, sisters, nephews, and nieces. They each receive a \$2,000 exemption before the inheritance is subject to tax. Class C beneficiaries are grandnephews, and grandnieces, firms, associations, corporations, other organizations, and those not elsewhere classified. In this class the first \$1,000 of the inheritance is exempt. The inheritances of class B and C beneficiaries are taxable as follows:

	<u>Class B</u>	<u>Class C</u>
Over \$1,000 to \$2,000	-	5 percent
Over \$2,000 to \$25,000	2 percent	5 percent
Over \$25,000 to \$50,000	4 percent	7 percent
Over \$50,000 to \$100,000	6 percent	9 percent
Over \$100,000 to \$500,000	8 percent	12 percent
Over \$500,000	10 percent	15 percent

Qualifying these rates is the state law allying the Virginia inheritance tax with the federal estate tax laws in order to take full advantage of the federal credit for state death taxes. Virginia statutes impose a tax equal to the federal estate tax credit if that credit is larger than the Virginia inheritance tax. In this manner the state can maximize its revenues, given the federal rate, because the Virginia tax assessment will never be less than the maximum federal credit for state death taxes. This process of imposing a floor on the tax liability is referred to as the "pick-up" statute.

In fiscal year 1973-74, the revenues from the inheritance tax were \$18.6 million, which represented 1.6 percent of total general fund revenues. We must note that the revenues from this source are subject to continual fluctuation because of the dependence on large inheritances for much of the revenue.

Comparison of Death Taxes in Virginia and Other States

Structure

Tables 3.31 through 3.33 provide information on how the Virginia inheritance tax compares with the death taxes in other states. The tables present the types of state death taxes, rates, and exemptions in effect as of July 1, 1973. We note in Table 3.31 that Virginia is among the large majority of states that have both an inheritance tax and a "pick-up" statute. The "pick-up" statute is widely used because with the present federal structure states can receive additional revenues while shifting the cost to the federal government.

Table 3.32 outlines the estate tax for each of the seventeen states using this alternative. Table 3.33 reveals that the exemptions that Virginia grants for a widow and children are lower than the exemptions

granted by the majority of other states. A large majority of the other states also have more progressive rate structures and higher rates than Virginia. In order to clarify the position of the Virginia inheritance tax in relation to more progressive schemes, we compare it to the North Carolina tax using a class A beneficiary. The North Carolina tax exempts the first \$10,000 of inheritance for each class A beneficiary; the rate structure is as follows:

First \$10,000 above exemption	1 percent
Over \$10,000 and to \$25,000	2 percent
Over \$25,000 and to \$50,000	3 percent
Over \$50,000 and to \$100,000	4 percent
Over \$100,000 and to \$200,000	5 percent
Over \$200,000 and to \$500,000	6 percent
Over \$500,000 and to \$1,000,000	7 percent
Over \$1,000,000 and to \$1,500,000	8 percent
Over \$1,500,000 and to \$2,000,000	9 percent
Over \$2,000,000 and to \$2,500,000	10 percent
Over \$2,500,000 and to \$3,000,000	11 percent
Over \$3,000,000	12 percent

Several differences between the Virginia and North Carolina inheritance taxes are obvious. First, in Virginia a tax is imposed on inheritances that North Carolina exempts from taxation. Second, the tax rates are more progressive over a larger number of inheritance levels in North Carolina than in Virginia. Table 3.34 presents the actual tax and the effective tax rates on equivalent inheritances in Virginia and in North Carolina. The actual and effective rates are higher in North Carolina than in Virginia for all but the three smallest taxable inheritances.^{1/} The "pick-up" statute comes into use in Virginia for class A inheritances at approximately \$770,000 (see Table 3.34). At inheritance levels above that amount the "pick-up"

^{1/} The greater progressiveness is also present in the rate structure for the North Carolina equivalent of Virginia classes B and C. However, there are no exemptions in these classes.

TABLE 3.31--TYPES OF STATE DEATH TAXES, JULY 1, 1973

Type of tax	State
"Pickup" tax only (6)	Alabama, Alaska, Arkansas, Florida, Georgia, New Mexico.
Estate tax only (2)	Mississippi, North Dakota.
Estate tax and "pickup" tax (7)	Arizona, New York, ¹ Ohio, Oklahoma, ¹ S. Carolina, ¹ Utah, Vermont ¹ .
Inheritance tax only (2)	South Dakota, West Virginia.
Inheritance tax and "pickup" tax (31)	California, ¹ Colorado, ¹ Connecticut, Delaware, ¹ District of Columbia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, ¹ Maine, Maryland, Massachusetts, Michigan, Minnesota, ¹ Missouri, Montana, Nebraska, New Hampshire, New Jersey, North Carolina, ¹ Pennsylvania, Tennessee, ¹ Texas, Virginia, ¹ Washington, ¹ Wisconsin, ¹ Wyoming.
Inheritance, estate and "pickup" taxes (2)	Oregon, ¹ Rhode Island ¹ .
No tax (1)	Nevada.

¹ Also has gift tax (16 States).

SOURCE: Commerce Clearing House, State Tax Reporter, as shown in Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism, 1973-74 (Washington: Government Printing Office, 1974), p. 296.

statute has the effect of raising the effective rates above those produced by the Virginia structure.

Receipts

The Bureau of the Census has compiled revenue data on the death and gift taxes of state governments.^{1/} Since death taxes account for the majority of such collections, the data give an idea of the relative effort of the states that levy death taxes. The 1972-73 per capita and per \$1,000 of personal income receipts from these taxes

^{1/} U. S. Bureau of the Census, State Government Finances in 1973, GF 73, No. 3 (Washington: Government Printing Office, 1974), pp. 21 and 50.

TABLE 3.32--STATE ESTATE TAX RATES AND EXEMPTIONS, JULY 1, 1973^{1/}

State	Rates	Maximum rate applies above	Exemption
Alabama.....	80 percent of 1926 Federal rates	\$10,000,000	\$100,000
Alaska.....	80 percent of 1926 Federal rates	10,000,000	100,000
Arizona ²	4/5 of 1-16 percent	10,000,000	100,000
Arkansas.....	80 percent of 1926 Federal rates	10,000,000	100,000
Florida.....	80 percent of 1926 Federal rates	10,000,000	100,000
Georgia.....	80 percent of 1926 Federal rates	10,000,000	100,000
Mississippi.....	1-16 percent	10,000,000	60,000
New Mexico.....	80 percent of 1926 Federal rates	10,000,000	100,000
New York ²	2-21 percent	10,100,000	³
North Dakota.....	2-23 percent	1,500,000	⁴
Ohio ²	2-7 percent	500,000	5,000 ⁵
Oklahoma ^{2,6}	1-10 percent	10,000,000	15,000
Oregon ²	2-10 percent	500,000	25,000
Rhode Island ²	1 percent	⁷	10,000
South Carolina ²	4-6 percent	100,000	60,000
Utah ²	5-10 percent	85,000	60,000 ⁸
Vermont ²	The tax rate is 30% of the Federal estate tax liability due to Vermont gross estate.		

^{1/} Excludes states shown in Table 3.33 which in addition to their inheritance taxes levy an estate tax to assure full absorption of the 80 percent federal credit.

^{2/} An additional estate tax is imposed to assure full absorption of the 80 percent federal credit.

^{3/} \$20,000 of transfers to spouse and \$5,000 to each lineal ascendant and descendant and to other specified relatives are exempt and deductible from first bracket.

^{4/} Exemption for spouse is \$20,000 or 50 percent of adjusted gross estate, for minor child, \$5,000, for lineal ancestor or descendants, \$2,000.

^{5/} An additional \$20,000 for spouse, \$7,000 for minor child, and \$3,000 for adult child.

^{6/} The maximum rate is increased from 10 percent to 15 percent and the exemption from \$15,000 to \$60,000 applicable July 1, 1974.

^{7/} Entire estate above exemption.

^{8/} Transfers, not to exceed \$40,000, if made to the husband, wife and/or children of the decedent, are exempt from tax.

SOURCE: Commerce Clearing House, State Tax Reporter, as shown in Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism, 1973-74, (Washington: Government Printing Office, 1974), p. 296.

TABLE 3.33--STATE INHERITANCE TAX RATES AND EXEMPTIONS, FOR SELECTED CATEGORIES OF HEIRS, JULY 1, 1973.

State ¹	Exemptions					Rates (percent)				In case of spouse	
	Widow	Minor child	Adult child	Brother or sister	Other than relative	Spouse or minor child	Adult child	Brother or sister	Other than relative	Size of first bracket	Level at which top rate applies
Alabama ²	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Alaska ²	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Arizona ²	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Arkansas ²	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
California ^{3,4}	\$ 5,000	\$12,000	\$ 5,000	\$ 2,000	\$ 300	3-14	3-14	6-20	10-24	\$ 25,000	\$ 400,000
Colorado	30,000	15,000	10,000	2,000	500 ⁵	2-8	2-8	3-10	10-19	50,000	500,000
Connecticut ^{3,6,7}	50,000	10,000 ⁹	10,000 ⁹	3,000	500	3-8 ⁹	2-8	4-10	8-14	150,000	1,000,000
Delaware ³	20,000	3,000	3,000	1,000	None	1-4 ⁹	1-6	5-10	10-16	50,000	200,000
District of Columbia ³	5,000	5,000	5,000	2,000	1,000	1-8	1-8	5-23	5-23	50,000	1,000,000
Florida ²	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Georgia ²	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Hawaii	20,000	5,000	5,000	500	500	2-6 ⁹	1.5-7.5	3.5-9	3.5-9	15,000	250,000
Idaho ⁴	10,000	10,000	4,000	1,000	None	2-15	2-15	4-20	8-30	25,000	500,000
Illinois	20,000	20,000	20,000	10,000	100	2-14 ¹⁰	2-14	2-14	10-30	20,000	500,000
Indiana ³	15,000	5,000	2,000	500	100	1-10	1-10	5-15	7-20	25,000	1,500,000
Iowa	40,000	15,000	15,000	None ¹¹	None ¹¹	1-8	1-8	5-10	10-15	5,000	150,000
Kansas	75,000	15,000	15,000	5,000	200 ⁵	0.5-2.5 ⁹	1-5	3-12.5	10-15	25,000	500,000
Kentucky	10,000	10,000	5,000	1,000	500	2-10	2-10	4-16	6-16	20,000	500,000
Louisiana ^{3,4}	5,000	5,000	5,000	1,000	500	2-3	2-3	5-7	5-10	25,000	25,000
Maine	15,000	10,000	10,000	500	500	2-6	2-6	8-12	12-18	50,000	250,000
Maryland ⁵	150	150	150	150	150	1	1	7½	7½	¹²	¹²
Massachusetts ^{5,13}	30,000 ¹⁴	15,000	15,000	5,000	5,000	1.8-11.8	1.8-11.8	5.5-19.3	8-19.3	10,000	1,000,000
Michigan ^{3,15}	30,000 ¹⁶	5,000	5,000	5,000	None	2-8	2-8	2-8	10-15	50,000	750,000
Minnesota ^{3,17}	30,000	15,000	6,000	1,500	500	1.5-10	2-10	6-25	8-30	25,000	1,000,000
Mississippi ²	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Missouri	20,000 ¹⁸	5,000 ¹⁹	5,000 ¹⁹	500	100 ⁵	1-6	1-6	3-18	5-30	20,000	400,000
Montana ³	20,000	5,000	2,000	500	None	2-8	2-8	4-16	8-32	25,000	100,000
Nebraska ³	10,000	10,000	10,000	10,000	500	1	1	1	6-18	¹²	¹²
Nevada	.....	.....	.....	.....	.....	No tax imposed	.....	.....	.....	.....	.....
New Hampshire	²⁰	²⁰	²⁰	None ²⁰	None ²⁰	²⁰	²⁰	15	15	²⁰	²⁰
New Jersey	5,000	5,000	5,000	500 ⁵	500 ⁵	1-16	1-16	11-16	15-16	10,000	3,200,000
New Mexico ²	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
New York ²	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
North Carolina ²¹	10,000 ²²	5,000 ²²	2,000	None	None	1-12	1-12	4-16	8-17	10,000	3,000,000
North Dakota ²	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Ohio ²	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Oklahoma ²	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Oregon ^{23,24}	None	None	None	1,000	500	2-10	2-10	2-15	4-20	25,000	500,000

See footnotes at the end of table.

TABLE 3.33--STATE INHERITANCE TAX RATES AND EXEMPTIONS, FOR SELECTED CATEGORIES OF HEIRS, JULY 1, 1973 (continued)

State ¹	Widow	Exemptions				Rates (percent)				In case of spouse	
		Minor child	Adult child	Brother or sister	Other than relative	Spouse or minor child	Adult child	Brother or sister	Other than relative	Size of first bracket	Level at which top rate applies
Pennsylvania	None ²⁵	None ²⁵	None ²⁵	None	None	6	6	15	15	¹²	¹²
Rhode Island ^{3,23}	\$10,000	\$10,000	\$10,000	\$ 5,000	\$ 1,000	2 - 9	2 - 9	3 - 10	8 - 15	\$ 25,000	\$1,000,000
South Carolina ² . . . . .	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
South Dakota ^{3*}	15,000	10,000	10,000	500	100	1½ - 4	1½ - 4	4 - 12	6 - 20	15,000	100,000
Tennessee ³	10,000 ²⁶	10,000 ²⁶	10,000 ²⁶	1,000 ²⁶	1,000 ²⁶	1.4 - 9.5	1.4 - 9.5	6.5 - 20	6.5 - 20	25,000	500,000
Texas ^{3,4}	25,000	25,000	25,000	10,000	500	1 - 6	1 - 6	3 - 10	5 - 20	50,000	1,000,000
Utah ² . . . . .	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Virginia ³	5,000	5,000	5,000	2,000	1,000	1 - 5	1 - 5	2 - 10	5 - 15	50,000	1,000,000
Washington ^{3,4}	5,000 ²⁷	5,000 ²⁷	5,000 ²⁷	1,000 ⁴	None	1 - 10	1 - 10	3 - 20	10 - 25	25,000	500,000
West Virginia ^{3*}	15,000	5,000	5,000	None	None	3 - 13	3 - 13	4 - 18	10 - 30	50,000	1,000,000
Wisconsin ^{3,28}	50,000	4,000	4,000	1,000	500	2½ - 12½	2½ - 12½	5 - 25	10 - 30	25,000	500,000
Wyoming	10,000	10,000	10,000	10,000	None	2	2	2	6	¹²	¹²

¹All States, except those designated by asterisk (*), impose also an estate tax to assure full absorption of the 80 percent Federal credit.
²Imposes only estate tax. See table 153.
³Exemptions are deductible from the first bracket.
⁴Community property passing to the surviving spouse is exempt, or only one-half is taxable.
⁵No exemption is allowed if beneficiary's share exceeds the amount shown in the exemption column, but no tax shall reduce the value of the amounts shown in the exemption column. In Maryland, it is the practice to allow a family allowance of \$450 to a widow if there are infant children, and \$225 if there are no infant children, although there is no provision for such deductions in the statute.
⁶The exemption shown is the total exemption for all beneficiaries falling into the particular class and is shared by them proportionately.
⁷An additional 30 percent surtax is imposed.
⁸Only one \$10,000 exemption is allowed for beneficiaries in Class A, which includes minor and adult children.
⁹Rate shown is for spouse only. A minor child is taxed at the rates applying to an adult child.
¹⁰With respect to taxable transfers passing to a husband or wife of a decedent dying on or after July 6, 1969, if taxable transfer exceeds \$5,000,000, the tax on the excess thereof is computed at 6%. Tax rates on the taxable amount up to and including \$5,000,000 are the same rates as provided for in excess of the exemption.
¹¹Estates of less than \$1,000 after deduction of debts are not taxable.
¹²Entire share (in excess of allowable exemption).
¹³Applicable to property or interests passing or accruing upon the death of persons who die on or after July 18, 1969, a 14% surtax is imposed in addition to the inheritance tax.
¹⁴In addition, an exemption to the extent of the value of single family residential property and to the extent of \$25,000 of the value, in the case of multiple family residential property, used by a husband and wife as a domicile, is allowed where the property was held by them as joint tenants or tenants by the entirety.
¹⁵There is no tax on the share of any beneficiary if the value of the share is less than \$100.
¹⁶Plus an additional \$5,000 for every minor child to whom no property is transferred.
¹⁷For a widow, an additional exemption is allowed equal to the difference between the maximum deduction for family maintenance (\$5,000) and the amount of family maintenance actually allowed by the Probate Court. The total possible exemption therefore would be \$35,000. If there is no surviving widow entitled to the exemption, the aggregate exemption is allowable to the children.
¹⁸In addition, an exemption is allowed for the clear market value of one-half of the decedent's estate, or one-third if decedent is survived by lineal descendants.
¹⁹Or the value of the homestead allowance, whichever is greater.
²⁰No tax imposed on spouses, lineal ascendants and descendants, and eff. 3/23/72 persons who for 10 consecutive years prior to their 15th birthday were members of the decedent's household.
²¹Gift taxes paid on gifts included in the gross estate of the decedent are credited against the estate tax.
²²A widow with a child or children under 21 and receiving all or substantially all of her husband's property, shall be allowed, at her option, an additional exemption of \$5,000 for each such child. The children shall not be allowed the regular \$5,000 exemption provided for such children.
²³Imposes also an estate tax. See table 00.
²⁴Oregon imposes a basic tax, measured by the entire estate in excess of a single exemption (\$15,000 prorated among all beneficiaries and deductible from the first bracket); and an additional tax, measured by the size of an individual's share for which each beneficiary has a specific exemption. All members of Class I (spouse, children, parents, grandparents, stepchildren or lineal descendants) are exempted from the additional tax.
²⁵The \$1,500 family exemption is specifically allowed as a deduction.
²⁶Widows and children are included in Class A, with one \$10,000 exemption for the entire class. Beneficiaries not in Class A are allowed one \$1,000 exemption for the entire class.
²⁷An additional \$5,000 exemption is allowed to the class as a whole.
²⁸These rates are subject to the limitation that the total tax may not exceed 20 percent of the clear market value of the property transferred to any distributee.

SOURCE: ACIR staff compilation based on Commerce Clearing House, State Tax Reporter, as shown in Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism, 1973-74, (Washington: Government Printing Office, 1974), pp. 279-298.

TABLE 3.34--A COMPARISON OF THE VIRGINIA AND NORTH CAROLINA INHERITANCE TAXES AT VARIOUS INHERITANCE LEVELS USING CLASS A SPOUSE

Inheritance Before Exemption (1)	Virginia			North Carolina		
	Taxable Inheritance (2)	Tax (3)	Effective Rate (%) (4)	Taxable Inheritance (5)	Tax (6)	Effective Rate (%) (7)
\$ 10,000	\$ 5,000	\$ 50	0.50	\$ 0	\$ 0	0
20,000	15,000	150	0.75	10,000	100	0.50
25,000	20,000	200	0.80	15,000	200	0.80
50,000	45,000	450	0.90	40,000	850	1.70
100,000	95,000	1,450	1.45	90,000	2,750	2.75
200,000	195,000	4,450	2.22	190,000	7,650	3.82
500,000	495,000	13,450	2.69	490,000	25,550	5.11
1,000,000	995,000	36,560 ^{a/}	3.66	990,000	60,450	6.04
1,500,000	1,495,000	68,240	4.55	1,490,000	100,350	6.69
2,000,000	1,995,000	103,920	5.20	1,990,000	145,250	7.26
2,500,000	2,495,000	143,600	5.74	2,490,000	195,150	7.81
3,000,000	2,995,000	187,280	6.24	2,990,000	250,050	8.33
4,000,000	3,995,000	286,640	7.17	3,990,000	369,950	9.25

^{a/} The "pick-up" tax becomes effective at this level. Tax is based on the federal schedule for credit for state death taxes. For North Carolina the "pick-up" tax does not become effective for these sizes of inheritances.

SOURCE: Tax Codes for the states of Virginia and North Carolina.

are shown below for Virginia and neighboring states:

<u>State</u>	<u>Death and Gift Tax Receipts in Fiscal Year 1972-73</u>	
	<u>Per Capita</u>	<u>Per \$1,000 of Personal Income</u>
U. S. Average (Excl. D.C.)	\$ 6.84	\$ 1.54
Kentucky	4.34	1.22
Maryland	2.90	.60
North Carolina	6.79	1.81
Tennessee	7.71	2.15
<u>Virginia</u>	3.47	.82
West Virginia	3.11	.87

These data indicate that Virginia's inheritance tax is relatively low when compared to either U. S. average and third lowest among the surrounding states on a per capita basis.

Economic Effects of the Inheritance Tax

There appears to be general agreement among economists that death taxes have fewer adverse effects on incentives than do income taxes.^{1/} Economists generally measure the effects of a tax by the distortions that it causes in the allocation of resources. Income taxes distort the allocation of resources because an income tax reduces the return from any given enterprise. When the rewards from a given effort are reduced, less of that activity will be undertaken. Whatever distortions death taxes may cause, they will be minimal because death taxes are paid only after a lifetime of work and accumulation and are likely to be given much less weight in decisions to work, save, and invest. Minimizing distortions is certainly not the only criteria for a tax system; however, it does deserve consideration.

^{1/} Richard A. Musgrave, The Theory of Public Finance, (New York: McGraw-Hill, Inc., 1959), p. 248.

The Virginia Gift Tax

The Virginia gift tax operates on a framework similar to that of the Virginia inheritance tax. The Virginia gift tax applies to the beneficiary shares of all property within the jurisdiction of the Commonwealth--real, personal, and mixed that is passed by gift in any one calendar year. The tax levied depends upon the actual value of the net taxable gift (total actual value of gift - exemptions) received by each beneficiary. As in the inheritance tax there are three classes of beneficiaries, each with different rates of tax and exemptions. The exemptions, classes, and tax rates are identical to those of the inheritance tax. The tax is paid by the donor at the end of the calendar year. If an individual grants a number of gifts over the period of a calendar year to the same individual the gift tax is applied to the total value of the gifts to the beneficiary; thus, the tax is based on a cumulative actual value for each beneficiary but only over the single calendar year. In fiscal year 1973-74, the revenues from the gift tax were \$1.1 million. This revenue source is subject to continual fluctuation. For example, gift tax revenues in fiscal year 1972-73 were \$1.6 million.

Any thorough discussion of death taxes should consider the interrelationship of the gift and inheritance taxes. To maintain the existing relationship between these taxes, any change in the inheritance tax would require a corresponding change in the gift tax. If the existing relationship of gift taxes vis-a-vis inheritance taxes were not maintained (e.g., only increasing the inheritance tax rates), taxpayers would be encouraged to distribute some part of their future estate before death because of the lower gift tax liability.

The Virginia gift tax is similar in concept to the federal gift tax. In both cases, the liability of the tax falls on the donor, and

the tax is based on the value of the property transferred as a gift minus exemptions. The similarity ends at this point because there are a number of federal provisions that greatly increase the amount of exemptions and because the federal gift tax does not distinguish between the classes of beneficiaries.

In computing the federal gift tax base in any one year, the first \$3,000 of gifts to each recipient is excluded; when a husband and wife each contribute half of the gift, the first \$6,000 is excluded. In addition to this annual exclusion, a \$30,000 total lifetime gift exclusion is granted to the donor that can be doubled for married couples. This lifetime exclusion may be used at any time at the discretion of the donor. The final exemption, one-half of the value of gifts made between a husband and wife, may be deducted from the amount subject to the gift tax. These adjustments to the total value of gifts yield net taxable gifts. After the taxable gift is determined for one year, the federal tax is cumulative in the sense that it applies each year to the aggregate sum of all taxable gifts made since enactment of the present tax.^{1/} This is at direct odds with the Virginia gift tax, which is not cumulative over time and which is levied separately on the value of the gift to each donee. These numerous adjustments help to lower the effects of the high nominal rates in the federal gift tax and the high tax imposed by the cumulative provisions.

An Analysis of 1973-74 Inheritance Tax Returns

To examine the inheritance tax structure and to see how the taxable base is actually composed, the Department of Taxation has undertaken a

^{1/} The tax liability in any one year consists of the differences between 1) the tax on the aggregate sum of all taxable gifts made since 1932 and 2) the amount of tax on the aggregate gifts made up to the beginning of the current taxable year.

comprehensive study of the inheritance tax returns from fiscal year 1973-74. Table 3.35 shows the number of beneficiaries, taxable amount, and total tax collections by class and by tax rate level. The percentage distribution of these items is presented in Table 3.36. Although these tables do not include the "pick-up" returns, they do provide information on the source of the bulk of inheritance tax collections. As shown in these tables, the distribution of the number of returns was skewed toward the lowest size classes. For example, the returns in the exempt and first taxable level of each of the three classes comprised 84.7 percent of the total returns. The tax collections, however, were skewed in the opposite direction. The returns at the lowest rate level for each class comprised only 13.0 percent of total revenue exclusive of the "pick-up". These data confirm the hypothesis that most of the returns are in the lower size classes and produce an extremely small amount of revenue largely because of the high number of small inheritances and the relatively low exemptions.

An examination of the "pick-up" returns reinforced the finding that a relatively small number of returns produced the largest portion of revenues. Our preliminary findings on "pick-up" returns indicate that less than 100 returns brought in over \$3.2 million in revenue. This dependence on larger inheritances points out the main reason for the revenue from the inheritance tax fluctuating from one year to another.

Alternative Inheritance Tax Exemption Levels and Rates

Before discussing possible changes in the existing law, we must emphasize that there has been a continuing discussion of possible changes in the federal estate and gift tax area for a number of years. To this date there has been no action nor has there been any indication that action might come in the immediate future. However, the potential for

TABLE 3.35--INHERITANCE TAXES EXCLUSIVE OF THE
"PICK-UP" FOR FISCAL YEAR 1973-74

<u>Class A Beneficiaries</u>			
<u>Number of Beneficiaries Taxable at Highest Rate Shown</u>		<u>Amount Taxable</u>	<u>Total Tax Collections</u>
Exempt	1,698	\$ 0	\$ 0
1%	11,577	140,268,077	1,402,625
2%	1,521	99,111,144	1,982,250
3%	1,044	181,894,651	5,456,833
4%	59	36,442,560	1,457,703
5%	14	26,660,318	1,333,016
	<u>15,913</u>	<u>\$484,376,750</u>	<u>\$11,632,427</u>
<u>Class B Beneficiaries</u>			
<u>Number of Beneficiaries Taxable at Highest Rate Shown</u>		<u>Amount Taxable</u>	<u>Total Tax Collections</u>
Exempt	908	\$ 0	\$ 0
2%	3,705	22,584,620	451,783
4%	474	15,605,721	624,212
6%	236	16,479,698	988,782
8%	109	19,608,650	1,568,692
10%	5	5,060,575	506,058
	<u>5,437</u>	<u>\$ 79,339,264</u>	<u>\$ 4,139,527</u>
<u>Class C Beneficiaries</u>			
<u>Number of Beneficiaries Taxable at Highest Rate Shown</u>		<u>Amount Taxable</u>	<u>Total Tax Collections</u>
Exempt	1,043	\$ 0	\$ 0
5%	3,096	16,497,461	824,963
7%	309	10,774,633	754,222
9%	127	8,561,881	770,569
12%	61	11,521,596	1,382,597
15%	7	6,968,461	1,045,268
	<u>4,643</u>	<u>\$ 54,324,032</u>	<u>\$ 4,777,619</u>
<u>Total</u>	<u>25,993</u>	<u>\$618,040,046</u>	<u>\$20,549,573</u>

Note: It must be noted that because of the technique used to gather the inheritance tax returns, the results include data for a period slightly larger than the 1973-74 fiscal year.

SOURCE: The data were compiled by the Department of Taxation.

TABLE 3.36--PERCENTAGE DISTRIBUTION OF INHERITANCE TAX DATA,
EXCLUSIVE OF THE "PICK-UP", FOR RETURNS, TAXABLE AMOUNTS, AND TAX COLLECTIONS,
FISCAL YEAR 1973-74

<u>Class A Beneficiaries</u>		
<u>Percentage of Beneficiaries Taxable at Highest Rates Shown</u>	<u>Percentage of Total Amount Taxable</u>	<u>Percentage of Total Tax Collections</u>
Exempt	6.5%	0%
1%	44.5	6.8
2%	5.9	9.6
3%	4.0	26.6
4%	0.2	7.1
5%	<u>0.1</u>	<u>6.5</u>
	61.2%	56.6%
<u>Class B Beneficiaries</u>		
<u>Percentage of Beneficiaries Taxable at Highest Rates Shown</u>	<u>Percentage of Total Amount Taxable</u>	<u>Percentage of Total Tax Collections</u>
Exempt	3.5%	0%
2%	14.3	2.2
4%	1.8	3.0
6%	0.9	4.8
8%	0.4	7.6
10%	<u>0.0</u>	<u>2.5</u>
	20.9%	20.1%
<u>Class C Beneficiaries</u>		
<u>Percentage of Beneficiaries Taxable at Highest Rates Shown</u>	<u>Percentage of Total Amount Taxable</u>	<u>Percentage of Total Tax Collections</u>
Exempt	4.0%	0%
5%	11.9	4.0
7%	1.2	3.7
9%	0.5	3.7
12%	0.2	6.7
15%	<u>0.0</u>	<u>5.1</u>
	17.9%	23.2%
<u>Total</u>	<u>100.0%</u>	<u>100.0%</u>

SOURCE: The data were compiled by the Department of Taxation.

change in the federal law does not mean that possible modifications in the Virginia inheritance and gift taxes cannot be examined.

The following analysis presents four alternative inheritance schedules that would increase the progressivity of the inheritance tax. Alternative 1 is presented in Table 3.37. The Revenue Resources and Economic Study Commission recommended this alternative to the 1974 session of the General Assembly. It became Senate Bill No. 60, which was carried over in the Senate. In the 1975 session the commission decided to defer its recommendation on this bill, and it was passed by indefinitely. This bill would have doubled the present exemption levels for each of the three classes of beneficiaries. Class A beneficiaries would have a \$10,000 exemption, class B, \$4,000, and class C, \$2,000. This doubling of present exemptions would remove the tax liability of many small estates that contribute little to total revenues. Moreover, the changes in the exemptions would place Virginia more in line with the exemption policies of the other states. To make the tax more progressive would also require a more graduated rate schedule using a larger number of brackets in each class than the present schedule. In the rate schedule for Alternative 1, the nominal rates for class A are greater for all beneficiary shares above \$10,000. For class B beneficiaries the tax rates do not change from current levels, except for the higher exemption, on all beneficiary shares up to \$500,000 but are higher above that amount. Class C beneficiaries are subject to the same tax rates as under present law, except for the higher exemption, on beneficiary shares up to \$100,000. On shares of \$100,000 to \$200,000 the rate actually declines; on beneficiary shares above that amount the tax rate increases.

The adoption of Alternative 1 would increase revenues from the inheritance tax by approximately 18 percent over revenues from the

TABLE 3.37--PROPOSED CHANGES IN THE INHERITANCE TAX
ALTERNATIVE 1

Class A	Rate (%)	Class B	Rate (%)
First \$10,000	Exempt	First \$4,000	Exempt
Over \$10,000 and to \$25,000	1	Over \$4,000 and to \$25,000	2
Over \$25,000 and to \$50,000	2	Over \$25,000 and to \$50,000	4
Over \$50,000 and to \$100,000	3	Over \$50,000 and to \$100,000	6
Over \$100,000 and to \$200,000	4	Over \$100,000 and to \$200,000	8
Over \$200,000 and to \$500,000	5	Over \$200,000 and to \$500,000	10
Over \$500,000 and to \$1,000,000	6	Over \$500,000 and to \$1,000,000	12
Over \$1,000,000 and to \$2,000,000	7	Over \$1,000,000 and to \$2,000,000	14
Over \$2,000,000	8	Over \$2,000,000	16
		Class C	Rate (%)
		First \$2,000	Exempt
		Over \$2,000 and to \$25,000	5
		Over \$25,000 and to \$50,000	7
		Over \$50,000 and to \$100,000	9
		Over \$100,000 and to \$200,000	11
		Over \$200,000 and to \$500,000	13
		Over \$500,000 and to \$1,000,000	15
		Over \$1,000,000 and to \$2,000,000	17
		Over \$2,000,000	19

current structure. On the basis of inheritance tax revenue in 1973-74, this would have meant an increase of approximately \$3.3 million in that fiscal year. Almost all of this increase would be borne by class A beneficiaries. The revenue from class C beneficiaries would actually decline slightly because of the slight decrease in their rates.

To maintain the existing relationship between the inheritance tax and the gift tax, the gift tax rates and exemptions would also have to be changed to those in Table 3.37. In 1973-74 gift tax revenues were \$1.1 million; therefore, the net effect of these changes would be to increase revenues by about \$200,000 annually.

The final provision of Senate Bill No. 60 was an increase in the minimum gross estate necessary to file a return from the present \$1,000 to \$4,000. We must note that in the case of a class C beneficiary with a proposed exemption allowance of \$2,000, there is a possibility that by requiring no returns on estates of less than \$4,000, the class C beneficiary may be in the position of owing tax but not being required to pay it because his share of an estate may be over \$2,000 but less than \$4,000. One way to alleviate this problem would have been to amend Senate Bill No. 60 to require a minimum gross estate of \$2,000 to file a return. The revenue loss of this proposal would be practically zero while still relieving the Department of Taxation of administrative burden.

Alternative 2 is quite similar to the first alternative (see Table 3.38). The treatment of class A beneficiaries is almost identical. Tax rates on class B beneficiaries are slightly higher than those set forth in Alternative 1 on all inheritances above \$25,000. This increase is generally an additional percentage point of tax. The greatest difference between Alternatives 1 and 2 is in class C. The rates are increased

TABLE 3.38--PROPOSED CHANGES IN THE INHERITANCE TAX
ALTERNATIVE 2

<u>Class A</u>	<u>Rate (%)</u>	<u>Class B</u>	<u>Rate (%)</u>
First \$10,000	Exempt	First \$4,000	Exempt
Over \$10,000 and to \$25,000	1	Over \$4,000 and to \$10,000	2
Over \$25,000 and to \$50,000	2	Over \$10,000 and to \$25,000	3
Over \$50,000 and to \$100,000	3	Over \$25,000 and to \$50,000	5
Over \$100,000 and to \$250,000	4	Over \$50,000 and to \$100,000	7
Over \$250,000 and to \$500,000	5	Over \$100,000 and to \$200,000	9
Over \$500,000 and to \$1,000,000	6	Over \$200,000 and to \$500,000	11
Over \$1,000,000 and to \$2,000,000	7	Over \$500,000 and to \$1,000,000	13
Over \$2,000,000	8	Over \$1,000,000 and to \$2,000,000	15
		Over \$2,000,000	17
		<u>Class C</u>	<u>Rate (%)</u>
		First \$2,000	Exempt
		Over \$2,000 and to \$5,000	5
		Over \$5,000 and to \$10,000	7
		Over \$10,000 and to \$25,000	9
		Over \$25,000 and to \$50,000	11
		Over \$50,000 and to \$100,000	13
		Over \$100,000 and to \$200,000	15
		Over \$200,000 and to \$500,000	17
		Over \$500,000 and to \$1,000,000	19
		Over \$1,000,000 and to \$2,000,000	21
		Over \$2,000,000	23

by approximately 4 percentage points at the \$25,000 to \$50,000 level, and this increase continues over the entire inheritance scale. The goal of this schedule is to double the exemptions for each class and to increase the tax proportionately for all classes and levels. In Alternative 1 the tax on class C beneficiaries did not increase in proportion to the other classes. Alternative 2 remedies this situation.

If Alternative 2 were adopted, the estimated rise in inheritance tax revenues would be approximately 27 percent. This would have meant an increase of approximately \$5.0 million in fiscal year 1973-74. On a percentage basis this increase would be borne equally by class A and class C beneficiaries and to a lesser extent by class B beneficiaries.

Alternative 3 attempts to simplify the tax to a degree by offering wider rate brackets than Alternative 1 (see Table 3.39). On the whole, it decreases the rates of tax for class A beneficiaries as compared to Alternative 1. It also decreases the rates of tax on class B beneficiaries relative to Alternative 1 although on a smaller scale. The rates of tax for class C increase. This option is in line with the actions of some states that are increasing the rates of tax on class C beneficiaries to a greater degree than on those beneficiaries who are lineal descendants.

Adoption of Alternative 3 would increase revenues from the inheritance tax by approximately 26 percent, or about \$4.8 million in fiscal year 1973-74. All three classes would share in the increase in equal proportions.

Finally, Alternative 4 is an attempt to moderate the increase in tax for class A's relative to the others (see Table 3.40). Class A receives an exemption of \$15,000 rather than \$10,000 as in the other alternatives. The class B exemption increases to \$5,000 from the

TABLE 3.39--PROPOSED CHANGES IN THE INHERITANCE TAX
ALTERNATIVE 3

Class A	Rate (%)	Class B	Rate (%)
First \$10,000	Exempt	First \$4,000	Exempt
Over \$10,000 and to \$50,000	2	Over \$4,000 and to \$25,000	4
Over \$50,000 and to \$100,000	3	Over \$25,000 and to \$50,000	6
Over \$100,000 and to \$500,000	4	Over \$50,000 and to \$100,000	8
Over \$500,000 and to \$1,000,000	6	Over \$100,000 and to \$500,000	10
Over \$1,000,000	7	Over \$500,000 and to \$1,000,000	12
		Over \$1,000,000	14
		Class C	Rate (%)
		First \$2,000	Exempt
		Over \$2,000 and to \$25,000	7
		Over \$25,000 and to \$50,000	10
		Over \$50,000 and to \$100,000	13
		Over \$100,000 and to \$500,000	15
		Over \$500,000 and to \$1,000,000	17
		Over \$1,000,000	19

TABLE 3.40--PROPOSED CHANGES IN THE INHERITANCE TAX
ALTERNATIVE 4

<u>Class A</u>	<u>Rate (%)</u>	<u>Class B</u>	<u>Rate (%)</u>
First \$15,000	Exempt	First \$5,000	Exempt
Over \$15,000 and to \$50,000	2	Over \$5,000 and to \$25,000	3
Over \$50,000 and to \$100,000	3	Over \$25,000 and to \$100,000	6
Over \$100,000 and to \$500,000	4	Over \$100,000 and to \$500,000	9
Over \$500,000 and to \$1,000,000	5	Over \$500,000 and to \$1,000,000	11
Over \$1,000,000 and to \$2,000,000	6	Over \$1,000,000 and to \$2,000,000	13
Over \$2,000,000	7	Over \$2,000,000	15
		<u>Class C</u>	<u>Rate (%)</u>
		First \$2,000	Exempt
		Over \$2,000 and to \$25,000	6
		Over \$25,000 and to \$100,000	9
		Over \$100,000 and to \$500,000	12
		Over \$500,000 and to \$1,000,000	15
		Over \$1,000,000 and to \$2,000,000	18
		Over \$2,000,000	21

\$4,000 granted by the other alternatives while the class C exemption remains unchanged from the other alternatives at \$2,000. Relative to Alternative 1, the tax rates decrease slightly for class A, remain almost the same for class B, and increase slightly for class C.

If adopted, Alternative 4 would increase inheritance tax revenues by approximately 12 percent. The increase in revenues would have been approximately \$2.2 million in fiscal year 1973-74. The largest part of the increase would come from class A beneficiaries even though they receive a \$15,000 exemption.

We must again indicate that to maintain the existing relationship between the inheritance tax and the gift tax, the gift tax rates and exemptions would also have to be changed. A modification of the gift tax rates and exemptions to those in Alternative 2 and 3 would yield approximately \$250,000 annually while a change to Alternative 4 would yield approximately \$100,000 annually.

Inclusion of Life Insurance in the Base

At present, by administrative ruling, the proceeds from life insurance are taxable only if they go to the estate. If they go directly to a designated beneficiary, they are exempt.

There are factors that support a change in this area. To exclude a part of life insurance from taxation could be considered arbitrary. Other death taxes do not have this exclusion; for example, the base of the federal estate tax includes the proceeds from all life insurance. It should be pointed out, however, that there are substantial differences in the Virginia inheritance tax structure and the federal estate tax structure. Although federal law includes life insurance proceeds, it does permit many deductions and exemptions that Virginia law does not allow. The other factor that supports a change in this area is that

the state is losing a large amount of revenue by not including all life insurance proceeds in the tax base. If life insurance had been included in the tax base for the year 1970, the base would have increased by an estimated \$35.6 million.^{1/} Given the assumption that it was subject to the overall effective rate of 3.3 percent for the inheritance tax in 1973-74, the additional revenue would have been approximately \$1.1 million annually.

On the other hand, there is reason not to support a change in this area. Virginia's inheritance tax is based on the concept of taxable estate. If the decedent had life insurance that was not payable to his estate, then the life insurance proceeds would not necessarily constitute part of the decedent's estate.

Consideration of an Estate Tax

Although this section has looked at alternatives, the preceding discussion and examination has been in the framework of an inheritance tax. The present inheritance tax could be replaced with an estate tax, which would tax the net value of a decedent's estate as a whole rather than taxing the individual inheritances. Although the estate concept of taxation is a substantial departure from the present treatment, there are a number of appealing features associated with this type of taxation. Here we shall examine the concept of an estate tax, discuss some of the advantages and disadvantages of this type of taxation, and finally present an alternative estate tax for Virginia using data from fiscal year 1973-74.

^{1/} This estimate is based on federal estate tax returns filed during 1970. See Internal Revenue Service, Statistics of Income, 1969, Estate Tax Returns, (Washington: Government Printing Office, 1972), p. 11. The Virginia figure was estimated by taking the ratio of Virginia life insurance in force to U. S. life insurance in force in 1969.

The base of the federal estate tax consists of the gross estate transferred after adjustments are made for certain exemptions and deductions. The gross estate includes the total amount of property that, according to estate tax law, is deemed to have been transferred at death. In an attempt to tax only the net estate a number of exemptions, including charitable bequests, administrative expenses, funeral expenses, and unpaid mortgages or other debt claims upon the estate properties, are allowed. The taxable base is further decreased by a marital deduction of not more than half the adjusted gross estate if left to the spouse and by an additional specific exemption of \$60,000, which is enough to eliminate most estates from the estate tax liability.

The primary advantage of the estate tax is in the administrative area because it is more efficient to administer for both a tax department and a decedent's estate. Estate taxation involves taxation of the entire net estate of the decedent rather than each individual recipient's inheritance. The change would eliminate the need for multiple rates and exemptions based on the relationship to the decedent. Thus, a tax department could significantly reduce paperwork and a taxpayer could lessen his necessary legal and filing expenses.

Another related advantage would result from conforming a Virginia estate tax to the existing federal estate tax. This conformity would parallel our reliance on the federal individual income tax structure. Although the federal estate tax structure has several weaknesses and although there is perennial discussion of substantial changes in the federal tax, conformity to the federal law would certainly bring many administrative advantages and efficiencies to the taxpayer and the taxing agency.

On the other hand, there are disadvantages associated with an estate tax. The taxation of estates rather than individual inheritances

would not provide preferential treatment to close family beneficiaries. Under the inheritance tax inheritances can be transferred at lower rates to spouse and children than to more distant relatives and friends. The estate tax after deductions, exemptions, etc., would apply equally whether the estate were distributed to family or otherwise.

One disadvantage of conformity to the federal estate tax would be Virginia's acceptance of a number of controversial areas in the federal estate tax, some of which include generation-skipping through trusts, marital deductions and interspousal transfers, charitable bequests, and estates distributed through gifts between living persons. We should emphasize that a number of these problem areas already effect the Virginia inheritance tax structure through the state's reliance on the federal estate tax credit for state death taxes for larger estates, commonly referred to as the "pick-up" returns.

The other disadvantage of conformity would be the potential for a major change in the estate tax at the federal level. As mentioned above, though, discussion of federal reform has taken place for a number of years and appears likely to continue without resulting in any significant overhaul in the near future.

An Alternative Virginia Estate Tax

To develop an alternative estate tax, we must first gain an understanding of the estate tax base in Virginia. Because little data have been available in this area, we have conducted an analysis of all 1973-74 inheritance tax returns and have been able to obtain data on federal gross estate and federal net taxable estate in Virginia. As a result, our only constraint in developing an alternative is that the Virginia base would have to conform to the federal provisions.

TABLE 3.41--DISTRIBUTION OF FEDERAL NET TAXABLE
ESTATE IN VIRGINIA BY SELECTED LEVELS, FISCAL YEAR 1973-74

<u>Level</u>	<u>Number of Estates at Highest Level</u>	<u>Total Federal Net Taxable Estate In Virginia</u>
\$ 0 - \$ 10,000	1,794	\$102,886,349
10,000 - 20,000	2,367	78,342,580
20,000 - 30,000	1,453	59,266,505
30,000 - 40,000	952	47,607,483
40,000 - 50,000	757	39,247,541
50,000 - 100,000	1,781	124,918,624
100,000 - 150,000	708	68,198,783
150,000 - 200,000	382	43,094,687
200,000 - 250,000	160	29,835,312
250,000 - 500,000	339	75,866,303
500,000 - 1,000,000	134	48,727,237
1,000,000 - 1,500,000	20	20,381,197
1,500,000 - 2,000,000	14	11,165,845
Over 2,000,000	18	26,575,681
Total	10,879	\$776,114,127

SOURCE: The data were compiled by the Virginia Department of Taxation.

Table 3.41 presents for the state by selected levels of federal net taxable estate the number of estates and, the total amount of net taxable estate that could be subject to tax. As the table shows, there were 10,879 estates in Virginia with a total of \$776,114,127 of federal net taxable estate in fiscal year 1973-74. It is important to note that this is the amount remaining after accounting for the marital deductions, exemptions, and exclusions allowed at the federal level.^{1/}

Virginia could implement one of a number of rate schedules that would yield approximately the same revenues as those collected from

^{1/} The total amount of federal gross estate in Virginia in fiscal year 1973-74 was \$960,116,377. This infers that total exemptions and deductions amounted to almost 20 percent of total estates.

TABLE 3.42--HYPOTHETICAL ESTATE TAX RATE SCHEDULE
AND REVENUES, FISCAL YEAR 1973-74

<u>Level</u>	<u>Net Taxable Estate</u>	<u>Tax Rate</u>	<u>Tax Liability</u>
\$ 0 - \$ 20,000	\$181,228,929	Exempt	\$ 0
20,000 - 50,000	146,121,529	1%	1,461,215
50,000 - 100,000	124,918,624	2%	2,498,372
100,000 - 200,000	111,293,470	3%	3,338,804
200,000 - 300,000	52,644,627	4%	2,105,785
300,000 - 500,000	53,056,988	5%	2,652,849
500,000 - 1,000,000	48,727,237	6%	2,923,634
1,000,000 - 1,500,000	20,381,197	7%	1,426,684
1,500,000 - 2,000,000	11,165,845	8%	893,268
Over 2,000,000	<u>26,575,681</u>	9% ^{a/}	<u>2,700,000</u>
Total	\$776,114,127		\$20,000,611

SOURCE: The data were compiled by the Virginia Department of Taxation.

^{a/} The 9 percent rate would apply until the net taxable estate reached approximately \$4,750,000; only after that would the federal "pick-up" rate apply.

the present inheritance tax. Table 3.42 presents one alternative. It exempts the first \$20,000 of federal net taxable estate from any tax. Estates from \$20,000-\$50,000 are taxed at 1 percent with \$50,000-\$100,000 at 2 percent, \$100,000-\$200,000 at 3 percent, etc. until the top rate of 9 percent is reached on estates over \$2,000,000. This alternative assumes that Virginia would continue to take advantage of the "pick-up" provision in the federal law.

As Table 3.42 shows, revenues from this alternative tax rate schedule in fiscal year 1973-74 would have been approximately \$20 million, or slightly above the \$18.6 million collected from the inheritance tax. Of course, a change in the inheritance tax would require a corresponding

change in the gift tax structure and rates to ensure that estates would not be completely distributed at lower tax rates before death.

Lifetime Exemption Under the Gift Tax

The present gift tax law allows a donor to take an unlimited number of annual exemptions with the amount and number each year dependent on the class and number of beneficiaries. The amounts of the exemption are identical to those allowed for the inheritance tax.

The commission has previously studied the feasibility of adopting a \$30,000 lifetime limit on the amount of annual exemptions that a donor can claim before becoming liable for the gift tax. The primary advantage of such a lifetime maximum on annual exemptions is that it would limit tax free gifts and increase revenues by a small amount. In addition, the constraint would strengthen the inheritance tax by not allowing donors to dispose gradually of their estates before they became subject to the inheritance tax.

On the other hand, there are reasons not to change the present exemption treatment. The revenue loss caused by the present treatment is relatively small. The gift tax in recent years has produced only \$1 to \$1.5 million annually; moreover the adoption of a maximum lifetime exemption policy would increase the administrative duties of the Department of Taxation. The department would have to maintain additional records to keep track of the total exemptions that a donor had claimed in the past to determine if the donor could still claim any exemptions. Finally, if a fixed lifetime exemption were granted, the amount of relief given to a donor who distributed his gifts to a class C beneficiary would be substantially higher than for a donor who chose to distribute to a class A or class B beneficiary. The result of this provision would be radically different from the present inheritance tax law,

which taxes gifts to class A beneficiaries less than class B and similarly class B beneficiaries less than class C beneficiaries.

One alternative to mitigate the effects of this last problem would be to allow a different maximum exemption for each of the three different classes of beneficiaries. For example, the limit on lifetime exemptions could be set at a total of five annual exemptions regardless of class. Thus, if the present exemptions were doubled, the maximum lifetime exemption would be \$50,000 for class A, \$20,000 for class B, and \$10,000 for class C. For a married couple these amounts could double. If a donor decided to apply the exemptions to more than one class of beneficiary, the situation could be handled by allowing the annual exemption to be granted until the fraction of all classes of exemptions used totaled 1. For example, if a donor wanted to distribute gifts to all three classes of beneficiaries and used 50 percent of the annual exemptions for class A, 25 percent for class B, and 25 percent for class C, the respective amounts of the lifetime exemption would be \$25,000, \$5,000, and \$2,500.

Senate Bill No. 59, carried over to the 1975 session of the General Assembly in the Senate and passed by indefinitely, embodies the lifetime exemption concept but not the specific one studied by the commission. A proposed amendment in the nature of a substitute drafted by the Department of Taxation reflects that specific lifetime constraint.^{1/} The revenue yield of such a measure would be small, perhaps \$100,000 per year.

^{1/} This substitute was Exhibit B in Senate Document No. 13, the report of the Revenue Resources and Economic Commission to the 1975 session of the General Assembly.

Tobacco Products Tax

The Virginia cigarette tax is one of the lowest in the nation. Only the North Carolina tax, which is 2 cents per pack, is less than the Virginia tax of 2.5 cents. As Table 3.43 shows, other states levy cigarette taxes that are as much as 8 times greater, but generally they range between 3 to 5 times greater than the Virginia levy. In addition to the state tax, Virginia is one of 8 states where localities are permitted to impose cigarette taxes. In 1974, 21 localities levied such taxes and collected \$12.7 million in gross revenue.^{1/} The rates of the local taxes ranged from 2 cents to 10 cents per pack. State tobacco tax collections for fiscal year 1973-74 totalled \$17.0 million. However, legislation that provides an increased discount to tobacco wholesalers became effective for fiscal year 1974-75 and will cause state tobacco tax collections to decline to an anticipated \$16.7 million in the first year of the 1974-76 biennium before they begin to increase again in the second year.

If the current tax were doubled, a significant increase in state revenues would result with only a modest increase to the consumer, and Virginia's tax rate would still be at almost the bottom of the scale relative to most other states. With a tobacco tax of 5 cents per pack, Virginia's tax would still be less than the Maryland and District of Columbia taxes of 6 cents, the West Virginia tax of 12 cents, and the Tennessee tax of 13 cents. Of all Virginia's

^{1/} Information in a memo by the Tobacco Tax Council, Inc. to Virginia Municipal Tax and Finance Officers in Places Imposing Local Cigarette Taxes, January, 1975.

neighboring states only North Carolina with its 2 cent tax and Kentucky with its 3 cent tax could compete for cigarette sales with lower tobacco taxes.

TABLE 3.43--STATE CIGARETTE TAX RATES AS OF JANUARY, 1975

<u>State</u>	<u>Cents per Pack</u>	<u>State</u>	<u>Cents per Pack</u>
Alabama	12	Missouri	9
Alaska	8	Montana	12
Arizona	13	Nebraska	13
Arkansas	17.75	Nevada	10
California	10	New Hampshire	11
Colorado	10	New Jersey	19
Connecticut	21	New Mexico	12
Delaware	14	New York	15
Dist. of Col.	6	North Carolina	2
Florida	17	North Dakota	11
Georgia	12	Ohio	15
Hawaii	10	Oklahoma	13
Idaho	9.1	Oregon	9
Illinois	12	Pennsylvania	18
Indiana	6	Rhode Island	13
Iowa	13	South Carolina	6
Kansas	11	South Dakota	12
Kentucky	3	Tennessee	13
Louisiana	11	Texas	18.5
Maine	16	Utah	8
Maryland	6	Vermont	12
Massachusetts	16	Virginia	2.5
Michigan	11	Washington	16
Minnesota	18	West Virginia	12
Mississippi	11	Wisconsin	16
		Wyoming	8

SOURCE: Tobacco Tax Council, Inc., "Monthly State Cigaret Tax Report", January, 1975.

If the tax went to 5 cents, the price to the consumer would only increase about 7 percent.^{1/} Such a small increase in price would probably not induce consumers to purchase cigarettes outside the state. Furthermore, because the demand for tobacco products is inelastic,^{2/} which means that when price increases sales will not decline enough to reduce total expenditures, the state would not have to be concerned with adverse effects on the market. Various studies have determined the elasticity of tobacco products to be between -.1 and -1.4, but generally the studies estimated elasticity between -.5 and -.7.^{3/} Thus, a price increase of 7 percent would probably result in a drop in cigarette sales of between 3.5 and 5 percent. The table below

^{1/} Based on the weighted average price of cigarettes in Virginia as furnished by the Tobacco Tax Council. The estimated price increase is biased upward because the weighted average does not provide for local cigarette taxes.

^{2/} Price elasticity = $\frac{\text{Percent change in quantity demanded}}{\text{Percent change in price}}$
and is always negative, which denotes the inverse relationship between price and quantity demanded. In absolute terms, if elasticity is less than 1, demand is inelastic; if it is greater than 1, demand is elastic.

^{3/} See for example, John M. Vernon, Norfleet W. Rives, Jr. and Thomas H. Maylor, "An Econometric Model of the Tobacco Industry," Review of Economics and Statistics, Vol. 51, No. 2 (Cambridge: May, 1969), pp. 149-158. S. M. Sackrin, "Factors Affecting the Demand for Cigarettes," Agricultural Economics Research, Vol. 14, No. 3 (Washington, D. C.: August, 1962), pp. 81-88.

shows the estimated effects on state revenues if a 5 cent per pack cigarette tax had been levied during fiscal year 1973-74, assuming various changes in sales:

	<u>Revenue</u> <u>(\$Mil.)</u>	<u>Change from Current Tax</u> <u>Amount</u>	
		<u>(\$Mil.)</u>	<u>Percent</u>
Current 2.5 cent tax	\$17.0	\$ ...	...
5 cent tax with:			
no change in sales	34.0	+17.0	100
5 percent drop in sales	32.3	+15.3	90
10 percent drop in sales	30.6	+13.6	80
20 percent drop in sales	27.2	+10.2	60

Thus, with a 5 percent drop in sales, which coincides with a 7 percent increase in price and the generally estimated elasticity for tobacco products, the state could realize a 90 percent increase in tobacco tax revenues.

Taxes on Alcoholic Beverages

Liquor sold in Virginia A.B.C. stores is subject to a 14 percent alcoholic beverages state tax. Included in the retail price of liquor is a 36 percent markup, which is set by the A.B.C. Board to meet the cost of operating the state-owned liquor stores and to produce a profit. These profits are a part of general fund revenues; thus, we can assume that the profits of a public monopoly are in lieu of higher taxes. Unfortified wine is subject to a tax of 35 cents per gallon, and fortified wine is subject to a 70 cents per gallon tax. Additional taxes are imposed on liquor and wine bought for resale by the drink.^{1/} Finally, an excise tax of 2 cents per 12-ounce bottle and \$6 per barrel is levied on beer and other malt beverages.^{2/}

Except for the additional tax imposed on bottle sales for resale by the drink, revenues from alcoholic beverages are deposited into the general fund. However, two-thirds of the wine tax and two-thirds, but not less than \$14,805,677 of A.B.C. profits, are distributed to localities on the basis of population. Listed below are revenues collected during fiscal year 1973-74 from the sale of alcoholic beverages and allocated to the general fund:

Alcoholic beverages state tax	\$26,885,105
Wine and spirits tax	2,410,658
Beer and beverage excise tax	18,685,771
A. B. C. profits	<u>26,103,101</u>
Total	\$74,084,635

^{1/} See the Code of Virginia, Section 4-15.3.

^{2/} See the Code of Virginia, Section 4-40.

The tax on alcoholic beverages bought for resale by the drink, which is allocated to a special fund, amounted to \$757,251 in 1973-74.

As a measure of Virginia's tax effort compared to neighboring states and the U. S. as a whole, total revenue from alcoholic beverages, including net profits, can be shown per capita and per \$1,000 of personal income using data computed by the Southern Regional Education Board.^{1/} Shown below are these data for fiscal year 1972-73.

ALCOHOLIC BEVERAGE REVENUES, FISCAL YEAR 1972-73

<u>State</u>	<u>Per Capita</u>	<u>Per \$1,000 of Personal Income</u>
U. S. Average (incl. D. C.)	\$10.89	\$2.16
District of Columbia	17.42	2.75
Kentucky	4.26	1.06
Maryland	6.16	1.12
North Carolina	14.25	3.33
Tennessee	12.90	3.15
<u>Virginia</u>	14.28	2.92
West Virginia	19.91	5.02

These measures indicate that Virginia's alcoholic beverage revenues are high relative to the U. S. average but that compared to surrounding states they represent a median effort.

Of the \$74.1 million in alcoholic beverage revenues collected in fiscal year 1973-74, approximately 60 percent was derived from the excise tax on beer and malt beverages and from the tax on liquor sold in A. B. C. stores. If the state wished to look to the sale of alcoholic beverages for additional revenue, increases in these two

^{1/} Kenneth E. Quindry and Carol S. Meyers, State and Local Potential, 1973, SREB, (Atlanta: Southern Regional Education Board, 1974), pp. 42-46.

taxes would probably offer the best alternatives. Estimates of the price elasticity for beer and for alcoholic beverages range from $-.5$ to $-.9$, indicating that the demand for them is inelastic.^{1/} With this assumption, if the Virginia excise tax on beer were increased from \$6 to \$7.50 per barrel, beer and beverage revenues would have increased by approximately \$4.4 million in fiscal year 1973-74. Assuming the same price elasticity, an increase from 14 to 15 percent in the alcoholic beverage state tax would have increased revenues by approximately \$1.7 million for the same fiscal year and by about the same amount for each additional percentage point increase in the tax.

On the other hand, increases in alcoholic beverage taxes as a source for additional revenue should be weighed against Virginia's competitive position with the District of Columbia. Since liquor prices in the District are substantially lower because of competition between sellers and a lower tax rate, many nonresidents, including Virginians, purchase liquor there. The relatively high per capita revenue for the District shown in the table above can be attributed to the attractive price differential. Thus, an increase in Virginia's alcoholic beverages taxes would widen this differential and further erode the already poor competitive price position of Virginia vis-a-vis the District. Higher rates of taxation would produce greater revenues; but the prices of liquor in other political subdivisions would become even more attractive, and the loss of sales to these places would temper the gain in revenues.

^{1/} See for example, Thomas F. Hogarty and Kenneth G. Elzinga, "The Demand for Beer," The Review of Economics and Statistics, Vol. 43, No. 2, (May, 1972), pp. 195-198. Julian L. Simon, "The Price Elasticity of Liquor in the U. S. and a Sample Method of Determination," Econometrica, Vol. 34, No. 1, (January, 1966), pp. 193-205.

State License Taxation

The state imposes a wide variety of business, occupational, and professional license taxes. In 1973-74 they produced \$3.3 million, or about .3 percent of total general fund revenues. Most state license taxes are levied at low, flat amounts, and eight produce three-fourths of the revenue. In Chapter VI, we shall look at state license taxation in some detail after thoroughly analyzing local license taxation. Included in the discussion will be alternatives to the present state system.

Taxes on Soft Drinks and Litter-Related Products

Crown Tax on Soft Drinks

At the present time there are six states with special taxes on soft drinks--Louisiana, Missouri, North Carolina, South Carolina, Tennessee, and West Virginia. The amount of revenues collected in fiscal 1973-74 varied from a low of \$313,000 for Missouri to a high of \$20,201,000 for North Carolina. The revenues were dependent upon the rates imposed on bottled soft drinks, soft drink syrups and base products, and the treatment of intrastate and interstate business.

If Virginia taxed soft drinks at a similar amount per capita as any one of the six states,^{1/} the state could realize between approximately \$0.3 million (Missouri rate) and \$18 million (North Carolina rate) in revenue with a tax at the average amount per capita generating about \$9.7 million in revenue.

^{1/} U. S. Department of Commerce, State Tax Collections in 1974, (Washington, D. C.: U. S. Government Printing Office, 1974), pp. 13-38; and Commerce Clearing House, Inc., State Tax Handbook, (Chicago: October, 1973), p. 548. The figure for Missouri reflects fiscal 1972 collections.

There are four points to consider in discussing the tax as a possible source of additional revenue for the Commonwealth. First, it would produce a limited amount of revenue (assuming Virginia used rates similar to those of other states). In 1973-74, even \$18 million would have been only 1.5 percent of total general fund revenues. Second, an extra tax would be imposed on a particular type of food product already subject to the general sales tax. Another point is the possible regressivity of this form of taxation. If the tax is regressive, policy makers will have to decide if this type of tax best serves the interests of the Commonwealth. A final point deals with the notion that this tax should be applied to discourage the creation of litter. Undoubtedly a crown tax applied in the "correct" way would discourage littering, but the states now using it tax all soft drinks regardless of the container in which it is sold. Thus, its purpose is probably to raise revenue and not to save the environment. In addition, it may be unfair to charge soft drink consumers with the entire cost of attempting to clean our environment since litter is composed of many products other than soft drinks.

Litter Taxation

A tax that may approximate a more "correct" way to discourage littering in comparison with the existing soft drink taxes is the state of Washington litter tax. The litter tax, established in 1972 by the Washington Model Litter Control Act, is levied at a rate of .015 percent on the gross proceeds of sales made within the state at the manufacturing, wholesale, and retail levels for thirteen categories of litter-related products. These categories are defined by the Washington Department of Revenue as follows:

1. Food for human or pet consumption
2. Groceries
3. Cigarettes and tobacco products
4. Soft drinks and carbonated waters
5. Beer and other malt beverages
6. Wine
7. Newspapers and magazines
8. Household paper and paper products
9. Glass containers
10. Metal containers
11. Plastic or fiber containers made of synthetic material
12. Cleaning agents
13. Non-drug drugstore sundry products

The desired effect of the tax is to hold businesses and industries that sell or produce litter-related products accountable for part of the cost of cleaning up the environment. With such an objective, revenue from the tax, approximately \$750,000 per year, is used to purchase litter receptacles for use in all public areas, to provide for a "state ecology patrol" to enforce the Washington Model Litter Control Act, which makes littering a misdemeanor, and in general to subsidize the cost of removing litter from the environment.

In order to develop an estimate of the revenue potential for Virginia of a tax patterned after the Washington litter tax, we first found the yearly sales data for the specified categories of litter-related products at all three levels. For the manufacturing level in Virginia, the most current data were the value of shipments listed in the Preliminary Report, 1972 Census of Manufacturers. At the wholesale level, we used sales data from the 1972 Census of Wholesale Trade. The Department of Taxation supplied the Virginia retail sales data for 1974 from its information on sales taxable under the sales and use tax. To ensure comparability to retail data we inflated the manufacture and wholesale data to 1974 dollars using appropriate indices.

Based on these data, estimates of gross receipts from litter-related products for Virginia in 1974 are as follows:

<u>Level</u>	<u>Gross Receipts</u> (Millions)
Manufacturing	\$ 3,555.3
Wholesale	2,960.2
Retail	<u>4,038.9</u>
Total	\$10,554.4

We reduced the value of shipments at the manufacturing level by one-third to allow for duplication included as the result of products of some industries being used as materials by other industries.^{1/} Since the Washington law provides for taxation of only 95 percent of total sales made by grocery stores in lieu of separately accounting for taxable and nontaxable sales and since sales of prescription drugs are nontaxable, total gross receipts at the retail level for Virginia also reflected these provisions. At the Washington rate of .015 percent, annual revenue in Virginia from the litter tax would have been approximately \$1.6 million in 1974.

Although the Washington litter tax attempts to allocate the cost of cleaning the environment among the many different industries and businesses that contribute to the problem, the structure of the tax may not be acceptable as a model for several reasons. First, the litter tax, even at a moderate rate, could diminish Virginia's relatively favorable climate for attracting new business. Second, since the Washington tax is levied at the manufacture, wholesale, and retail levels, it results in multiple taxation of the designated tax base. A more equitable approach might be a value added litter tax. We found that

^{1/} U. S. Department of Commerce, Preliminary Report, 1972 Census of Manufacturers, Virginia, (Washington, D. C.: U. S. Bureau of the Census, 1974), p. 8. The report estimates that the value of finished manufactures - total value of shipments less duplication - is two-thirds the total value of shipments for all manufacturing industries.

after estimating value added for the thirteen specific categories for Virginia, application of a .015 percent rate would have yielded approximately \$600,000 in revenues in 1974.^{1/} A final point is that the tax base as defined by the thirteen categories of litter-related products is inconsistent in certain broad areas. For instance, the litter tax law allows grocery stores the option of paying the tax on 95 percent of total sales in lieu of separately accounting for sales of grocery and nongrocery products. Similarly, drugstores exercise the option of paying the tax on 50 percent of total sales in lieu of separately accounting for sales of drugstore sundry products and prescription drugs. An apparent inequity exists in that no provision is made to treat other businesses that sell a mixture of taxable and nontaxable items, such as department stores, in a similar fashion. In addition, the Washington tax is levied on soft drinks, beer, and wine but is not levied on whisky and other liquors. Even though the state has a monopoly over the sale of such alcoholic beverages and would itself pay the tax, it is an inequity.

Elimination of Disposable Beverage Containers

An alternative to an additional tax on soft drinks or a litter tax would be a measure similar to the Oregon Bottle Law. The Oregon Bottle Law became effective on October 1, 1972, and places a minimum 5¢ refundable deposit on all beer and soft drink containers sold in the state. However, beer and soft drink containers certified by the Oregon Liquor Control Commission as reusable by more than one bottler or distributor require only a 2¢ refundable deposit. The law stipulates

^{1/} The detailed methodologies used to make the revenue estimates for Virginia based on the Washington litter tax are available from the Research Division of the Department of Taxation.

that all beer and soft drink retailers must refund to consumers the minimum deposit of 5¢, or 2¢ if certified, on beverage containers of the type and variety sold by the retailer. In addition, bottlers or wholesale distributors of beer and soft drinks must refund to the retailer the minimum deposit of 5¢, or 2¢ if certified, on beverage containers of the type and variety sold by the wholesaler or bottler. Finally, there is an outright ban on the sale of the pull-tab variety of aluminum or metal containers.

The purpose of the law is twofold: (1) to reduce the littering of beverage containers by providing a monetary incentive either to purchase reusable or return disposable containers sold in the state and (2) to encourage usage of certified, standard returnable beverage containers by beer and soft drink bottlers and distributors in the state. Indications are that the bottle law has been effective in both instances. The Oregon Department of Environmental Quality estimates that the number of beverage containers entering the solid waste stream as litter or disposed trash has been reduced by 88 percent as a result of the bottle law. Similarly, the reduction in beverage container litter along Oregon's highways is estimated at between 65 and 90 percent. In addition to the reduced cost of the collection and disposal of littered beverage containers, the National Institute for Applied Research of Davis, California estimates an energy savings of approximately 50 percent as a result of reusing glass bottles 18 to 20 times.^{1/} Evidence of the success of the second objective, to encourage the use of a certified, standard returnable container, is the sale of 24 separate brands of beer in the same returnable bottle. A similar

^{1/} Kessler R. Cannon, The Oregon Minimum Deposit Law--Landmark Environmental Legislation, (Portland: Department of Environmental Quality, 1974), p. 8.

trend is not, however, apparent in the soft drink industry because of the identification of nationally advertised soft drinks with specially designed bottles. We should emphasize that the Oregon bottle law is a litter-reduction measure rather than a tax for revenue purposes.

Opponents of the law point out that the bottle law has had adverse effects on the beer and soft drink industry in Oregon. For instance, two small canning plants have been forced out of business as a result of the restrictions placed on aluminum and metal beverage containers. New capital outlay expenditures total \$5.35 million and capital losses and changeover costs are approximately \$175,000. In addition, retailers have experienced increased storage and handling costs. However, total operating income for all sectors combined in the beer and soft drink industries has increased by \$3.93 million per year since the law went into effect.^{1/}

Conclusion

Estimates indicate that revenue from a soft drink tax at rates similar to those in other states could range between \$0.3 million and \$18 million. A litter tax similar to that in Washington could produce approximately \$1.6 million in Virginia. Of course, a bottle law similar to the Oregon bottle law would produce no revenue.

At issue is the degree to which a revenue producing tax can be effective in decreasing the litter problem. Should the tax be imposed only on disposable soft drink bottles and cans, or should all beverage containers, disposable and nondisposable, and other litter-related items be taxed as well? As an alternative, would a litter measure aimed at the people who litter be a better solution than a tax on litter-related items?

^{1/} Kessler R. Cannon, The Oregon Minimum Deposit Law--Landmark Environmental Legislation, (Portland: Department of Environmental Quality, 1974), pp. 1-15; and U. S. News and World Report, (Washington, D. C.: December 3, 1973), p. 99.

Federal General Revenue Sharing

Federal general revenue sharing began in 1972 as a \$30.2 billion five-year program with objectives that were many and varied. In this section we shall examine the present law, the proposed extension of the law and some of the objectives of revenue sharing.

The Present Law

The amounts appropriated under the present revenue sharing program on a fiscal year basis are:

<u>Period</u>	<u>Amount</u> <u>(Millions)</u>
January - June, 1972	\$2,650.0
July - December, 1972	2,650.0
January - June, 1973	2,987.5
Fiscal 1973-74	6,050.0
Fiscal 1974-75	6,200.0
Fiscal 1975-76	6,350.0
July - December, 1976	3,325.0

with each state receiving the higher amount of either the House or Senate formula.

The House formula, which now favors Virginia, distributes the funds on the basis of general tax effort, individual income tax collections, population, urbanized population, and population inversely weighted for per capita income. The Senate version distributes the funds on the basis of population, state and local tax effort, and inverse per capita income.

The amounts already received or expected for state and local governments in Virginia are as follows:

<u>Fiscal Year</u>	<u>State Government Total (Millions)</u>	<u>Local Government Total (Millions)</u>
1972-73 <u>a/</u>	44.1	88.3
1973-74 <u>a/</u>	39.9	78.6
1974-75	40.3 <u>b/</u>	80.6 <u>c/</u>
1975-76	41.0 <u>b/</u>	82.0 <u>c/</u>
1976-77	32.2 <u>c/</u>	64.4 <u>c/</u>

a/ Actual payments

b/ Official budget estimates

c/ Staff estimate or projection

The official budget estimates and the staff projections require three assumptions:^{1/}

1. That Virginia will continue to receive the same percentage share (about 2 percent) of the total funds in future years as in 1972-73 and 1973-74. This assumption is necessary because of the numerous variables involved in a sophisticated forecast for which we lack data. Moreover, the Department of Treasury will not make forecasts of state entitlements.
2. That the total state share will be split one-third to the state government and two-thirds to local governments.
3. That payment will be made not later than five days after the close of each quarter. This would mean that the payment for the April-June quarter would fall in the next fiscal year.

These numbers indicate that the state government received \$84.0 million in the 1972-74 biennium and that it should receive \$81.3 million in the 1974-76 biennium and \$32.2 million in the first year of the 1976-78 biennium.

^{1/} Data provided by the federal Office of Revenue Sharing in May, 1975, indicate that the estimates and the projection are low by 1 to 2 percent.

The state government may use the funds on any expenditure items. The state may not, however, use them to match federal categorical grants and must maintain the existing levels of financial aid to local governments.

The local revenue sharing funds are distributed to counties (or independent cities) on the basis of population, tax effort (adjusted taxes per \$1,000 of personal income), and relative income, or state per capita income divided by county per capita income, and are split between the county government and all towns within the county on the basis of adjusted taxes. The amount received by an individual town is also based on population, tax effort, and relative income. Local funds are restricted to high priority maintenance and operation expenditure categories, such as health, recreation, public safety, and public transportation, but for capital outlays there are no limitations. The funds may not be used for current outlays for education. Local governments are also subject to the federal matching constraint.

The Proposed Law

President Ford has recommended that general revenue sharing be extended from January 1, 1977, until September 30, 1982, with the amount distributed growing by \$150 million annually and a \$39.85 billion total appropriation for the five and three-quarters years. The distribution formula and the constraints on use of the funds for state and local governments would be the same as those in the present law. There would be an increase in the maximum per capita allocation constraint from the present 145 percent of the average per capita allocation to localities to 175 percent; this would be introduced in 5 equal steps over the extension period. Such an increase would help the central cities, such as Norfolk or Richmond, that are currently at the

maximum. If we assume that Virginia would continue to receive about 2 percent of total funds and that the total share would be split one-third to state government and two-thirds to local governments, the state would receive \$265.7 million, and the localities, \$531.3 million. Annualizing these amounts would mean an average of \$46.2 million at the state level and \$92.4 million for localities each year. (To analyze the fiscal assistance that an extension of general revenue sharing could provide to the state and the localities, see Chapters IV and V.)^{1/}

Objectives of General Revenue Sharing

Among the objectives suggested for revenue sharing at its inception were:

1. To promote efficiency in government.
2. To make government programs more responsive to the people.
3. To induce greater tax effort by state and local governments.
4. To limit tax increases by state and local governments.
5. To provide aid to the financially pressed major cities in the nation.
6. To provide an alternative to categorical grants in giving inter-governmental assistance.
7. To equalize the fiscal capacity of state and local governments.

The first two objectives are assigned to almost every new governmental program at the federal, state, or local levels. Whether any program ever achieves such objectives is problematical, but there is nothing to indicate as yet that revenue sharing has led to less efficiency or

^{1/} The Office of Revenue Sharing provided all information on the current law and its proposed extension.

less responsiveness from government.

Obviously, to induce greater tax effort and to limit tax increases are contradictory goals. Making tax effort a part of the distribution formula for the entire state as well as local governments was an attempt to make recipient governments take greater advantage of their taxing capacity, for the reward would then be more federal revenue sharing funds. Of course, tax effort is only one of several variables that determine the amount received by a state or local government; changes in the others may reinforce or detract from the assumed effects of increased tax effort. In addition, general revenue sharing represents only 2.5 to 3.5 percent of state or local revenues throughout the nation. (In Virginia, it is a part of the state government's general fund but makes up only about 3 percent of collections; at the local level, it is roughly 6 percent of revenues). Observers may never be able to resolve completely whether revenue sharing has provided the assumed incentives for raising tax effort.

If anything, the preliminary evidence points to taxes being reduced or maintained at their present levels. For 1973-74, 15 state governments indicated in a questionnaire from the Office of Revenue Sharing that revenue sharing had permitted them to reduce taxes, 7 said that it prevented tax increases or new taxes, and 3 stated that it allowed maintenance of current tax levels. In the same survey all local governments across the nation responded; 4 percent said it reduced taxes, 62 percent, that it prevented tax increases or new taxes, and 34 percent, that it permitted maintenance of existing tax levels. Virginia would have fallen into the last 2 categories. We can say that revenue sharing does provide the marginal revenues necessary to balance a budget that state and local governments have such difficulty finding. As a result, many of them will continue to view it as a hedge against new or

higher taxes.

A significant factor behind the passage of revenue sharing was the hope that it would assist the financially troubled major cities in the nation. At present, there is some limited evidence that it may have helped to stabilize the fiscal situation in the cities. ^{1/} The proposed extension of the revenue sharing law would increase the maximum per capita allocation constraint from 145 percent to 175 percent of the average per capita allocation to localities; many cities are now at the constraint, and this proposal is recognition of its deleterious impact on them.

To provide an alternative to categorical or conditional grants was a high priority objective for many proponents of revenue sharing. They felt that the categorical grants had too many complexities, inhibited fiscal planning, and forced state and local government to become proficient at "grantsmanship" rather than at satisfying the demand for public goods and services. Certainly the revenue sharing distribution formulas are not difficult to understand, and a state or local government can easily incorporate the anticipated amounts into its budgetary planning. In addition, state and local governments have wide latitude in how they spend these funds. In 1973-74, state governments throughout the nation spent 52 percent of revenue sharing in education, 8 percent each on public transportation and health, and 7 percent each on general government and social services for the poor or aged. Much of the funds allocated

^{1/} David A. Caputa and Richard L. Cole, "General Revenue Sharing Expenditures Decisions in Cities over 50,000," Public Administration Review, Volume 35, No. 21 (Washington: March/April, 1975), pp. 136-142.

to education undoubtedly went to aid elementary and secondary education at the local level. Virginia fell into this national pattern because of the large portion of revenue sharing funds used for its standards of quality educational aid program in 1973-74. In that same year localities nationwide expended 36 percent on public safety, 19 percent on public transportation, 11 percent on environmental protection, and 7 percent each on health and recreation. Of course, we can expect to see the continuation of categorical grants as well as general purpose or unconditional grants (e.g. revenue sharing) but possibly with different goals - categorical grants to support programs in the national interest and general purpose grants to provide funds for state and local services. ^{1/}

One of the fundamental objectives of revenue sharing was to equalize the fiscal capacity of state and local governments. Revenue sharing might not be necessary if the distribution of income and wealth were the same throughout the country. If all communities had the same average income and wealth, the same tax structure could produce the same revenues everywhere. The federal government would finance only programs with national benefits. Each community would determine the level of expenditures and, in turn, of tax rates to provide public services with local or regional benefits for the people within its boundaries. With the same fiscal capacity, expenditures might differ, but no community would be hindered by a lack of resources. However, this ideal arrangement is not attainable in a national system in which the distribution of income and wealth is unequal.

^{1/} Except where otherwise noted, information on the effort and uses of general revenue sharing came from the Office of Revenue Sharing of the Department of the Treasury, General Revenue Sharing: Reported Uses 1973-74, (Washington: Government Printing Office, 1975).

The most efficient way for the federal government to equalize fiscal capacity and to permit poorer state and local governments to provide more adequate public services is through a revenue sharing plan that allocates funds on the basis of population possibly weighted by the inverse of per capita income. For example, a \$100 per person grant would add much more to fiscal capacity in a poorer state than in a rich one. If the grant were allowed to rise as per capita income dropped, the effect would be magnified. These 2 factors are part of the actual distribution formulas for the states, and the result does appear to be a percentage increase in the fiscal resources of the poorer states (as determined by per capita income) as much as double the rise in the resources of the richer states. At the local level population and relative income are 2 of the 3 components in the distribution formula; therefore, equalization should also occur there. However, the law does contain the maximum constraint already mentioned as well as a minimum constraint, 20 percent of the average per capita allocation to localities, and the results are not as clear.^{1/}

If a state wished to change the formula allocating funds among localities, it could do so once under the present law. The proposed extension would carry the same limitation. The law says that:

"A State may by law provide for the allocation of funds among county areas, or among units of local government (other than county governments), on the basis of the population multiplied by the general tax effort factors of such areas or units of local government, on the basis of the population multiplied by the relative income factors of such areas or units of local government, or on the basis of a combination of those two factors..."^{2/}

^{1/} Joseph A. Pechman, "State-Local Finance Beyond Revenue Sharing," The Economic Outlook for 1973, (Ann Arbor: November, 1972), pp. 69-80.

^{2/} Public Law 92-512, Section 108 (c).

The impact of any formula modifications can be analyzed by looking at a hypothetical state with three localities. We assume that the population and the other factors for the three are those in the note to Table 3.44 with \$1 million in local revenue sharing funds available for distribution. The table indicates the amount received by each locality under the present formula and 3 basic alternatives chosen from an almost infinite number of combinations. The present formula would distribute about 52 percent of the total to locality A, which has the largest population, the greatest tax effort, and the highest per capita income, 34 percent to locality B, and about 14 percent to locality C, which has the smallest of each of the three factors. At the same time it would add twice as much to the fiscal resources of locality C as compared to those in localities A or B on the basis of personal income. Eliminating relative income from the formula would increase somewhat the amounts going to localities A and B but would nearly cut in half the funds received by locality C. Removing tax effort would primarily shift the funds from locality A to locality C. The amount actually received by locality C would not, however, be based on the alternative formula but on the maximum permitted any local government, which is now 145 percent of the per capita allocation to localities. Using population squared and the other two factors would raise by approximately one-fifth the funds distributed to the relatively populous locality A and would cut by about three-fourths the monies received by locality C with its smaller population. From these hypothetical examples, we can make the following observations for Virginia:

1. To shift revenue sharing funds to the central cities and suburban counties, which among Virginia localities have the larger populations and make a greater tax effort, would involve a formula placing greater emphasis on those two factors.

TABLE 3.44 --DISTRIBUTION OF \$1 MILLION IN LOCAL REVENUE SHARING FUNDS TO THREE HYPOTHETICAL LOCALITIES UNDER THE PRESENT FORMULA AND THREE ALTERNATIVES

Locality	Present Formula		Population Times Tax Effort		Population Times ^{a/} Relative Income		Population ² Times Tax Effort Times Relative Income	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
A	\$521,000	52.1	\$577,000	57.7	\$451,147 (432,000)	45.1 (43.2)	\$642,000	64.2
B	340,000	34.0	367,000	36.7	367,603 (362,000)	36.8 (35.2)	315,000	31.5
C	139,000	13.9	77,000	7.7	181,250 (216,000)	18.1 (21.6)	43,000	4.3

Note: The factors used to allocate the \$1 million in general revenue sharing to the three hypothetical localities are:

Locality	Population	Adjusted Taxes	Personal Income	Per Capita Income	Tax Effort	Relative Income
A	20,000	\$1,500,000	\$ 60,000,000	\$3,000	\$25.00	.875
B	15,000	750,000	37,500,000	2,500	20.00	.952
C	<u>5,000</u>	<u>100,000</u>	<u>7,500,000</u>	<u>1,500</u>	<u>13.30</u>	<u>1.750</u>
State	40,000	\$2,350,000	\$105,000,000	\$2,625	\$22.38	1.000

a/ No locality is permitted to receive more than 145 percent, nor less than 20 percent of the per capita allocation to localities. In this example, the per capita amount is \$25, 145 percent of it is \$36.25, and 20 percent is \$5.00. This formula would provide locality A with \$432,000, or \$21.60 per capita, and locality B with \$362,000, or \$24.13 per capita. Locality C would receive \$216,000, or \$43.20 per capita and as a result would be constrained to 5,000 x \$36.25, or \$181,250. The difference would be allocated between Localities A and B based on their relative shares.

2. To shift the funds to the rural counties with their lower per capita incomes would mean giving greater weight to the relative income factor.
3. Any attempts to over- or underemphasize a particular factor could place specific localities against the maximum or minimum per capita constraints. The result could then be distributing the funds to localities not originally intended to receive them.

Conclusion

General revenue sharing has been a relatively small but important new source of revenue for state and local governments throughout the nation. Its continuation beyond 1976 would almost certainly have their full support even though their reasons may vary markedly.

Pari-Mutuel Betting and a State Lottery

Introduction

Pari-mutuel betting on thoroughbred, standardbred, and greyhound racing and a lottery have been mentioned as potential state revenue sources. Adoption of legislation allowing any of them is now permitted under the constitution. We discuss pari-mutuel betting first.

Pari-Mutuel Betting

The 1971 extra session of the General Assembly created a commission to "study and report upon the most practicable and feasible methods for the conduct of pari-mutuel betting on horse racing under a plan which will further the public interest and produce maximum revenues to the Commonwealth and its political subdivisions from the conduct of such activities." The 1972 session of the legislature continued the commission, which submitted a report in the fall of 1972 recommending pari-mutuel wagering on horse racing. The necessary legislation was introduced at the 1973 session but was defeated, and the General Assembly continued the commission for another year. The commission again recommended pari-mutuel betting on horse racing to the 1974 session of the General Assembly, but the legislation was defeated once more.^{1/}

^{1/} See House Joint Resolution No. 8 of 1971, House Joint Resolution No. 84 of 1972, and House Joint Resolution No. 291 of 1973. For more on the subject see Report of the Pari-Mutuel Betting Study Commission (Richmond: Department of Purchases and Supply, 1972) and Report of the Pari-Mutuel Betting Study Commission (Richmond: Department of Purchases and Supply, 1974).

The commission's 1972 report discusses the basic issues involved in bringing horse racing to Virginia, including state control through a racing commission, the possible location of racing facilities, the types of tracks and their estimated cost, and the revenue potential of racing. To analyze this potential the report makes the following assumptions:

1. That there would be two racing facilities operating, one in Northern Virginia and the other in the Hampton Roads area.
2. That the racing facilities would be designed for year-round use with each track allowed 100 or more days of racing.
3. That at each facility there would be a one mile thoroughbred racing strip and a five-eighths mile standardbred strip.
4. That the take-out from the pari-mutuel handle would be 15 percent with the state, the horsemen, and the racing association each receiving one-third. The breakage, or odd cents of a payoff, would also be divided equally among those three.

Using these assumptions, the report estimates that in the first year of operation of the two racing facilities the state would receive at least \$3 million as its share of the take-out and breakage. In the second or third year, the state share would rise to about \$7.5 million and after five years to around \$10 million.^{1/} Thus, if racing were approved during the 1976-78 biennium and if construction of the tracks began soon thereafter, revenues would not begin to reach their full potential until the middle of the 1980's.

A State Lottery

Twelve states now have functioning lotteries. The first state

^{1/} Report of the Pari-Mutuel Betting Study Commission (Richmond: Department of Purchases and Supply, 1972).

to establish a lottery in recent times was New Hampshire in 1964 with New York following in 1967. Since 1970, ten states, Connecticut, Maryland, Massachusetts, Michigan, New Jersey, Pennsylvania, Rhode Island, Maine, Ohio, and Illinois, have established lotteries. All lottery states follow the basic operating practices and procedures of the New Jersey lottery which when introduced in 1971 represented a major departure from the methods of operation of the earlier New Hampshire and New York lotteries. The basic elements introduced by the New Jersey lottery were:

1. Low priced tickets (50 cents).
2. Frequent drawings (weekly and now daily).
3. Widespread and accessible ticket sales outlets (supermarkets, drug stores, restaurants and taverns).
4. A large number of prizes and prize winners.
5. Tickets based purely on numbers rather than recording of names and addresses of purchasers on ticket stubs.
6. Strong state promotional and advertising effort to sell tickets and market the lottery.

The National Science Foundation (NSF) funded a study of state lotteries and off-track betting by the Futures Group.^{1/} Published in 1974, it provides a considerable amount of information on the operations of state lotteries. According to the NSF study and based on discussions with state lottery officials, the characteristics of a successful state lottery (or "good game" in lottery terminology) are:

1. Simplicity.
2. Large number of chances to win.

^{1/} David Weinstein and Lillian Deitch, The Impact of Legalized Gambling: The Socioeconomic Consequences of Lotteries and Off-Track Betting, (New York, 1974).

3. Large number of winners.
4. Chance at a large prize (e.g., \$1 million).
5. Variety of games.
6. High percentage of revenue paid out as prizes (the larger the payout, the larger is participation).
7. Diversity of large prize winner's geographic location within a state.
8. Frequent top prize winners (weekly in some states).
9. Better participation (chance to pick one's own number).

In addition to the structural and operating characteristics of a lottery, there are other factors that determine its revenue producing ability. These include:

1. The level of competition from nearby states and from other legal or illegal forms of gambling.
2. The levels of personal income of state citizens.
3. The propensity of state citizens to gamble.

Other considerations related to state lotteries based on the findings of the NSF study are:

1. That state lotteries are not large revenue producers in terms of total state tax revenues. In states operating lotteries in 1973, lottery revenues ranged from 0.7 percent to 3.4 percent of total tax revenues.
2. That although lottery revenues are small in terms of total revenues, they can be significant sources of new or discretionary funds.
3. That states not prohibited by their constitution from doing so generally earmark lottery revenues for special purposes (e.g., education, property tax relief for the elderly, aid to Vietnam veterans, etc.). The NSF study found that earmarking did not appreciably increase net spending in these designated areas.
4. That constant promotion plus the introduction of new variations in terms of prizes or prize structures are necessary to maintain interest, participation, and revenues.
5. That state lotteries have little impact on illegal gambling.

With the experience other states with their lotteries and certain assumptions on the characteristics of the lottery, it is possible to estimate the range of potential revenues that might accrue to Virginia. Table 3.45 presents the relevant population, income, and participation data for the states with a lottery. We assume that:

1. The range of weekly per capita participation would run from the lowest level in a current lottery state (New York at \$.12) to the average of all lottery states (\$.20).
2. Gross lottery revenues would be split as follows:
 - 45 percent--prize payout
 - 15 percent--operating expenses
 - 40 percent--revenues to state
3. Lottery tickets would sell for \$.50 per ticket.
4. Virginia's estimated 1974 population of 4,908,000 from the U. S. Census Bureau is the base for participation and revenue calculations.

Revenues would vary by up to \$8 million:

<u>Per Capita Participation</u>		<u>Gross Lottery Sales</u>	<u>Net Revenues</u>
<u>Weekly</u>	<u>Annual</u>	(Millions)	(Millions)
\$.12	(\$6.24)	\$30.6	\$12.3
\$.13	(\$6.76)	33.2	13.3
\$.14	(\$7.28)	35.7	14.3
\$.15	(\$7.80)	38.3	15.3
\$.16	(\$8.32)	40.8	16.3
\$.17	(\$8.84)	43.4	17.4
\$.18	(\$9.36)	45.9	18.4
\$.19	(\$9.88)	48.5	19.4
\$.20	(\$10.40)	51.0	20.4

Each \$.01 increase in weekly per capita participation would raise lottery ticket sales by roughly 100,000, gross lottery sales by \$2.5 million, and net revenues by \$1 million. Thus, we estimate that the net revenue to Virginia from the operation of a state lottery similar to those operating in the other 12 lottery states would range from a low of \$12 million annually to a high of \$20 million annually.

TABLE 3.45
 LOTTERY STATES: A COMPARISON

<u>State</u>	<u>Population 1974 (000)</u>	<u>Percent Urban 1970</u>	<u>Total Personal Income (Millions)</u>	<u>Per Capita Income</u>	<u>1973 Per Capita Lottery Participation</u>	
					<u>Annual</u>	<u>Weekly</u>
New Hampshire	808	56.5	\$ 3,713	\$4,694	\$ 8.84	(\$.17)
New York	18,111	85.6	104,198	5,705	6.24	(\$.12)
New Jersey	7,330	88.9	43,026	5,845	16.64	(\$.32)
Connecticut	3,088	77.3	18,265	5,938	11.96	(\$.23)
Massachusetts	5,800	84.6	30,561	5,253	12.48	(\$.24)
Michigan	9,098	73.9	50,201	5,551	15.60	(\$.30)
Maryland	4,094	76.6	22,339	5,489	11.44	(\$.20-.22)
Pennsylvania	11,835	71.5	59,427	4,993	11.96	(\$.23)
Illinois	11,131	83.0	64,833	5,770	N.A.	
Ohio	10,737	75.3	54,474	5,076	20.80	(\$.40) ^{1/}
Maine	1,047	50.9	4,196	4,082	7.80	(\$.14)
Rhode Island	937	87.0	4,710	4,841	* 19.24	(\$.37)
Virginia	4,908	63.1	23,506	4,886		

Note: The average per capita lottery participation in all lottery states is \$.20 weekly or \$10.40 per year per person.

* 1974 figures.

^{1/} Based on operations in first few months.

SOURCE: U. S. Department of Commerce.

Summary of Major Sources

In Table 3.46 we show the effects of alternative changes in several of the state's general fund revenue sources in the 1976-78 biennium. We still assume that new revenues from a crown tax, horse racing, or a lottery would be applied to the general fund. We select for each revenue source the most reasonable effective date for any changes. For example, the individual income tax, which is the most important source of revenue, is forecast to produce \$810.2 million in 1976-77 with the present structure and rates. If the structure based on the Tax Reduction Act of 1975 and rate schedule J were adopted, we assume that the change would become law on July 1, 1976, but with an effective date of January 1, 1976. For 1976-77 the schedule would produce an additional \$56.0 million for the seventeen month period (allowing for a thirty day lag in collections). Thus, the transitional effect of any change is reflected in the first year of the next biennium while the twelve month impact is shown in 1977-78.

The table can be used to put together any revenue package desired. As an illustration, to exclude food purchases from the sales tax base and increase the rate from 3 to 4 percent would generate at the state level an extra \$6.6 million in revenue in 1976-77.

TABLE 3.46--PROJECTED REVENUES FROM ALTERNATIVE
CHANGES IN REVENUE STRUCTURE AND/OR RATES,
1976-78 BIENNIUM
(Millions of Dollars)

Revenue Source	1976-77		1977-78	
	Projected Revenue	Change from Present Tax	Projected Revenue	Change from Present Tax
CORPORATIONS--INCOME TAX				
Present structure; present 6% rate	\$ 133.9	...	\$ 155.0	...
Present structure; 7% rate	162.6	+28.7	180.8	+25.8
INDIVIDUALS AND FIDUCIARIES--INCOME TAX				
Present structure:				
Present rates	810.2	...	977.6	...
Rate schedule A	886.6	+76.4	1,047.0	+69.4
Rate schedule B	901.7	+91.5	1,060.7	+83.1
Rate schedule C	928.6	+118.4	1,085.1	+107.5
Rate schedule D	1,013.6	+203.4	1,162.4	+184.8
Structure based on the Tax Reduction Act of 1975:				
Present rates	785.9	-32.3	948.3	-29.3
Rate schedules E, F, G, and H	810.2	...	977.6	...
Rate schedule J	866.2	+56.0	1,028.4	+50.8
Rate schedule K	944.7	+134.5	1,099.8	+122.2
Rate schedule L	955.5	+145.3	1,109.6	+132.0
Rate schedule M	989.9	+179.7	1,140.9	+163.3
Structure based on President Ford's plan:				
Present rates	760.0	-66.7	917.0	-60.6
Rate schedule I	810.2	...	977.6	...
Rate schedule N	906.0	+95.8	1,064.6	+87.0
Rate schedule O	938.3	+128.1	1,093.9	+116.3
Rate schedule P	955.5	+145.3	1,109.6	+132.0
Rate schedule Q	1,026.5	+216.3	1,174.1	+196.5
Structure based on the House Ways and Means Committee plan:				
Present rates	760.0	-66.7	917.0	-60.6
Rate schedule I	810.2	...	977.6	...
Rate schedule N	906.0	+95.8	1,064.6	+87.0
Rate schedule O	938.3	+128.1	1,093.9	+116.3
Rate schedule P	955.5	+145.3	1,109.6	+132.0
Rate schedule Q	1,026.5	+216.3	1,174.1	+196.5
Taxation of 100 percent of all capital gains				
			An additional \$10 to \$15 million in each fiscal year	
Elimination of the Virginia dividend exclusion				
			An additional \$3 to \$5 million in each fiscal year	
TAX CREDIT TO COMPENSATE FOR SALES TAX ON FOOD (EXCLUDING LOCAL OPTION)				
\$22 credit per exemption	-103.1	-103.1	-104.5	-104.5
\$22 credit per exemption but limited to AGI of under \$10,000	-55.1	-55.1	-55.8	-55.8
\$22 credit per exemption but limited to AGI of under \$7,000	-39.8	-39.8	-40.3	-40.3
STATE SALES AND USE TAX (EXCLUDING LOCAL OPTION)				
Present structure; present rate	486.4	...	552.7	...
Present structure; 4% rate	637.0	+150.6	736.9	+184.2
Excluding food purchases; present rate	378.4	-108.0	420.6	-132.1
Excluding food purchases; 4% rate	493.0	+6.6	560.8	+8.1
Excluding food and nonprescription drugs; present rate	371.2	-115.5	411.8	-140.9
Excluding food and nonprescription drugs; 4% rate	483.4	-3.0	549.0	-3.7
Adding selected services; present rate	529.8	+43.4	605.8	+53.1
Adding selected services; 4% rate	694.8	+208.4	807.7	+255.0
INHERITANCE TAX				
Present structure; present rates	21.9	...	23.0	...
Present structure:				
Rate schedule 1	24.3	+2.4	27.1	+4.1
Rate schedule 2	25.5	+3.6	29.2	+6.2
Rate schedule 3	25.4	+3.5	29.0	+6.0
Rate schedule 4	23.5	+1.6	25.8	+2.8
Present structure with inclusion of insurance; present rates	23.0	+1.1	24.9	+1.9
TOBACCO PRODUCTS TAX				
Present structure; present rates	19.1	...	20.5	...
Present structure; 5 cent rate; no change in sales	38.2	+19.1	41.0	+20.5
Present structure; 5 cent rate; 5% drop in sales	36.3	+17.2	38.9	+18.4
Present structure; 5 cent rate; 10% drop in sales	34.4	+15.3	36.9	+16.4
Present structure; 5 cent rate; 20% drop in sales	30.6	+11.5	32.8	+12.3

TABLE 3.46--PROJECTED REVENUES FROM ALTERNATIVE
CHANGES IN REVENUE STRUCTURE AND/OR RATES,
1976-78 BIENNIUM
(Millions of Dollars) (Continued)

Revenue Source	1976-77		1977-78	
	Projected Revenue	Change from Present Tax	Projected Revenue	Change from Present Tax
ALCOHOLIC BEVERAGES STATE TAX				
Present structure; present 14% rate	31.2	...	33.0	...
Present structure; 15% rate	33.2	+2.0	35.1	+2.1
BEER AND BEVERAGE EXCISE TAX				
Present structure; present rates	24.2	...	26.6	...
Present structure; 25% increase in rates	29.2	+5.0	32.8	+6.2
CROWN TAX ON SOFT DRINKS				
Average per capita revenue of states with the tax	10.4	+10.4	12.0	+12.0
PARI-MUTUEL BETTING AND LOTTERY				
Pari-mutuel betting				From two racing facilities the state could expect about \$3 million in the first year of operation, \$7.5 million after two or three years, and around \$10 million after five years. Only the \$3 million figure might be achieved in the next biennium.
Lottery				Estimated receipts for a year range between \$12 million and \$20 million depending on the degree of public acceptance.

Methodologies for projected revenues due to structure or rate changes are as follows:

- Corporations--Income Tax** - The projected revenues from the present structure and rate were increased by 16.7 percent. The projected changes for 1976-77 include seventeen months of revenues because an effective date of January 1, 1976, was assumed.
- Individuals and Fiduciaries--Income Tax** - Percentage relationships between 1972 revenue estimates under the present structure and rates and revenue estimates for the alternative structures and rate schedules were applied to projected revenues under the present structure and rates. The projected changes for 1976-77 include seventeen months of revenues because an effective date of January 1, 1976, with a thirty day collections lag was assumed. Slightly different cash flow effects for the structural changes as compared to the rate changes would probably cause the actual impact of a structural change or a combination of the two to vary from the projection effects by less than 1 percent of total individual income tax collections. For taxation of 100 percent of capital gains, the forecast is equivalent to the estimate of \$10 to \$15 million in additional revenues each year given in the text; for elimination of the Virginia dividend exclusion, the projection is also equal to the estimate of \$3 to \$5 million in extra revenues per year provided in the text. Each assumed that the effective date would be January 1, 1976, but that the additional revenues for 1976-77 would only reflect the impact of the change on tax or calendar year 1976.
- Tax Credit to Compensate for Sales Tax on Food** - The number of exemptions to which the credit would apply in tax year 1972 was assumed to be 4,451,000. This number was increased by 1.3 percent per year for 4 and 5 years, respectively. An effective date of January 1, 1976, was utilized along with the assumption that persons would claim the credit on the tax return filed for 1976. The credit was increased from \$13.50 to \$22 to account for the projected rise in the cost of food. The methodology for the credit limited to those with incomes under either \$7,000 to \$10,000 was similar except that the initial number of exemptions in 1972 was assumed to be 1,716,529 and 2,378,474, respectively. This methodology may slightly overstate the cost of the AGI limited credit since inflation may be driving persons above the AGI cutoff level. No forecasts were made of the revenue loss caused by a sliding scale credit for persons with incomes under \$7,000 or \$10,000 although the cost would have been less than that for the \$22 credit limited only by income level.
- State Sales and Use Tax** - The percentage relationships between the present structure and rate and the alternatives shown in Table 3.30 for 1973-74 were applied to the projected revenues for the present structure and rate for 1976-77 and 1977-78. The changes projected for 1976-77 include eleven months of revenues because an effective date of July 1, 1976, with a thirty day collections lag was used.
- Inheritance Tax** - Percentage relationships between 1973-74 revenue estimates under the present structure and rates and revenue estimates under the present structure and alternative rate schedules were applied to projected revenues under the present structure and rates. Projections for revenues from including insurance were based on the percentage relationship of the estimate for calendar year 1970 to collections under the present structure and rates for 1969-70. Inheritance tax revenues were estimated to be 95 percent of inheritance and gift tax revenues. The changes forecast for 1976-77 include six months of revenue, for an effective date of July 1, 1974, with a one-half year collections lag was assumed.
- Tobacco Products Tax** - For a doubling of the rate and no change in sales projected revenues from the present structure and rates were multiplied by 2; for 5, 10, and 20 percent decreases in sales, the doubled revenues were decreased by 5, 10, and 20 percent, respectively. An effective date of July 1, 1976, with no collections lag was assumed. These forecasts account for the doubling of the discount to tobacco wholesalers, which passed at the 1973 session of the General Assembly, became effective July 1, 1974, and costs about \$1 million annually. A 5 percent drop in sales implies a price elasticity of demand of about -.7 which is considered the most reasonable of the estimates of the elasticity of demand for tobacco products.
- Alcoholic Beverages State Tax** - The projected revenues with the present structure and the present rate were increased by 7.1 percent and then reduced to account for a price elasticity of demand of -.79. An effective date of July 1, 1976, with no collections lag was assumed.
- Beer and Beverage Excise Tax** - The projected revenues with the present structure and the present rates were increased by 25 percent and then reduced to account for a price elasticity of demand of -.7. An effective date of July 1, 1976, with a thirty day collections lag was assumed; thus the projected changes for 1976-77 include only eleven months of revenues.
- Crown Tax on Soft Drinks** - The estimated revenue for Virginia for fiscal 1973-74, based on the average per capita revenue of states with the tax, was increased by 5.4 percent a year, the average annual ratio of growth of the value of soft drink shipments between 1969 and 1972, from the 1967 and 1972 Census of Manufacturers - Virginia. An effective date of July 1, 1976, with a thirty day collections lag was used; as a result, the forecast for 1976-77 reflects eleven months of revenues.
- Pari-Mutuel Betting and Lottery** - Estimates were made in the text for racetracks and a lottery. If approved, a lottery could probably be in full operation by 1977-78, but racetracks could not become fully operational until several years following the 1976-78 biennium.

SPECIAL FUNDS

This report is primarily concerned with analysis and projection of revenues and expenditures passing through the general fund. Revenues earmarked for special purposes however account for more than half the state's total collections (as can be seen in Table 3.47) and will be discussed briefly here.

TABLE 3.47.--TOTAL REVENUES FROM GENERAL FUND, SPECIAL AND OTHER FUNDS 1964-1970
(Millions)

Revenues Going Into	Biennium							
	1966-68		1968-70		1970-72		1972-74	
	Amount	%	Amount	%	Amount	%	Amount	%
General Fund	\$1,021.4	44.6	\$1,489.6	49.3	\$1,784.9	46.3	\$2,371.3	46.6
Special and Other Funds	<u>1,267.3</u>	<u>55.4</u>	<u>1,535.3</u>	<u>50.7</u>	<u>2,070.6</u>	<u>53.7</u>	<u>2,715.7</u>	<u>53.4</u>
Total Funds	<u>\$2,288.7</u>	<u>100.0</u>	<u>\$3,024.9</u>	<u>100.0</u>	<u>\$3,855.5</u>	<u>100.0</u>	<u>\$5,087.0</u>	<u>100.0</u>

Source: Derived from Tables 3.5 and 3.48

Table 3.48 shows historical collections of special funds revenue by source for the past five bienniums, while Table 3.49 summarizes the major special funds revenue sources for the 72-74 biennium. As can be seen, relatively few sources account for the bulk of special funds revenue. The three major motor vehicle related sources (motor vehicle fuel tax, motor vehicle sales and use tax and motor vehicle licenses) account for 25 percent of special funds revenue, while grants from the federal government (including revenue sharing) amount to almost 45 percent and institutional revenues account for an additional 15 percent. Together these major sources make up 85 percent of special funds revenue.

TABLE 3.48.--TOTAL REVENUES FROM SPECIAL FUNDS AND OTHER FUNDS NOT APPLICABLE TO THE GENERAL FUND, 1962-64 TO 1972-74

Public Service Corporations	\$2,386,158	\$2,538,670	\$2,706,609	\$4,875,709	\$3,362,150
Capitation	3,555,468	2,474,158	1,618,068	683,348	...
Motor Vehicle Fuel Tax ^{a/}	227,616,161	253,915,591	288,013,205	334,681,773	471,707,531
Payroll Tax for Unemployment Compensation	40,321,541	33,944,233	28,366,474	26,179,095	42,579,662
Motor Vehicle Sales and Use Tax	...	34,116,517	53,132,767	68,667,163	88,636,880
Other Taxes	1,275,382	1,076,543	1,687,874	2,739,098	3,867,774
Sub-Total, Taxes	275,154,710	328,065,712	375,524,997	437,826,186	610,153,997
RIGHTS AND PRIVILEGES					
Hunting and Angling Licenses	5,026,741	5,823,227	6,585,252	7,559,460	8,357,478
Motor Vehicle Licenses	81,897,255	88,346,130	98,933,981	113,002,668	123,235,999
Registration of Title of Motor Vehicles	9,349,859	9,088,536	9,880,979	11,354,291	13,039,699
Chauffeurs' and Motor Vehicles Operators' Permits	8,713,692	9,242,553	12,875,512	16,892,331	12,230,770
All Other Licenses and Permits	3,764,064	4,306,822	5,480,327	6,963,424	9,431,867
Fees for Examination to Practice Professions	62,902	65,545	68,531	73,442	71,042
Fees for Miscellaneous Privileges and Services	22,111,312	25,521,196	32,670,652	40,929,558	70,988,112
Sub-Total, Rights and Privileges	130,925,825	142,394,009	166,495,234	196,775,174	237,354,967
Total from Taxation	\$406,080,535	\$470,459,721	\$542,020,213	\$634,601,360	\$847,508,964
OTHER THAN TAXATION					
SALES OF PROPERTY AND COMMODITIES ^{b/}	6,238,826	9,008,243	11,660,323	17,160,021	24,136,300
ASSESSMENT FOR SUPPORT OF SPECIAL SERVICES	7,947,751	7,831,659	8,987,604	11,584,081	11,563,760
INSTITUTIONAL REVENUES	133,825,738	174,339,361	233,016,540	303,800,408	419,194,567
INTEREST AND RENTS	38,871,279	51,510,805	73,230,661	104,799,763	116,587,824
GRANTS AND DONATIONS					
Grants from the Federal Government	460,213,767	502,174,770	603,615,008	929,934,368	1,114,832,347
Donations from Cities and Counties	5,751,798	14,552,423	19,030,056	22,012,960	30,207,969
Donations from Individuals and Others	2,494,013	4,716,755	4,547,476 ^{d/}	2,678,632	2,600,995
Sub-Total, Grants and Donations	468,459,578	521,443,948	627,192,540	954,625,960	1,147,641,311
REVENUE SHARING	...	...	...	...	84,021,856
FINES, FORFEITURES, COSTS, PENALTIES, AND ESCHEATS	10,619,233	12,566,280	14,396,829	15,861,803	20,564,619
MISCELLANEOUS					
Receipts from Cities, Counties, and Towns for Street and Road Work	6,141,035	7,381,081	12,728,382	12,900,742	22,940,381
Receipts from Cities and Counties for Medical Care and Services Premiums for Old Age Assistance Programs	...	2,275,699	1,225,800	...	...
Receipts from Reportable Violations--DMV	2,597,951	3,465,783	3,721,281	3,915,539	4,374,607
Proceeds from the Sale of Surplus Property	1,964,913	2,242,615	2,245,509	2,701,105	3,518,813
Other	4,528,378	4,792,912	4,850,035 ^{d/}	8,610,240	13,614,536
Sub-Total, Miscellaneous	15,232,277	20,158,090	24,771,007	28,127,626	44,448,337
Total Other Than Taxation	\$681,194,682	\$796,858,386	\$993,255,504	\$1,435,959,662	\$1,868,158,574
Total ^{c/}	<u>\$1,087,275,217</u>	<u>\$1,267,318,107</u>	<u>\$1,535,275,735</u>	<u>\$2,070,561,022</u>	<u>\$2,715,667,538</u>
Special Revenue Funds	\$1,059,283,510	\$1,234,440,091	\$1,496,149,811	\$2,026,743,294	\$2,664,053,327
Reserves for Specified Purposes	27,982,576	32,870,560	39,116,214	43,797,571	51,583,820
In Suspense--Not Allocated	9,131	7,456	9,710	20,157	30,391

a/ Excludes amount transferred to General Fund for appropriations for analyzing gasoline, diesel fuel, and motor oils

b/ Excludes alcoholic beverage sales.

c/ Excludes contributions for retirement.

d/ In fiscal year 1969-70, \$95 of Donations from Individuals and Others was transferred to the General Fund under the category Miscellaneous-Other; therefore, this transfer is reflected in the category Miscellaneous-Other rather than Donations from Individuals and Others in this table.

Sources: Report of Comptroller, Fiscal Year Ended June 30, 1963 through Fiscal Year Ended June 30, 1969, Schedule B-1; Statement No. 1, (Richmond: Department of Accounts); Report of Comptroller, Fiscal Year Ended June 30, 1970, Schedule B-1, Statement Nos. 1, 3, and 4; Report of Comptroller, Fiscal Year Ended June 30, 1974, Schedules 1-A and 1-B; Unpublished Statement of Revenues Collected, All Funds and General Fund, Fiscal Year Ended June 30, 1971 through Fiscal Year Ended June 30, 1974; Unpublished Schedule of Reserve and Suspense Funds, Fiscal Year Ended June 30, 1971 through Fiscal Year Ended June 30, 1974 (Richmond: Department of Accounts).

TABLE 3.49.--SUMMARY OF MAJOR SOURCES OF SPECIAL FUNDS REVENUE 1972-74 BIENNIUM

<u>Revenue Source</u>	<u>Amount</u>	<u>Percent of Total Special Fund Revenues</u>	<u>Percent of Total Revenues from all Sources</u>
Taxes	\$610,153,997	22.5	12.0
Motor Vehicle Fuel Tax	\$471,707,531	17.4	9.3
Motor Vehicle Sales & Use Tax	88,636,880	3.3	1.7
Other Taxes	49,809,586	1.8	1.0
Rights and Privileges	237,354,967	8.7	4.7
Motor Vehicle Licenses	123,235,999	4.5	2.4
Other Rights and Privileges	114,118,968	4.2	2.3
Institutional Revenues	419,194,567	15.4	8.2
Interest and Rents	116,587,824	4.3	2.3
Grants from Federal Government	1,114,823,347	41.1	21.9
Revenue Sharing	84,021,856	3.1	1.7
All Other Sources*	<u>133,530,980</u>	<u>4.9</u>	<u>2.6</u>
Total	<u>\$2,715,667,538</u>	<u>100.0</u>	<u>53.4</u>

Source: Tables 3.5 and 3.48.

* Detailed sources of special fund revenues will be found in Table 3.48.

Motor Vehicle Related Special Funds Revenue Sources

Table 3.50 summarizes the 1975-76 yield of special funds revenues from motor vehicle related sources as estimated by the Department of Highways. The current climate of uncertainty regarding the future availability of motor vehicle fuels and the possibility of federal legislation aimed at curtailing the demand for motor fuels make projections of these items exceedingly difficult. Based on the best information available at present, however, the annual total of receipts from these sources is not expected to change significantly through 1982. The major assumption underlying this projection is that the base of the motor fuels tax will not differ appreciably from its 1973-74 level. Because of the overall importance of the motor fuels tax, as shown below, any change in the amount of other items is not anticipated to affect future revenue collections considerably.

TABLE 3.50.--ESTIMATED HIGHWAY REVENUES, 1975-76
(Thousands)

<u>Revenue Source</u>	<u>Amount</u>	<u>Percent of Total</u>
Motor Vehicle Fuel Tax	\$230,640 ^{a/}	44.1
Motor Vehicle Sales and Use Tax	40,000	7.7
Motor Vehicle Licenses	66,091	12.6
Motor Vehicle Title Registration	6,980	1.3
Other Motor Vehicle Related Fees ^{b/}	<u>17,336</u>	<u>3.3</u>
Sub Total	\$361,047	69.0
Less Other Agencies ^{c/}	<u>29,784</u>	<u>5.7</u>
Net State Revenue	\$331,263	63.3
Federal Aid	<u>192,359</u>	<u>36.7</u>
Total Revenue	\$523,622	100.0

^{a/} Includes amounts to be appropriated in conformance with statutory provisions for the two counties not in the secondary system.

^{b/} Includes permit fees, offense assessments, state corporation fees, Department of Highway fees, and miscellaneous Division of Motor Vehicle fees.

^{c/} Funds for support of Division of Motor Vehicles and partial support of Highway Safety Division, Virginia State Police, and Department of Conservation and Economic Development.

Source: Department of Highways, unpublished data.

Motor Vehicle Fuel Tax

As noted in Table 3.49 the motor vehicle fuel tax is a major source of revenue accounting for 17.4 percent of Virginia's special funds revenue and 9.3 percent of total revenue from all sources. Virginia's 9 cents per gallon rate is above the national 8 cent median. Virginia's neighboring states impose varying rates: Tennessee 7 cents, District of Columbia 8 cents, West Virginia 8.5 cents, North Carolina 9 cents and Kentucky 9 cents. Rates in other states range from five to ten cents as shown in Table 3.51.

TABLE 3.51.--STATE GASOLINE TAX RATES, JANUARY 1, 1975^{1/}
(per gallon)

Less than 7¢	7¢	7.5¢	8¢	8.5¢	9¢ or more
Hawaii (5¢)	Alabama	Georgia	Alaska	Arkansas	Connecticut (10¢)
Nevada (6¢)	California	Illinois	Arizona	Idaho	Delaware (9¢)
Oklahoma (6.58¢)	Colorado	Massachusetts	Dist. of Columbia	Nebraska	Kentucky (9¢)
Texas (5¢)	Iowa		Florida	West Virginia	Maine (9¢)
	Kansas		Indiana		Maryland (9¢)
	Minnesota		Louisiana		Michigan (9¢)
	Missouri		New Jersey		Mississippi (9¢)
	Montana		New York		New Hampshire (9¢)
	New Mexico		Rhode Island		North Carolina (9¢)
	North Dakota		South Carolina		Pennsylvania (9¢)
	Ohio				Vermont (9¢)
	Oregon				Virginia (9¢)
	South Dakota				Washington (9¢)
	Tennessee				
	Utah				
	Wisconsin				
	Wyoming				
Total....4	.....17	.....3	.....10	.....4	.....13

^{1/} Excludes local taxes.

Source: Commerce Clearing House, Inc., "State Tax Review," various recent weekly issues, especially October 1, 1974 and January 15, 1975.

Motor Vehicle Sales and Use Tax

Virginia's motor vehicle sales and use tax accounts for 3.3 percent of special funds revenue and 1.7 percent of revenue from all sources. It is imposed by the state at a rate of two percent of the "total price paid for a motor vehicle and all attachments thereon and accessories thereto, without any allowance or deduction for trade-ins or unpaid liens or encumbrances".^{1/} Localities are prohibited from imposing this tax.^{2/}

Nationally only Delaware, Oregon, and New Hampshire impose no tax on the sale of motor vehicles. Alaska has no state tax on such sales but local general sales taxes apply. In thirty-six states motor vehicles sales are subject to the general sales tax while twelve others,^{3/} including Virginia, impose a selective sales tax on motor vehicle transfers. In addition to the state tax, local sales taxes are allowed on motor vehicle sales in eleven states including Virginia's neighbors North Carolina and Tennessee.

In comparison with neighboring states, Virginia's present tax is lower than in every area except North Carolina where it is the same. The District of Columbia rate is 5 percent with no allowance for trade-ins. Maryland levies a 4 percent tax with a similar policy on trade-ins. North Carolina has a state tax of 2 percent not to exceed \$120 with no allowance for trade-ins, and in addition, Mecklenburg County levies a 1 percent tax. Tennessee has a state tax of 3 percent and allows for trade-ins. Also, most Tennessee localities impose taxes ranging from 1 to 1.75 percent. West Virginia uses a 5 percent tax and allows for trade-ins. Kentucky imposes a tax of 5 percent and allows for trade-ins only on used vehicles previously registered in the state.

1/ Code of Virginia, Section 58-685.11.

2/ Code of Virginia, Section 58,685.25.

3/ Includes the District of Columbia.

Institutional Revenues

Institutional revenues are those fees and charges collected by agencies for services rendered ie: tuition at colleges and universities and medical fees at hospitals. Analysis or projection of institutional revenues are beyond the scope of this report even though they account for roughly fifteen percent of total special fund revenues.

Grants from Federal Government

Federal grants represent by far the largest single source of special funds revenue - amounting to 41.1 percent in 1972-74. They accounted for 21.9 percent of the total state revenue from all sources in that Biennium. As with institutional revenue, federal grants analysis is beyond the scope of this report. However, Table 3.52 will give the reader a general view of the magnitude of federal fund appropriations for the 1974-76 period.

TABLE 3.52.--FEDERAL FUND APPROPRIATIONS BY FUNCTION 1974-76 BIENNIUM*

<u>Function</u>	<u>Amount</u>	<u>Percent of Total Federal Funds</u>
<u>Operating Expenses</u>		
Education	\$287,612,650	21.1
Elementary-Secondary	\$198,934,330	14.6
Higher Education	87,235,930	6.4
Other Education	<u>1,442,390</u>	0.1
Health and Welfare	540,056,715	39.6
Mental Health	\$1,549,580	0.1
Public Health	21,773,045	1.6
Medicaid	224,276,120	16.5
Public Welfare	237,462,420	17.4
Vocational Rehabilitation	<u>54,995,550</u>	4.0
Administration of Justice	29,258,400	2.1
Resource and Economic Development	108,119,165	7.9
General Administration and Legislative	16,326,760	1.2
Transportation	353,829,475	26.0
Other Operating Expenses	<u>964,225</u>	<u>0.1</u>
Total Operating Expenses	\$1,336,167,390	98.0
Nonrecurring Items	19,850,000	1.5
Capital Outlays	<u>7,133,650</u>	<u>0.5</u>
Total Appropriations from Federal Funds	\$1,363,151,040	100.0

Source: Division of the Budget, unpublished data.

* Excludes appropriations made by 1975 session of the General Assembly.

CHAPTER IV

STATE EXPENDITURE PROJECTIONS

Introduction

The focus of this chapter is on future general fund expenditures. Past appropriations rather than expenditures are used for background, since the appropriation data are readily available in a form useful for analysis. The use of appropriations rather than expenditures does not hamper the study since the concepts are similar.

Expenditures or appropriations are divided into the same two overall categories as revenues--the general fund and special funds. In the 1974-76 biennium, general fund appropriations represent slightly less than half of the total appropriations. However, outlays from the general fund are a sole or primary source of support for numerous state activities (e.g., education, public welfare, mental health, and public health). Moreover, as already explained, much of the revenue for special fund outlays comes from federal categorical grants-in-aid, the sale of services or commodities by the state, and state taxes earmarked for highways and employment security. Therefore, the emphasis of most of the legislative appropriations process is on general fund expenditures and revenues.

In the first section of this chapter, we analyze general fund expenditures for recurring operating expenses in a way comparable to the analysis of general fund revenues in Chapter III.^{1/} Projections of general fund expenditures for each of the next three bienniums for programs whose scope (breadth) and quality (depth) remain unchanged are made first. These are designated as baseline projections. In the second section, the total baseline projection of general fund expenditures is compared for each of the bienniums to the estimate of total general fund revenues that assumes no changes in the law. The comparison illustrates any future baseline surplus or deficit or "gap." Legislated changes in specific programs that increase scope and quality and recurring cost are analyzed in the third section. Even though the projections are only for general fund expenditures for recurring operating expenses, future increases in these operating expenses may require additional capital outlays. For example, if future enrollments at state-supported colleges and universities are higher, general fund outlays for operating expenses at these institutions will be expected to increase. At the same time, the additional students may require more capital outlay for classrooms. Projections of capital outlays are discussed in the fourth section. A final section covers the potential for general obligation borrowing.

All expenditure projections are estimates that are solely the work of the staff and are separate from the administrative budget. The cooperating state agencies are not responsible for the projections, and no official endorsement on their part should be implied. The projections are at the level of the major functional categories or specific programs in a functional category as listed in the 1974-76 budget.

^{1/} Explanations of specific concepts and methodologies follow in the appropriate sections.

The projections are as valid as the assumptions used to make them, and although all assumptions are considered reasonable, they will be subject to the actual play of events. The 1976-78 projections are likely to be closer to the mark than the 1980-82 projections; nevertheless, the long-term projections at least illustrate future trends in expenditures.

Baseline Projections of General
Fund Expenditures for Recurring Operating Expenses

Methodology

The baseline methodology involves three factors. For a projection base it utilizes the expenditures required to provide a given level of public services at one period in time. It then evaluates the effect that changes in population and prices have on the expenditures required to maintain over time the base period level of services. Projections of population change provide the basis for anticipating the variation in expenditures required to maintain a constant level of public services per eligible recipient at constant prices. Projections of price trends, combined with the estimated change in population, provide an estimate of the change in expenditures required for a constant real level of public services per capita at anticipated prices. In effect, provision of the base period level of public services is continued into the future with adjustments in the required expenditures only for population and price changes.^{1/} As part of the method, no changes are assumed in the scope and quality of services unless already written into law.

A simple example illustrates how the methodology works. Assume that in

^{1/} For more on the technique, see Lawrence R. Regan and George P. Roniger, "The Outlook for State and Local Finances," Fiscal Issues in the Future of Federalism, CED Supplementary Paper No. 23 (New York: Committee for Economic Development, 1968), p.236.

year 1 the expenditures required to maintain a desired level of public services are \$100 million, and that we want to know what the same level of services will cost in year 2. The population that benefits from the services is expected to increase by 2 percent from year 1 to year 2, and the price of the services is expected to increase by 5 percent from year 1 to year 2. We multiply the expenditures of year 1 by the population ratio ($\frac{102}{100}$) and the price ratio ($\frac{105}{100}$) to find the appropriations required to provide the base period level of services in year 2:

$$(\$100 \text{ million} \times 1.02 \times 1.05 = \$107.1 \text{ million})$$

Application of the Methodology

Programs with operating expenses financed out of the general fund for fiscal year 1975-76 provide the level of public services for the base year. The programs incorporate all past changes in scope and quality, and they are kept free of any such future changes unless already provided for by law (in effect, a change in scope and quality made in the past). The programs, therefore, provide the base level of public services whose cost we want to estimate for each of the fiscal years in the next three bienniums. The actual projection base is the 1975-76 general fund appropriations for operating expenses, which are given by major functional category or specific program in a functional category and are adjusted for any changes presently planned for the future. All appropriations are taken from the Appropriations Act approved April 8, 1974, and the Supplemental Appropriations Act approved March 24, 1975, unless noted otherwise in Table 4.1.

For the population ratio, hereafter called the population-workload ratio, the functional categories are divided into two types. For those categories that consume a relatively large share of the general fund and/or provide

services for a specific group, population-workload projections for that group are used. These have been provided by the agencies that administer the programs. For example, the projected annual rates of change of average daily membership from fiscal year 1975-76 to fiscal year 1981-82 are used for the population-workload ratio for the Basic School Aid Fund administered by the State Department of Education. For those categories with programs that consume a relatively small share of the general fund and/or are administrative in nature, we are less specific and assume that the programs benefit the entire state population. The projected average annual rate of increase from fiscal year 1975-76 to fiscal year 1981-82 for total population is therefore used for the population-workload ratio for such categories as resource and economic development and general administration.

For the price ratio, we use the projected annual rates of increase from fiscal year 1975-76 to fiscal year 1981-82 of the price index that relates most closely to the programs in the functional category. The price indexes are the implicit price deflator for state and local government purchases of goods and services (state and local implicit price deflator), the consumer price index (CPI), and the medical services portion of the consumer price index. For example, the medical services portion of the consumer price index is used for the mental health, public health, and medicaid categories. These projected price indexes are based on the same assumed annual rates of increase in the implicit price deflator for gross national product that were used in making the revenue projections in Chapter III.

Table 4.1 summarizes the application of the methodology to the general fund. It shows for each functional category or specific program(s) the projection base, the population, and the price index used.

TABLE 4.1--SUMMARY OF THE APPLICATION OF THE BASELINE METHODOLOGY TO GENERAL FUND EXPENDITURES

Category	Projection Base (1975-76 Appropriations)	Population Whose Projected Annual Rates of Increase are the Basis for the Population-Workload Ratio	Price Index Whose Projected Annual Rates of Increase are the Basis for the Price Ratio
Elementary-secondary education			
Virginia Schools for the Deaf and Blind	\$ 4,311,540	Program caseload	State and local implicit price deflator
Basic School Aid Fund:			
Basic appropriation	329,295,060	Average daily membership	State and local implicit price deflator
Compensatory education	9,293,400	Fifth and sixth grade enrollment	State and local implicit price deflator
Maximum local increase	1,159,605	Derived from basic school appropriation	
No loss provision	9,137,650	Derived from basic school appropriation	
Special education	25,990,385	Special education enrollment	State and local implicit price deflator
Gifted and talented	1,440,000	37% of average daily membership	State and local implicit price deflator
Vocational education	16,812,635	Vocational education enrollment	State and local implicit price deflator
Teacher education - staff improvement	1,609,500	Enrollment	State and local implicit price deflator
General adult education	623,500	Total population over 20 years of age	State and local implicit price deflator
Incentive grants	8,285,900	Average daily membership	State and local implicit price deflator
(Subtotal)	\$ (403,647,635)		
Shared Revenue Sales Tax	129,900,000	One-third of projected sales and use tax revenue	State and local implicit price deflator
Other education	101,932,930	Enrollment	State and local implicit price deflator
Subtotal	\$ 639,792,105		
Higher education			
Four-year institutions	\$ 197,866,570	Full-time equivalent enrollment	State and local implicit price deflator
Community colleges	54,294,245	Full-time equivalent enrollment	State and local implicit price deflator
Other	22,858,275	Constant percentage of the other 1975-76 appropriations	
Subtotal	\$ 275,019,090		
Other education and culture	\$ 5,333,210	Total population	State and local implicit price deflator
Mental health	\$ 77,269,600	Program caseload	Medical services portion of the CPI
Public health	\$ 36,355,735	Total population ^{a/}	Medical services portion of the CPI
Medicaid	\$ 82,197,850	Program caseload	Medical services portion of the CPI
Public welfare			
Auxiliary grants to the aged, permanently and totally disabled, and blind	\$ 2,084,920 ^{b/}	Program recipients	CPI
Aid to dependent children	52,195,700	Program recipients	CPI
Work incentive program and day care services	1,500,000	Program recipients	State and local implicit price deflator
Three major state programs (General Relief, Foster Care for Children, and Hospitaliza- tion of the Indigent)	13,775,200	Program recipients	CPI and medical services portion of the CPI
Administration of public assistance and services	11,140,180	Program caseload	State and local implicit price deflator
Other	5,359,100	Total population and relevant program recipients	CPI and state and local implicit price deflator
Subtotal	\$ 86,055,100		
Vocational rehabilitation			
Administered by the Department of Vocational Rehabilitation	\$ 4,001,755	Total population ^{c/}	State and local implicit price deflator
Administered by the Commission for the Visually Handicapped	366,015	Program recipients	State and local implicit price deflator
Subtotal	\$ 4,367,770		

TABLE 4.1--SUMMARY OF THE APPLICATION OF THE BASELINE METHODOLOGY TO GENERAL FUND EXPENDITURES

Administration of justice	\$ 128,386,370	Total population	State and local implicit price deflator
Resources and economic development	\$ 34,547,225	Total population	State and local implicit price deflator
General administration	\$ 38,588,575	Total population	State and local implicit price deflator
Legislative	\$ 7,031,035	Total population	State and local implicit price deflator
Transportation	\$ 3,574,370	Total population	State and local implicit price deflator
Unallocated by function			
Employee benefits	\$ 42,595,635	Total population	State and local implicit price deflator
State aid to localities-share revenues	21,100,000	Projected in Chapter III	
Debt service	8,195,400	Projected by the Department of the Treasury	
Other	42,152,585	Total population	State and local implicit price deflator
Subtotal	\$ 114,043,620		
Total general fund operating expenses	\$1,532,561,655		

a/ Even though some of the Health Department programs provide services to specific groups, the more reasonable basis for the population-workload ratio is the annual growth rate of total population.

b/ Old age assistance, aid to the blind, and aid to the permanently and totally disabled programs were terminated January 1, 1974. In accordance with Federal requirements and provisions of Chapter 264, Acts of Assembly of 1973 auxiliary grants are required for recipients who were on the rolls in December, 1973, so their income would not be reduced after January 1, 1974; this assures maintenance of a minimum standard of living.

c/ Even though some programs of the Department of Vocational Rehabilitation provide services to a specific group, the most reasonable basis for the population-workload ratio is the annual growth rate of total population.

Projected General Fund Expenditures

Tables 4.3 to 4.19 show the projected general fund expenditures by major functional category. The projected expenditures are given on a biennial basis and are compared with the actual appropriations for the present biennium and the previous six. Appropriations are utilized for the historical comparison because the functional categorization was changed for the 1970-72 biennium, and because expenditure data grouped in this fashion are not readily available. For all functional categories the change in the total amount from the preceding biennium is given in dollar and percentage terms. The actual appropriations from the 1962-64 to the 1974-76 biennium account for increases in population-workload, prices, and scope and quality, while the projected expenditures account only for the first two factors. Appropriations in the period beginning July 1, 1966, grew rapidly in nearly all functional categories. The primary reasons were significant program changes which expanded the scope and quality of the services provided by the state. Therefore, in most cases the actual appropriations display a more rapid rate of growth than the projected expenditures.

The programs or agencies placed under each functional category are provided. The annual rate of change for specific population-workloads, provided by the relevant agencies, are also given. Table 2.1 provides the data for categories with population-workload ratios based on the projected annual rate of change for total population. The projected price index changes developed by the staff appear below in Table 4.2.

TABLE 4.2--PROJECTED ANNUAL RATE OF CHANGE FOR SELECTED PRICE INDEXES

Fiscal Year	Annual Rate of Change (Percent)				
	Implicit Price Deflator	Implicit Price Deflator For State and Local Govt. Purchases of Goods and Services	Implicit Price Deflator For All Government Purchases of Buildings Except Military	Consumer Price Index	Medical Services Portion of the Consumer Price Index
1976-77	+7.0	+7.8	+11.4	+7.7	+7.1
1977-78	+6.2	+6.9	+10.0	+6.4	+6.3
1978-79	+5.4	+6.0	+ 8.7	+5.7	+5.5
1979-80	+5.0	+5.6	+ 8.1	+5.1	+5.1
1980-81	+4.8	+5.4	+ 7.7	+4.8	+4.9
1981-82	+4.6	+5.1	+ 7.5	+4.8	+4.6

Source: Appendix Table A.6.

Elementary-Secondary Education

TABLE 4.3.--ELEMENTARY-SECONDARY EDUCATION, ACTUAL APPROPRIATIONS, 1962-64 TO 1974-76, AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$ 280,645,293	\$ ...	...
1964-66	327,200,480	+46,555,187	+16.6
1966-68	519,817,355	+192,616,875	+58.9
1968-70	686,913,870	+167,096,515	+32.1
1970-72	825,392,410	+138,478,540	+20.2
1972-74	1,004,948,335	+179,555,925	+21.8
1974-76	1,236,341,690	+231,393,355	+23.0
Projected expenditures			
1976-78	1,475,697,000	+239,355,310	+19.4
1978-80	1,621,439,000	+145,742,000	+9.9
1980-82	1,772,771,000	+151,332,000	+9.3

Programs or agencies in this functional category include the Virginia Public Telecommunications Council, the Virginia School for the Deaf and Blind, the Virginia School at Hampton, and the Department of Education. The largest of the individual appropriations under this category are the basic school aid fund and the distribution to localities of one-third of the state's sales and use tax collections. Projections for these items are discussed below.

The Basic School Aid Fund

The large increase in elementary and secondary education appropriations for the 1974-76 biennium was primarily due to the new standards of quality program. Under this program, the basic school aid fund now consists of a basic appropriation for regular day school activities plus an additional allotment for compensatory education, special education, vocational education, education of the gifted and talented, teacher education and staff improvement, general adult education, and incentive grants. The fund also includes monies for drivers' education,

sick leave with pay for teachers, and for maintaining libraries and other teaching materials in public schools which had previously been funded as separate categorical items.

The basic appropriation which each school division receives from the fund is calculated by multiplying its average daily membership by the standards of quality cost per student. The sales tax returned to the division on the basis of school age population for the calendar year preceding the fiscal year is then deducted and the remaining amount is multiplied by a local index of fiscal capacity (derived from true values of real estate, personal income, and taxable retail sales) to determine the state and local share. The following example illustrates the method of distribution for 1974-75:

County	1974-75 ADM	Column 2 x \$687	1974 Sales Tax Returned	Col. 3 less Col. 4	Index	Required Local Share Col. 4 x Col. 6	Basic State Share Col. 5 less Col. 7
1	2	3	4	5	6	7	8
Accomack	6,171	\$4,239,477	\$717,800	\$3,521,677	.41	\$1,443,888	\$2,077,789

In calculating the basic grant above, it is further provided that no locality shall be required to raise its total operations expenditures for education beyond a certain limit. For 1975-76, this limit is 7 percent plus one-half the difference between 7 percent and the total percentage increase in operation expenditures as required by the formula. In addition, to protect localities from sudden changes in state funding, the basic appropriation also carries a no loss provision. This provision assures localities that unless they experience a loss in average daily membership, their share of state funds under this appropriation will not be reduced below the amounts they received in 1973-74 from the basic school aid fund, the supplemental fund, and the categorical grants for drivers' education, teachers' sick leave, and maintaining libraries and other teaching materials. For 1975-76, an additional appropriation of \$9.1 million was made for this assurance.

Projections of the basic appropriation, including the maximum local increase provision and the no loss provision, are made by substituting projected ADM

and projected program costs per pupil into the basic school aid formula. The projections for average daily membership are based on enrollment projections supplied by the Department of Education and assume that the relationship between a average daily membership and enrollment will remain constant over the projection period. Future program costs, on the other hand, are derived by increasing the 1975-76 standards of quality amount (\$730 per pupil in ADM) by the projected increases in the implicit price deflator for state and local government purchases of goods and services. Figures for the sales tax distribution necessary to run the formula are estimated from fiscal year payments projected under shared revenues elsewhere in this chapter and the total amount is distributed to localities according to each division's percentage share of the 1974 collections returned under this item. Other assumptions with respect to this calculation allow for no change in the composition of the local composite index over future years and require that each locality operate at the prescribed standards of quality cost. This may, or may not, be the case since some localities may meet the standards of quality by spending a lesser amount per pupil.^{1/}

As for the other items making up the basic school aid fund, these are projected on the basis of specific price and population factors as shown in Table 4.1. The future amounts for these items are then added to the projections of the basic appropriation above to arrive at a total program projection for the basic school

^{1/} Localities may legally claim a lesser amount of state funding than appropriated by the basic formula if they determine that they can meet the requirements of the standards of quality by spending a lesser amount per pupil. Since the auditing of this provision will take place after the close of the fiscal year, appropriations must be made as if all divisions will operate at the standards of quality cost as prescribed by the state.

aid fund. Using this technique, the total projected appropriations for the basic school aid fund are as follows:

1. Basic School Aid Fund

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1974-76	\$780,677,760	\$ ...	...
Projected appropriations			
1976-78	892,489,000	+111,811,240	+14.3
1978-80	934,007,000	+41,518,000	+4.7
1980-82	968,666,000	+34,659,000	+3.7

Shared Revenue (Sales and Use Tax)

The Virginia Retail Sales and Use Tax Act authorizes the distribution of the proceeds of a one cent tax to be distributed to localities for educational purposes on the basis of school age population. The projected amounts for this distribution, shown below, are calculated by taking one-third of the state's three cent tax projected in Chapter III. These funds will be collected by the State Comptroller and distributed to localities upon census figures furnished by the Department of Education.

2. Shared Revenue (Sales and Use Tax)

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1974-76	\$247,900,000	\$ ...	...
Projected appropriations			
1976-78	346,367,000	+98,467,000	+39.7
1978-80	429,967,000	+83,600,000	+24.1
1980-82	528,700,000	+98,733,000	+23.0

Other Elementary - Secondary Education

Other appropriations for elementary - secondary education (primarily for state administration and contributions for teacher fringe benefits) are projected on the basis of anticipated changes in the implicit price deflator for state and local government purchases of goods and services and enrollment. The level of enrollment used in these projections is expected to increase in the near future as the result of the start up of kindergarten and because of the earlier age requirements now permitted for students to enter the first grade. After 1976-77, however, total enrollment is expected to decline, reflecting the drop in the number of births which occurred in the early part of the 1970's. The projected declines in enrollment for more distant years contribute to the slower growth of elementary - secondary education appropriations after the 1976-78 biennium.

Higher Education

TABLE 4.4--HIGHER EDUCATION, ACTUAL APPROPRIATIONS
1962-64 TO 1974-76, AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$ 69,749,766	\$ ...	...
1964-66	80,395,135	+10,645,369	+15.3
1966-68	131,337,775	+50,942,640	+63.4
1968-70	202,894,180	+71,556,405	+54.5
1970-72	279,746,730	+76,852,550	+37.9
1972-74	384,420,580	+104,649,850	+37.4
1974-76	514,767,790	+130,347,210	+33.9
Projected expenditures			
1976-78	659,192,000	+144,424,210	+28.1
1978-80	790,776,000	+131,584,000	+20.0
1980-82	905,860,000	+115,084,000	+14.6

Programs or agencies in functional category include Virginia's four-year colleges and universities, the community college system, the Executive Office (interstate compacts only), the State Board of Health (nurse and dental hygienist

scholarships, and the MCV Hospital health services fund), the State Education Assistance Authority, the State Council on Higher Education for Virginia, the Department of Education (law enforcement scholarships), regional education and scholarships, Norfolk Area Medical Center Authority, and supplementary aid for higher education.

The primary reason for the large increase in outlays in the 1966-68 biennium was the creation of the community college system. Expansion of the system and other institutions caused large increases in the following four bienniums.

The projected expenditures for four-year institutions and community colleges are as follows:

1. Four-Year Institutions

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1974-76	\$373,788,930	\$ ...	...
Projected expenditures			
1976-78	466,111,000	+92,322,070	+24.7
1978-80	549,055,000	+82,944,000	+17.8
1980-82	622,951,000	+73,896,000	+13.5

2. Community Colleges

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1974-76	\$ 99,294,710	\$ ...	...
Projected expenditures			
1976-78	138,368,000	+39,073,290	+39.4
1978-80	176,087,000	+37,719,000	+27.3
1980-82	207,723,000	+31,636,000	+18.0

The full-time equivalent enrollment expected in fiscal year 1975-76 is 95,586 for senior institutions and 44,202 for community colleges. The projected annual rates of increase of enrollment in four-year institutions and community colleges are as follows:

<u>Fiscal Year</u>	<u>Percent Change from Previous Year</u>	
	<u>Four-Year Institutions</u>	<u>Community Colleges</u>
1975-76	+3.9	+10.0
1976-77	+3.2	+7.5
1977-78	+2.1	+6.1
1978-79	+1.8	+5.7
1979-80	+1.1	+3.3
1980-81	+0.4	+0.3

Enrollment projections are based upon the latest preliminary information available from the State Council of Higher Education as of the time of this writing. These figures make the assumption that after 1976 the rate of college attendance will rise, but at a decreasing rate; that tuition fees, and financial aid to students, will not undergo a marked change; and that Virginia's secondary schools will not reach national parity in holding power before the early 1980's. If these restrictions are overcome, then enrollments will run slightly ahead of the projected figures. This would also be true if a greater than anticipated number of students should choose to attend public rather than private institutions.

Other Education and Cultural

TABLE 4.5--OTHER EDUCATION AND CULTURAL, ACTUAL
APPROPRIATIONS, 1962-64 TO 1974-76
AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$ 2,240,020	\$ ...	...
1964-66	2,372,890	+132,870	+5.9
1966-68	3,333,370	+960,480	+40.5
1968-70	4,590,190	+1,256,820	+37.7
1970-72	5,652,590	+1,062,400	+23.1
1972-74	8,017,700	+2,005,110	+35.5
1974-76	10,314,300	+2,296,600	+28.6
Projected expenditures			
1976-78	12,131,000	+1,816,700	+17.6
1978-80	14,016,000	+1,885,000	+15.5
1980-82	15,946,000	+1,930,000	+13.8

Programs or agencies in the functional category include the Virginia State Library, the Virginia Museum of Fine Arts, the Science Museum of Virginia, the Virginia Commission of the Arts and Humanities, and state participation in regional and national programs (includes Southern Regional Education Board and Compact on Education).

Mental Health

TABLE 4.6--MENTAL HEALTH, ACTUAL APPROPRIATIONS,
1962-64 TO 1974-76, AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$ 46,721,835	\$ ...	...
1964-66	50,674,850	+3,953,015	+8.5
1966-68	66,116,860	+15,442,010	+30.5
1968-70	84,729,935	+18,613,075	+28.1
1970-72	110,848,930	+26,118,995	+30.8
1972-74	117,749,150	+6,900,220	+6.2
1974-76	150,271,780	+32,522,630	+27.6
Projected expenditures			
1976-78	159,765,000	+9,493,220	+6.3
1978-80	174,756,000	+14,991,000	+9.4
1980-82	192,199,000	+17,443,000	+10.0

Programs or agencies in the functional category include the Department of Mental Health and Mental Retardation, the State Mental Health and Mental Retardation Board, the Virginia Treatment Center for Children, the Central State Hospital, the Petersburg Training School, the Eastern State Hospital, the Southwestern State Hospital, the Western State Hospital, the Northern Virginia Mental Health Institute, the Piedmont State Hospital, the Catawba Hospital, the DeJarnette Center for Human Development, the Lynchburg Training School and Hospital, the Northern Virginia Center for the Mentally Retarded, the Southeastern Virginia Center for the Mentally Retarded, the Southwestern Virginia Center for the Mentally Retarded, the Danville Area Regional Mental Hospital, and the Virginia Developmental Disabilities Planning and Advisory Council.

The decline in the projected rate of expenditures reflects efforts of the Department of Mental Health and Mental Retardation to reduce the population level, thereby increasing the employee/patient ratio to a level which will earn the approval of the National Joint Commission on Accreditation of Hospitals. Therefore, the slower growth rate does not represent a cutback in the program; instead it sets the stage for a significant increase in scope and quality.

The total population projected by the Department of Mental Health and Mental Retardation for 1975-76 is approximately 11,340 and is estimated to decline through 1977-78 at approximately 4 percent per year. After 1978 total population is projected to remain relatively stable at 10,450 persons through 1982.

Public Health

TABLE 4.7--PUBLIC HEALTH, ACTUAL APPROPRIATIONS,
1962-64 TO 1974-76, AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$ 21,860,105	\$ ...	...
1964-66	23,611,645	+1,751,540	+8.0
1966-68	32,132,590	+8,520,945	+36.1
1968-70	40,353,040	+8,220,450	+25.6
1970-72	55,203,330	+14,850,290	+36.8
1972-74	60,067,610	+4,864,280	+8.8
1974-76	71,220,915	+11,153,305	+18.6
Projected expenditures			
1976-78	81,916,000	+10,695,085	+15.0
1978-80	93,719,000	+11,803,000	+14.4
1980-82	105,610,000	+11,891,000	+12.7

Programs or agencies in the functional category include the Department of Health, the State Board of Health (except Medicaid, nurse and dental hygienist scholarships and the M.C.V. Hospital Health Services Funds), the Blue Ridge Sanatorium, and the Division of Consolidated Laboratory Services (for public health activities only).

The increase in the 1966-68 biennium was caused by the expansion of the local health services program.

Medicaid

TABLE 4.8--MEDICAID, ACTUAL APPROPRIATIONS,
1962-64 TO 1974-76, AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$ ...	\$ ...	...
1964-66	...	...	...
1966-68	...	...	...
1968-70	20,226,205	+20,226,205	...
1970-72	57,504,670	+37,278,465	+184.3
1972-74	110,890,685	+53,386,015	+92.8
1974-76	150,059,095	+39,168,410	+35.3
Projected expenditures			
1976-78	198,638,000	+48,578,905	+32.4
1978-80	248,582,000	+49,944,000	+25.1
1980-82	307,163,000	+58,581,000	+23.6

Medicaid, a relatively new program, reflects high but rapidly decreasing historical and projected growth rates.

In 1970-71, the average number of public assistance and medically indigent persons eligible for services totalled 196,300; in 1971-72, 250,800; and, in 1972-73, 270,025. Estimates of the number of recipients in the 1974-76 biennium reflect the new Federal Supplemental Security Income (SSI) Program regulations as they relate to Medicaid for SSI recipients. Beginning January 1, 1974, all adult public assistance recipients (the aged, the blind, and the disabled) will be transferred to the SSI program. However, they will continue to be eligible for Medicaid. In addition, it is understood that all additional persons found eligible for the SSI program after January 1, 1974, will be eligible for such assistance. It is now estimated that in 1974-75 there will be an average of 302,600 eligible Medicaid recipients, and in 1975-76 319,600 eligible recipients. The number of eligible recipients is expected to increase at an average annual rate of 6.0 percent through 1982.

Public Welfare

TABLE 4.9.--PUBLIC WELFARE, ACTUAL APPROPRIATIONS,
1962-64 TO 1974-76, AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$ 21,648,965	...	...
1964-66	27,400,060	\$ +5,751,095	+26.6
1966-68	33,013,545	+5,613,485	+20.5
1968-70	48,364,760	+15,351,215	+46.5
1970-72	78,211,125	+29,846,365	+61.7
1972-74	142,016,990	+63,805,865	+81.6
1974-76	163,325,930	+21,308,940	+15.0
Projected expenditures			
1976-78	218,359,000	+55,033,070	+33.7
1978-80	274,393,000	+56,034,000	+25.7
1980-82	340,176,000	+65,783,000	+24.0

Programs or agencies in the functional category include the Department of Welfare and Institutions, the Virginia Commission for the Visually Handicapped, the Division of War Veterans Claims, Confederate pensions, the food distribution program under the Board of Agriculture and Commerce, the Home for Needy Confederate Women, and the Virginia Council for the Deaf.

Public welfare outlays, which have experienced extremely rapid growth since the 1968-70 biennium, are expected to grow at a relatively lower rate during the remainder of the projection period. A portion of the immediate slowdown reflected in the 1974-76 biennium was the result of complete federal takeover on January 1, 1974, of three major programs and their administrative burden, old age assistance, aid to the permanently and totally disabled--both of which are administered by the Department of Welfare and Institutions--and aid to the blind, administered by the Virginia Commission for the Visually Handicapped.

Title XX of the Social Security Act, which will become effective October 1, 1975, will have an impact upon public welfare outlays. Although projected caseloads do reflect in part some of the changes inherent in Title XX, specific incidence has not been calculated. The number of recipients is projected to increase for each of the major non-federalized programs as follows:

<u>Fiscal Year</u>	<u>Percent Change</u>			
	<u>General Relief</u>	<u>Foster Care</u>	<u>Aid to Families with Dependent Children^{a/}</u>	<u>Hosp. of the Indigent</u>
1976-77	+1.5	+10.3	+11.0	+1.3
1977-78	-1.3	+10.7	+10.0	+1.3
1978-79	-14.4	+8.4	+5.6	+1.3
1979-80	+1.5	+6.7	+8.3	+1.3
1980-81	+1.6	+8.3	+7.6	+1.2
1981-82	+1.4	+6.7	+3.6	+1.2

a/ Partially federally funded.

By far the largest remaining public welfare program in terms of general fund expenditures is Aid to Families with Dependent Children. At a level of \$98,211,700 this program represents 60.1 percent of the entire 1974-76 public welfare outlay. The specific AFDC projection is presented in the following table:

<u>Aid to Families with Dependent Children</u>			
<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
<u>Actual appropriations</u>			
1974-76	\$ 98,211,700	\$ ...	...
<u>Projected expenditures</u>			
1976-78	135,429,000	+37,217,300	+37.9
1978-80	174,302,000	+38,873,000	+28.7
1980-82	218,227,000	+43,925,000	+25.2

Vocational Rehabilitation

TABLE 4.10--VOCATIONAL REHABILITATION, ACTUAL APPROPRIATIONS,
1962-64 TO 1974-76, AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$ 129,245	\$ ...	...
1964-66	207,405	+78,160	+60.5
1966-68	2,752,160	+2,544,755	+1,227.0
1968-70	4,097,525	+1,345,365	+48.9
1970-72	5,787,635	+1,690,110	+41.2
1972-74	6,872,380	+1,084,745	+18.7
1974-76	8,535,300	+1,662,920	+24.2
Projected expenditures			
1976-78	9,972,000	+1,436,700	+16.8
1978-80	11,573,000	+1,601,000	+16.1
1980-82	13,209,000	+1,636,000	+14.1

Programs or agencies in the functional category include the Department of Vocational Rehabilitation, the Virginia Commission for the Visually Handicapped, and the Virginia Rehabilitation Center for the Blind. The Department of Vocational Rehabilitation was not established as a separate entity until 1966-68 biennium. Most outlays that would have been made by the department prior to the biennium were made by the Department of Education and came under the elementary-secondary education category. Only small outlays for vocational rehabilitation made by the Commission for the Visually Handicapped came under this category prior to the 1966-68 biennium. Therefore, the cause for the large increase from 1964-66 to the 1966-68 biennium was primarily a change in administration, not a change in scope and quality. The projected annual rates of increase of the case-load for the appropriations administered by the Commission for the Visually Handicapped are those programs and administrative costs exclusive of those programs and administrative costs associated with public welfare.

Administration of Justice

TABLE 4.11.--ADMINISTRATION OF JUSTICE, ACTUAL APPROPRIATIONS, 1962-64 TO 1974-76, AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$ 36,545,785	\$ ...	...
1964-66	39,225,935	2,680,150	+7.3
1966-68	67,879,485	28,653,550	+73.0
1968-70	90,543,675	22,664,190	+33.4
1970-72	120,155,455	29,611,780	+32.7
1972-74	157,940,450	36,896,995	+30.7
1974-76	242,796,645	84,856,195	+53.7
Projected expenditures			
1976-78	292,022,000	49,225,355	+20.3
1978-80	337,414,000	45,392,000	+15.5
1980-82	383,859,000	46,445,000	+13.8

Programs or agencies in the functional category include the Supreme, Circuit, and District Courts, magistrate system, judicial retirement system, Judicial Council and judicial conferences, Public Defender Commission, Department of Law (for the Attorney General), Division of Justice and Crime Prevention, Compensation Board (for state share of salaries and expenses of local commonwealth attorneys, and state share of salaries and expenses of local sheriffs and sergeants) Virginia State Crime Commission, Law Enforcement Officers Training Standards Commission, Department of State Police, Division of Consolidated Laboratory Services (for administration of justice activities only), Department of Welfare and Institutions (for correctional institutions and activities only), Rehabilitative School Authority, Department of Accounts (for payments to beneficiaries of law enforcement officers pursuant to the Line of Duty Act), and judges and justices recalled to active duty.

Beginning in the 1966-68 biennium, the operating expenses of the Department of State Police were paid from the general fund rather than from special funds. This change represented an expansion of general fund activities.

Resource and Economic Development

TABLE 4.12.--RESOURCES AND ECONOMIC DEVELOPMENT, ACTUAL APPROPRIATIONS, 1962-64 TO 1974-76, AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$...	\$ 3,543,010	+18.0
1964-66	23,259,730	+8,219,949	+35.3
1966-68	31,479,679	+6,987,531	+22.2
1968-70	38,467,210	+7,423,395	+19.3
1970-72	45,890,605	+11,768,490	+25.6
1972-74	57,910,310	+11,565,375	+20.0
1974-76	69,475,685		
Projected expenditures			
1976-78	78,579,000	+9,103,315	+13.1
1978-80	90,794,000	+12,215,000	+15.5
1980-82	103,292,000	+12,498,000	+13.8

Programs or agencies in the functional category include the Division of Industrial Development, the State Corporation Commission, the Department of Labor and Industry, the Department of Agriculture and Commerce, the Virginia Soil and Water Conservation Commission, the Department of Conservation and Economic Development, Virginia Historic Landmarks Commission, the Virginia Historical Society, other historical museums, other historical foundations and memorial commissions, the Commission of Outdoor Recreation, the Board of Regents of Gunston Hall, the State Water Control Board, the State Air Pollution Control Board, the Breaks Interstate Park Commission, other river and park commissions, the Marine Resources Commission, other fisheries commissions, the Virginia Institute of Marine Sciences, the Commission on Solid Wastes, the Virginia Independence Bicentennial Commission, the Department of Community Colleges (for special programs only), Division of Consolidated Laboratory Services (for resource and economic development activities only), specific examination and registration boards associated with the Department of Professional and Occupational Registration, and miscellaneous activities.

General Administration

TABLE 4.13.--GENERAL ADMINISTRATION, ACTUAL APPROPRIATIONS,
1962-64 TO 1974-76, AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$ 18,723,525	\$ ...	...
1964-66	20,702,400	+1,978,875	+10.6
1966-68	29,589,135	+8,886,735	+42.9
1968-70	38,859,365	+9,270,230	+31.3
1970-72	49,157,080	+10,297,715	+26.5
1972-74	59,956,495	+10,687,915	+21.7
1974-76	74,197,690	+14,241,195	+23.7
Projected expenditures			
1976-78	87,772,000	+13,574,310	+18.3
1978-80	101,415,000	+13,643,000	+15.5
1980-82	115,375,000	+13,960,000	+13.8

Programs or agencies in the functional category include the Executive Office, the Division of the Budget, the Division of Engineering and Buildings, the Division of Automated Data Processing, Division of Personnel, the Division of State Planning and Community Affairs, the State Board of Elections, the State Office of Emergency Services, the Division of Drug Abuse Control, the Council on the Environment, the Virginia Commission for Children and Youth, the Art Commission, the Department of the Treasury, the Department of Accounts (for recording financial transactions of the state, collecting old claims, reissuing of old warrants, paying clerks of court for state revenue collection, and paying premiums on bonds of county officers), the Compensation Board (for regulating compensation of fee and salaried officers, the state share of salaries and expenses of local commissioners of the revenue, and the state share of salaries and expenses of local treasurers), the Department of Purchases and Supply, the Department of Taxation, the Commission on the Status of Women, and the Southern Growth Policies Board.

Legislative

TABLE 4.14.--LEGISLATIVE, ACTUAL APPROPRIATIONS,
1962-64 TO 1974-76, AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$2,365,180	\$ ...	...
1964-66	2,432,835	+67,665	+2.9
1966-68	2,984,955	+552,120	+22.7
1968-70	3,702,010	+717,055	+24.0
1970-72	5,348,850	+1,646,840	+44.5
1972-74	7,122,220	+1,793,370	+33.5
1974-76	13,477,075	+6,354,855	+89.2
Projected expenditures			
1976-78	15,992,000	+2,514,925	+18.7
1978-80	18,478,000	+2,486,000	+15.5
1980-82	21,022,000	+2,544,000	+13.8

Programs or agencies in the functional category include the General Assembly of Virginia, the Division of Legislative Services, the Virginia Advisory Legislative Council, the Virginia Code Commission, the Virginia Commission on Interstate Cooperation, the Commission on Veterans Affairs, the Joint Legislative Audit and Review Commission, the Department of Law (for Commissioners for the Promotion of Uniformity of Legislation in the United States only), the Auditor of Public Accounts, and the Office of the Lieutenant Governor.

Transportation

TABLE 4.15.--TRANSPORTATION, ACTUAL APPROPRIATIONS,
1962-64 TO 1974-76, AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$ 2,821,940	\$ ...	...
1964-66	2,863,510	+41,570	+1.5
1966-68	4,156,010	+1,292,500	+45.1
1968-70	4,244,620	+88,610	+2.1
1970-72	8,146,615	+3,901,995	+92.0
1972-74	8,578,770	+432,155	+5.3
1974-76	7,164,510	-1,414,260	-16.5
Projected expenditures			
1976-78	8,130,000	+965,490	+13.5
1978-80	9,394,000	+1,264,000	+15.5
1980-82	10,687,000	+1,293,000	+13.8

Programs or agencies in the functional category include the Washington Metropolitan Area Transit Commission, the Virginia Airports Authority, and the Virginia Ports Authority.

Employee Benefits (Unallocated by Function)

TABLE 4.16.--EMPLOYEE BENEFITS (UNALLOCATED BY FUNCTION), ACTUAL APPROPRIATIONS,
1962-64 TO 1974-76 AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$ 11,588,835	\$ ...	...
1964-66	12,701,385	+1,112,550	+9.6
1966-68	23,443,890	+10,742,505	+84.6
1968-70	28,002,255	+4,558,365	+19.4
1970-72	32,843,380	+4,841,125	+17.3
1972-74	62,211,655	+29,368,275	+89.4
1974-76	80,851,175	+18,639,520	+30.0
Projected expenditures			
1976-78	96,886,000	+16,034,825	+19.8
1978-80	111,946,000	+15,060,000	+15.5
1980-82	127,356,000	+15,410,000	+13.8

This category includes the state share of payment for supplemental retirement, social security, group life insurance for state employees and local special employees, employee hospital - medical insurance, and unemployment compensation benefits.

The large increase in the 1972-74 biennium was due primarily to base and rate changes in social security, significantly increasing the level of the state share, and also provision of the Blue Cross-Blue Shield health plan for employees.

State Aid to Localities - Shared Revenues (Unallocated by Function)

TABLE 4.17.--STATE AID TO LOCALITIES - SHARED REVENUES (UNALLOCATED BY FUNCTION), ACTUAL APPROPRIATIONS, 1962-64 TO 1974-76, AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$ ...	\$ ...	...
1964-66	...	...	...
1966-68	25,140,000	+25,140,000	...
1968-70	25,890,000	+750,000	+3.0
1970-72	28,476,000	+2,586,000	+10.0
1972-74	33,600,000	+5,124,000	+18.0
1974-76	41,100,000	+7,500,000	+22.3
Projected expenditures			
1976-78	57,082,000	+15,982,000	+38.9
1978-80	44,267,000	-12,815,000	-22.4
1980-82	46,820,000	+2,553,000	+5.8

State aid to localities in the form of shared revenues comes from A.B.C. profits and the wine and spirits tax. Funds are distributed to localities for general purposes on the basis of population. An accounting change placed these shared revenues in general funds outlays in the 1966-68 biennium, and they are listed under the Department of Accounts in the Appropriations Act. The projected expenditures are the estimated distributions for each biennium.

The proceeds from 1 percentage point of the sales and use tax are also shared with the localities. Because these revenues are earmarked for education, they are listed under elementary - secondary education.

The projected increase in expenditures for the 1976-78 biennium is a result of a change in the manner in which A.B.C. profits will be distributed in the future. Through the fiscal year 1975-76, after the first \$750,000, two-thirds of the A.B.C. profits during the year will be distributed to localities sixty days after the close of the fiscal year. After 1976, two-thirds of the A.B.C. profits, after the first \$187,500 a quarter, will be distributed to localities 10 days after the close of the quarter. With the change to the quarterly payment system, localities will receive in the fiscal year 1976-77 their full 1976 share of profits and, in addition, three quarterly payments in 1977.

Debt Service (Unallocated by Function)

TABLE 4.18.--DEBT SERVICE (UNALLOCATED BY FUNCTION), ACTUAL APPROPRIATIONS, 1962-64 TO 1974-76, AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$ 1,730,000	\$ ...	...
1964-66	225,000	-1,505,000	-87.0
1966-68	130,000	-95,000	-42.2
1968-70	5,000	-125,000	-96.1
1970-72	18,716,600	+18,711,600	+3,742.3
1972-74	17,794,400	-922,200	-4.9
1974-76	16,657,600	-1,136,800	-6.4
Projected expenditures			
1976-78	15,608,000	-1,049,600	-6.3
1978-80	14,564,000	-1,044,000	-6.7
1980-82	13,502,000	-1,062,000	-7.3

General obligation bonds in the amount of \$81,000,000 were issued during the 1968-70 biennium. As a result, debt service on general obligation bonds rose considerably. (Debt service meets the repayment requirements on the principal and the interest on the outstanding portion.)

Other (Unallocated by Function)

TABLE 4.19.--OTHER (UNALLOCATED BY FUNCTION), ACTUAL APPROPRIATIONS, 1962-64 TO 1974-76, AND PROJECTED EXPENDITURES, 1976-78 TO 1980-82

<u>Biennium</u>	<u>Amount</u>	<u>Change from Preceding Biennium</u>	
		<u>Amount</u>	<u>Percent</u>
Actual appropriations			
1962-64	\$ 2,439,395	\$ ...	...
1964-66	8,962,500	+6,523,105	+267.4
1966-68	4,544,885	-4,417,615	-49.3
1968-70	15,948,320	+11,403,435	+250.9
1970-72	25,508,170	+9,559,850	+60.0
1972-74	32,940,445	+7,710,245	+30.2
1974-76	65,614,270	+32,673,825	+99.2
Projected expenditures			
1976-78	95,878,000	+30,263,730	+46.1
1978-80	110,782,000	+14,904,000	+15.5
1980-82	126,031,000	+15,249,000	+13.8

The programs or agencies in the category include the Department of Military Affairs, the Civil Air Patrol, central appropriations to the Governor (for adjusting base rates of pay and overtime, and for adjusting salaries of agency heads and judiciary), supplementing appropriations to state agencies, and local service charges.

Of the 99.2 percent increase in appropriations for the 1974-76 biennium, approximately 56 percent (\$18.2 million) was for effecting 1974-75 and 1975-76 salary scale adjustments for state employees in classified positions and for meeting authorized overtime payments. The remaining increase was attributed to supplementary appropriations to state agencies.

As witnessed by the percent change column in Table 4.19, the programs and agencies in this grouping are subject to widely varying appropriations from biennium to biennium. For this reason, these particular projections should be considered less definitive than those of the other functional categories.

Summary

Table 4.20 summarizes the actual appropriations and the projected expenditures for general fund operating expenses. Through the next three bienniums elementary-secondary education, higher education, public welfare, and administration of justice are expected to account for approximately three-fourths of the operating expenses.

For elementary-secondary education, enrollment is expected to decline slightly throughout the entire projection period. However, even though the number of students will decrease there will be a more than offsetting increase in cost due to the effect of inflation. For this reason total outlays may be expected to rise. In higher education expenditures will increase as enrollment grows in all types of institutions. The rate of growth of enrollment is, however, projected to be lower than in recent years.

Public welfare outlays will increase more gradually than they have in the immediate past. Caseloads in all the major nonfederalized programs are projected to increase and the anticipated effects of Title XX are responsible for increased expenditure projections.

The large increase in the 1976-78 "other" appropriations are chiefly due to the effect of an approximately \$18.2 million increase for the adjustment of base rates of pay and overtime as authorized by the 1975 General Assembly session.

In other functional categories, the population served is projected to remain nearly constant (mental health) or to increase in proportion to general population growth (e.g., public health, vocational rehabilitation, and resources and economic development).

TABLE 4.20.--GENERAL FUND OPERATING EXPENSES: ACTUAL APPROPRIATIONS AND PROJECTED EXPENDITURES, 1962-64 TO 1980-82

Operating Expenses	Actual Appropriations						Projected Expenditures			
	1962-64	1964-66	1966-68	1968-70	1970-72	1972-74	1974-76	1976-78	1978-80	1980-82
EDUCATION										
Elementary-Secondary Education	\$280,645,293	\$327,200,480	\$519,817,355	\$686,913,870	\$825,392,410	\$1,004,948,335	\$1,236,341,690	\$1,475,697,000	\$1,621,439,000	\$1,772,771,000
Higher Education	69,749,766	80,395,135	131,337,775	202,894,180	279,746,730	384,420,580	514,767,790	\$659,192,000	\$790,776,000	\$905,860,000
Other Education and Cultural	2,240,020	2,372,890	3,333,370	4,590,190	5,652,590	8,017,700	10,314,300	12,131,000	14,016,000	15,946,000
HEALTH AND WELFARE										
Mental Health	46,721,835	50,674,850	66,116,860	84,729,935	110,848,930	117,749,150	150,271,780	159,765,000	174,756,000	192,199,000
Public Health	21,860,105	23,611,645	32,132,590	40,353,040	55,203,330	60,067,610	71,220,915	81,916,000	93,719,000	105,610,000
Medicaid	...	...	...	20,226,205	57,504,670	110,890,685	150,059,095	198,638,000	248,582,000	307,163,000
Public Welfare	21,648,965	27,400,060	33,013,545	48,364,760	78,211,125	142,016,990	163,325,930	218,359,000	274,393,000	340,176,000
Vocational Rehabilitation	129,245	207,405	2,752,160	4,097,525	5,787,635	6,872,380	8,535,300	9,972,000	11,573,000	13,209,000
ADMINISTRATION OF JUSTICE	36,545,785	39,225,935	67,879,485	90,543,675	120,155,455	157,940,450	242,796,645	292,022,000	337,414,000	383,859,000
RESOURCE AND ECONOMIC DEVELOPMENT	19,716,720	23,259,730	31,479,679	38,467,210	45,890,605	57,910,310	69,475,685	78,579,000	90,794,000	103,292,000
GENERAL ADMINISTRATION AND LEGISLATIVE										
General Administration	18,723,525	20,702,400	29,589,135	38,859,365	49,157,080	59,956,495	74,197,690	87,772,000	101,415,000	115,375,000
Legislative	2,365,180	2,432,835	2,984,955	3,702,010	5,348,850	7,122,220	13,477,075	15,992,000	18,478,000	21,022,000
TRANSPORTATION	2,821,940	2,863,510	4,156,010	4,244,620	8,146,615	8,578,770	7,164,510	8,130,000	9,394,000	10,687,000
UNALLOCATED BY FUNCTION										
Employee Benefits	11,588,835	12,701,385	23,443,890	28,002,255	32,843,380	62,211,655	80,851,175	96,886,000	111,946,000	127,356,000
State Aid to Localities--Shared Revenues	...	...	25,140,000	25,890,000	28,476,000	33,600,000	41,100,000	57,082,000	44,267,000	46,820,000
Debt Service	1,730,000	225,000	130,000	5,000	18,716,600	17,794,400	16,657,600	15,608,000	14,564,000	13,502,000
Other	<u>2,439,395</u>	<u>8,962,500</u>	<u>4,554,885</u>	<u>15,948,320</u>	<u>25,508,170</u>	<u>32,940,445</u>	<u>65,614,270</u>	<u>95,878,000</u>	<u>110,782,000</u>	<u>126,031,000</u>
TOTAL OPERATING EXPENSES	\$538,926,609	\$622,235,760	\$977,851,694	\$1,337,832,160	\$1,752,590,175	\$2,273,038,175	\$2,916,171,450	3,563,619,000	4,068,308,000	4,600,878,000

The Baseline Gap

Using projected revenues in Chapter III and baseline operating expenditures in this chapter, a comparison can be made of the two sides of the fiscal ledger. The difference between revenues and expenditures, henceforth called the gap, is shown in Table 4.21.

With revenues expected to rise faster than expenditures, a positive gap or surplus is projected for baseline outlays in each of the next three bienniums. Two factors contributing to anticipated surpluses on the revenue side are projected increases in the state sales and use tax collections and the increases in the individual and the corporate income tax receipts. For example, in 1976-78 these changes are expected to bring in about \$834 million in revenue.

Worth noting are three factors expected to stabilize expenditures. Total elementary-secondary enrollment is expected to peak in 1976-77 and thereafter to decline for each year of the projection period. Since this category accounts for nearly 45 percent of all 1974-76 general fund operating expenditures, a declining rather than an increasing workload is highly significant. In addition, recent inflationary pressures are anticipated to decline as well as the rate of population growth. The reduced population growth rate is mainly attributable to a falling birth rate.

Uncertainties in federal funding could have a significant impact on the actual gap outcome. Please consult qualification numbers five and six following Table 4.21 for clarification.

TABLE 4.21.--PROJECTIONS OF GENERAL FUND GAP, 1976-78 TO 1980-82
(Millions of Dollars)

<u>Biennium</u>	<u>Revenues</u>	<u>Operating Expenditures</u>	<u>Gap (Revenues Minus Expenditures)</u>
1976-78	\$3,882.2	\$3,563.6	\$ +318.6
1978-80	4,960.0	4,068.3	+891.7
1980-82	6,448.7	4,600.9	+1,847.8

Sources: Tables 3.5 and 4.20.

The gap projections are subject to several qualifications:

1. A gap is a residual figure and therefore subject to considerable error, since small adjustments in revenue or expenditure projections have a magnified impact. For example, a 2 percent increase in projected 1976-78 expenditures and a 2 percent reduction in revenues would change the gap forecast to \$169.7 million--a 46 percent reduction.
2. As a general rule, short-run forecasts are more accurate than long-term forecasts. For this reason, the results for 1976-78 are probably closer to the mark than those for 1980-82.
3. The above gaps refer to baseline expenditure projections. They make no allowance for increases in scope or quality, nor do they make any allowance for capital outlays.
4. Realization of the reduced caseloads desired in Virginia mental hospitals will require the establishment of community facilities or other form of patient care capacity. If this capacity is not forthcoming, then mental hospital caseloads may be expected to be larger than projected, resulting in a higher baseline outlay.
5. Title XX of the Social Security Act will become effective October 1, 1975, and is expected to increase significantly the number of income eligible recipients and public welfare outlays. At the time of this writing no specific information is available as to the size and nature of the state plan and its effect on particular caseloads. However, the anticipated increase in participation will have a direct dollar for dollar reducing effect on the projected surpluses.
6. Federal revenue sharing is scheduled to expire December 31, 1976. Therefore, it has not been included in the revenue projections beyond that date. Should it be extended, revenues in the last two projected bienniums would be larger than stated. However, if federal revenue sharing funds are considered special fund revenues rather than general fund revenues available for operating expenditures, then this would have the effect of reducing the surplus gap by \$33.7 million in the 1976-78 biennium.

Scope and Quality

Recent Changes in Scope and Quality

Table 4.22 presents quantitative estimates of changes in scope and quality for the period 1967-68 to 1973-74.^{1/} The formula used to make the estimates is:

$$\frac{1973-74 \text{ Appropriations}}{1967-68 \text{ Appropriations}} \times \frac{\text{Population-Workload Ratio}}{\text{Price Ratio}} = \text{Scope and Quality Ratio}^{2/}$$

Because annual outlays by functional category are not presently available, the 1967-68 outlays for each category were estimated by splitting the biennial appropriations in half. The only exception is public welfare outlays. For this activity figures were taken from the relevant Appropriations Acts and from data provided by the Department of Welfare and Institutions. The population-workload and price ratios are then calculated; their product is the baseline growth factor. The bases for these ratios are found in Table 4.1. Between fiscal years 1967-68 and 1973-74, total population grew by an estimated 6.7 percent (or 1.1 percent per year). Specific enrollments or caseloads are again derived from information provided by the relevant state agency. The historical price indexes, given in appendix Table A.8 are adjusted to a fiscal year basis. By dividing the 1973-74 appropriations by the 1967-68 appropriations times the baseline growth factor, a residual ratio, which is the estimated change in scope and quality, is found.

^{1/} Longer alternative base periods were considered, but were abandoned as they offered no detectable advantages in return for two important shortcomings. The vocational rehabilitation function did not attain its full organizational level until 1966-68 biennium when the Department of Vocational Rehabilitation was formed. Higher education underwent a fundamental change with the development in recent years of the community college system. Productivity increases under the new system were so great that longer base periods tended to yield negative scope and quality measures which lend themselves to misinterpretation.

^{2/} Lawrence R. Kegan and George P. Roniger, "The Outlook for State and Local Finances," in Fiscal Issues in the Future of Federalism, CED Supplementary Paper, No. 23 (New York: Committee for Economic Development, 1968), p.256.

The scope and quality methodology is the best alternative which is adaptable to our purposes. However, its results will be misleading if three important reservations are not kept in mind.

First, since the methodology is only able to measure changes in monetary terms, non-monetary improvements such as changes in productivity are overlooked or may even be positively distorted. For example, if a specific program manages over time to serve a vastly larger number of people at a lower cost per recipient, the formula will reflect this change as a decrease in scope and quality.^{1/}

Second, measuring scope and quality changes with respect to general fund expenditures yields an insight into growth from the viewpoint of state government, but not necessarily from that of anyone else. For instance, in programs which are partially federally funded, shifting a portion of the federal burden to the state general fund will increase the scope and quality measure from the state's point of view although the recipient's total amount remains unchanged. Since it is the intent of this work to analyze only general fund expenditures, the measurement is valid but results should not be misapplied.

Third, the residual accounts for all change not due to population-workload and price growth. For example, new fields of study at colleges and universities mean more enrollment, but data limitations preclude estimation of the impact that these improvements have on the population-workload factors. Also, the price indexes may have overstated the increases in prices. For example, the state

^{1/} For a hypothetical example, refer to the formula and assume that the expenditures in year one are unchanged in year two and that prices remain constant. If the program has managed to serve more people in year two than it did in year one, then the denominator of the fraction will be larger than the numerator. This situation could prevail, for example, in education where given facilities and personnel might serve a larger (or for the opposite result a smaller) number of students with very little change in cost. This type of productivity change has a perverse impact on scope and quality ratios.

and local implicit price deflator is biased upward, for it does not account for growth in the productivity of state employees. Again, though, the impact of such factors cannot be quantified.

The reservations cited above do not invalidate scope and quality judgments, but they do demonstrate the necessity for considering specific scope and quality ratios as "soft" approximations rather than as "hard" and precisely comparable figures.

For summary Table 4.22 below the estimate of total scope and quality is calculated by weighting each category estimate with the ratio of the appropriations in the category to total general fund appropriations. The total scope and quality change is equal to the sum of these weighted estimates. For the table, all ratio changes are converted to percentage changes.

TABLE 4.22.--ESTIMATED INCREASE IN SCOPE AND QUALITY,
FISCAL YEARS 1967-68 TO 1973-74^{a/}

<u>Functional Category</u>	<u>Percentage Increase in Scope and Quality</u>	
	<u>Total</u>	<u>Average Annual Rate</u>
Elementary-Secondary Education (excluding sales and use tax proceeds)	14.5	2.3
Higher Education	14.3	2.3
Other Education and Culture	51.8	7.2
Mental Health	53.6	7.4
Public Health	30.9	4.6
Medicaid ^{b/}	34.7	7.7
Public Welfare	95.3	11.4
Vocational Rehabilitation	39.5	5.6
Administration of Justice	55.4	7.6
Resources and Economic Development	26.0	3.9
General Administration	35.3	5.2
Legislative	65.5	8.8
Transportation	34.9	5.1
Employee Benefits	86.9	10.6
Other	740.2	34.8
Total (excluding sales and use tax proceeds)	42.1	6.0

a/ Two functional categories are excluded: (1) debt service and (2) state aid to localities which do not fit into the conceptual framework.

b/ Medicaid did not begin until the 1968-70 biennium. Therefore, the scope and quality increases were calculated between the fiscal years 1969-70 and 1973-74.

Future Expansion of Scope and Quality

There is little doubt that in the next three bienniums demands for expanding the scope and quality of programs will continue. There is an observable tendency for individuals to demand more and better public services as their standard of living rises. The business community, too, tends to demand better trained labor as the economy grows. In addition, the current emphasis on government spending as a remedy for most social and economic problems is not likely to moderate.

It is difficult to estimate the magnitude of scope and quality increases for any specific program other than to feel reasonably confident that growth will continue at rates consistent with the recent past. An annual rate of improvement applicable to all categories can, therefore, be chosen from our historical estimates. In Table 4.22 we noted the scope and quality changes which took place between 1967-68 and 1973-74 in each functional category. The impact of expanding scope and quality on the projected baseline gaps is shown by applying the median annual rate of improvement, 6 percent, to each of the functional categories. Where specific observations are in order, they will be found under the appropriate section.

Elementary-Secondary Education

Methods of funding elementary-secondary education changed significantly in the last biennium under the new standards of quality program discussed under the baseline projections for elementary-secondary education and again in Chapter VI. Although another revision in the funding program is not expected in the near future, if scope and quality of all programs in elementary-secondary education increased at a 6 percent annual rate beginning fiscal year 1976-77, the additional cost would be:

<u>Biennium</u>	<u>Additional Outlays (Millions)</u>
1976-78	\$+104.2
1978-80	+270.5
1980-82	+470.8

Higher Education

<u>Biennium</u>	<u>Additional Outlays (Millions)</u>
1976-78	\$ +61.6
1978-80	+180.5
1980-82	+343.8

The 1967-68 to 1973-74 annual average scope and quality increase of 2.3 percent for higher education is misleading because of the first and third methodological reservations discussed earlier. During its formative period a new program often may be expected to reflect a very large increase in productivity by serving a mushrooming population. The community college system increased its population workload from 6,121 in 1967-68 to 36,069 in 1973-74, an increase of 590 percent in the number of students served over a six-year period. On the other hand, general fund appropriations for the same period went from approximately \$9.2 million to \$41.2 million, or an increase of some 450 percent. Referring to the

original formula, the depressing effect on scope and quality of this disproportionate population increase becomes obvious.

It is believed that as the community college system approaches its designed capacity and the population workload growth rate tapers off scope and quality ratios for higher education will rise. As there is no satisfactory method available for predicting the timing or magnitude of such an anticipated change the average general fund scope and quality increase rate of 6 percent is utilized for higher education.

Mental Health

If the scope and quality of all programs in mental health increased at 6 percent, the additional cost would be:

<u>Biennium</u>	<u>Additional Outlays (Millions)</u>
1976-78	\$+14.7
1978-80	+39.8
1980-82	+72.9

As mentioned in the baseline discussion, the Department of Mental Health and Mental Retardation is attempting to reduce the patient/employee ratio in an effort to earn the approval of the National Joint Commission on Accreditation of Hospitals. If the Department's expectations of a reduced hospital caseload are to be realized, some patients must be moved to other facilities which are not currently part of the program. However, the nature and costs of desirable alternative care facilities are uncertain. If a vigorous program is initiated to develop additional services rapidly, then the projected scope and quality outlays will be too low.

Public Health

Public health scope and quality projections based on a 6 percent annual rate of increase are as follows:

<u>Biennium</u>	<u>Additional Outlays (Millions)</u>
1976-78	\$ +7.6
1978-80	+21.3
1980-82	+40.1

Medicaid

The Medicaid program did not begin until the 1968-70 biennium. Between 1969-70 and 1973-74 the program experienced an average annual increase in scope and quality of 7.7 percent. However, due to briefness of the program, the average annual rate of scope and quality increase for all general fund functions has been applied. It is important to note that Medicaid is not predominantly operated from the general fund. These computations assume that the general fund share will remain reasonably stable at approximately 40 percent of total program cost. Keeping these reservations in mind, the scope and quality projections are:

<u>Biennium</u>	<u>Additional Outlays (Millions)</u>
1976-78	\$ +18.6
1978-80	+56.8
1980-82	+116.8

Public Welfare

Applying the 6 percent rate of increase for public welfare scope and quality we project:

<u>Biennium</u>	<u>Additional Outlays (Millions)</u>
1976-78	\$ +20.5
1978-80	+62.7
1980-82	+129.1

It is important to remember that funds for public welfare programs come in large part from non-general fund sources. Consequently, a 6 percent annual scope and quality increase in the total program requires not only the above general fund outlays, but also a constant ratio of special to general funds and availability of special funds in sufficient quantity to maintain the ratio.

Administration of Justice

If the scope and quality of programs in this function increased at the median rate of 6 percent annually, it would require the baseline outlay plus:

<u>Biennium</u>	<u>Additional Outlays (Millions)</u>
1976-78	\$ +63.2
1978-80	+76.9
1980-82	+145.7

Employee Benefits

The scope and quality of employee benefits have been subject to wide variations over given periods. For example, between 1960-61 and 1969-70 the scope and quality of employee benefits increased at an average annual rate of 5.2 percent,^{1/} and during the 1967-68 to 1971-72 base period they increased at 0.7 percent per year.^{2/} For the base period 1967-68 to 1973-74 scope and quality was estimated to have grown at 10.6 percent yearly. For this reason the average rate for all functions was employed. At an average annual rate of 6 percent the estimated scope and quality requirements are as follows:

<u>Biennium</u>	<u>Additional Outlays (Millions)</u>
1976-78	\$ +9.0
1978-80	+25.5
1980-82	+48.3

^{1/} Knapp, John L., and Associates, Fiscal Prospects and Alternatives. The Division of State Planning and Community Affairs, Richmond, Va., April, 1971, p.210.

^{2/} Lipman, Barry E., and Vorhies, Benjamin A., et al. Fiscal Prospects and Alternatives: 1974. The Division of State Planning and Community Affairs and Department of Taxation, Richmond, Va., June, 1973, p. 240.

Other

Scope and quality increases for this category are projected at 6 percent per year and are as follows:

<u>Biennium</u>	<u>Additional Outlays (Millions)</u>
1976-78	\$ +8.9
1978-80	+25.3
1980-82	+47.8

The historical scope and quality growth rate of 34.8 percent per year appears to be unreasonably high. However, most of this abnormally high growth was due to the adjusting of base rates of pay and overtime.

Additional Categories

The scope and quality of programs in any of the other categories could be expanded. Their estimated scope and quality requirements based on the average general fund rate of 6 percent are reflected in the table below:

TABLE 4.23.--ADDITIONAL SCOPE AND QUALITY OUTLAYS
(MILLIONS OF DOLLARS)

	<u>Bienniums</u>		
	<u>1976-78</u>	<u>1978-80</u>	<u>1980-82</u>
Resource and Economic Development	\$+7.3	\$+20.7	\$+39.2
General Administration	+8.2	+23.1	+43.8
Legislative	+1.5	+4.2	+8.0
Transportation	+0.8	+2.1	+4.1
Other Education and Culture	+1.1	+3.2	+6.0
Vocational Rehabilitation	+0.9	+2.6	+5.0

Summary

The categories discussed above account for approximately 98 percent of general fund outlays and include all functions except debt service and state aid to localities. If all programs were expanded as projected, the additional scope and quality outlays would change the baseline gaps as follows:

<u>Biennium</u>	<u>Baseline Gap (Millions)</u>	-	<u>Additional Outlays for Scope and Quality (Millions)</u>	=	<u>Scope and Quality Gap (Millions)</u>
1976-78	\$ +318.6		\$ +328.1		\$ -9.5
1978-80	+891.7		+815.2		+76.5
1980-82	+1,847.8		+1,521.4		+326.4

It may be desired to reduce or even eliminate scope and quality expenditures for some functions while others may be increased significantly. The table only reflects the cumulative impact which may be expected if individual functions receive appropriations according to the median annual rate of 6 percent.

Capital Outlays

Introduction

For the next three bienniums we show requests for capital outlays from the general fund, and we project amounts actually funded. Then, there is a discussion of the potential for funding these capital outlays through general obligation borrowing. We do not project capital outlays funded from revenue bonds^{1/}, which are primarily for the construction of self-supporting facilities at colleges and universities, or from special funds, which are in part federal outlays.

Requests for Capital Outlays from General Fund Revenues

Table 4.24 presents the projected capital outlay requests from the general fund for the next three bienniums. In each biennium the requests from colleges and universities are expected to be about 60 percent of the total. Requests to improve mental and public health facilities are anticipated to be the next single largest category. Most of the remaining requests are projected to come from administration of justice and resource and economic development.

The requests in the 1978-80 and 1980-82 bienniums assume that the requests in the preceding biennium will be completely funded or that the requests not funded will be dropped, but neither result will occur in all likelihood. During the 1960's about 45 percent of requests were funded; in the 1970-72 biennium the ratio dropped to 13.7 percent and then rose in 1972-74 to 30 percent. The 1974-76 biennium saw 14 percent of the requests funded (\$52 million of \$372.8 million). Moreover, only a small percentage of those requests not funded in previous years were dropped; in other words, agencies maintained the same set of

^{1/} Article X, Section 9(c) of the Constitution permits the state to secure revenue bonds with its full faith and credit subject to certain limitations.

TABLE 4.24.--PROJECTED CAPITAL OUTLAYS FROM THE GENERAL FUND,
1976-78 TO 1980-82 BIENNIUMS
(Millions of Dollars)

<u>Biennium</u>	<u>Higher Education</u>	<u>Mental Health and Public Health</u>	<u>Administration of Justice</u>	<u>Resource & Economic Development and Other Categories^{a/}</u>	<u>Total^{b/}</u>
1976-78	\$213,767,892	\$78,131,280	\$101,602,459	\$71,379,897	\$464,881,528
1978-80	146,530,691	38,335,950	509,000	35,206,010	220,581,651
<u>1980-82</u>	88,863,495	15,154,200	301,000	36,754,650	<u>141,073,345</u>
1976-82 Total Requests					\$826,536,524

a/ Over the three bienniums approximately 80 percent of the total requests are for resources and economic development.

b/ Due to deficiencies in information and/or lack of information submitted, totals are incomplete.

Note: Projections prepared by the Division of Engineering and Buildings, April 4, 1975. The inflation factor embodied in the requests are estimates made by each institution submitting a request for capital outlays.

priorities until they were satisfied. We therefore assume that the \$320.8 million left over from this biennium is included in the \$464.9 million requested for the 1976-78 biennium. Also included are new agency requests and an allowance for inflation. If 40 percent of the 1976-78 requests were funded, appropriations for the remaining \$278.9 million would be requested in the following biennium (after the requests are adjusted for inflation). This would cause deferral of many, if not all, of the 1976-78 requests to the 1978-80 biennium. Thus, the funding of only a portion of each biennium's capital outlay requests would rule out the sum total of requests (\$826.5 million) shown in Table 4.24.

Projected Capital Outlays from General Fund Revenues

Because requests for capital outlays appear to be a poor basis for projecting capital outlays from general fund revenues, we utilize historical ratios of general fund appropriations for capital projects to general fund appropriations for recurring programs. In recent bienniums, the ratio has remained fairly constant. Only in the 1966-68 and 1970-72 bienniums does the ratio differ significantly from the historical average of 6.3 percent:

<u>Biennium</u>	<u>Ratio (Percent)</u>	<u>Appropriations For Capital Projects (Millions)</u>
1958-60	8.1	\$ 30.1
1960-62	8.3	38.1
1962-64	5.9	31.7
1964-66	5.8	35.8
1966-68	10.7	104.7
1968-70	8.3	111.1 ^{a/}
1970-72	2.5	43.2
1972-74	5.6	126.8
1974-76	1.8	52.0
Simple Average	6.3	\$ 63.7

^{a/} This figure includes \$81 million in general obligation bonds which funded requests made to the general fund.

If we assume that the 6.3 percent ratio of capital to recurring outlays were to hold for the next three bienniums, the capital outlays required for baseline growth would be:

<u>Biennium</u>	<u>Baseline Capital Outlays (Millions)</u>
1976-78	\$224.5
1978-80	256.3
1980-82	289.9

Most of the capital outlay requests are expected to be for higher education, mental health, public health, and administration of justice.

If outlays are realized as projected in the scope and quality summary, then scope and quality capital outlays may be estimated by applying the 6.3 percent ratio. The same methodology is used as for baseline capital outlays and yields the following result:

<u>Biennium</u>	<u>Additional Scope and Quality Capital Outlays (Millions)</u>
1976-78	+\$20.7
1978-80	+51.4
1980-82	+95.8

These projected capital outlays would change the baseline and scope and quality gaps to:

<u>Biennium</u>	<u>Baseline Gap (Millions)</u>	<u>Scope and Quality Gap (Millions)</u>	<u>Baseline Gap with Capital Outlays (Millions)</u>	<u>Scope and Quality Gap with Capital Outlays (Millions)</u>
1976-78	\$ +318.6	\$ -9.5	\$ +94.1	\$-254.7
1978-80	+891.7	+76.5	+635.4	-231.2
1980-82	+1,847.8	+326.4	+1,557.9	-59.3

In summary, baseline growth and the expansion of scope and quality would require large capital outlays from the general fund. Meeting the baseline capital requirements and improving the scope and quality of most programs would, however, cause projected revenues from present sources to fall short of projected outlays in the next three bienniums.

Four important reservations must be kept in mind when considering the projected gaps:

1. Of primary immediate concern is the long range fate of federal revenue sharing. If it is continued beyond the January 1, 1976, expiration date, the anticipated deficits for 1976-78 and 1978-80 could be narrowed and the 1980-82 deficit reduced or transformed to a surplus.
2. If categorical grants from the federal government were to be reduced or terminated and the state elects to continue affected programs via general fund expenditures, then the projected deficits will be expanded.
3. If the state elects to adopt a broad plan that would significantly increase the number of eligible recipients under Title XX, then the projected deficits in each biennium will be deepened (see qualification No. 5 under Table 4.21).
4. Short term projections are usually more reliable than long term projections, so the accuracy of the 1976-78 figures is probably greater than that of the 1980-82 biennium.

Capital Outlays from General Obligation Borrowing

It is not necessary to finance all capital outlays from general fund revenues; general obligation borrowing could be another source. In this section we provide estimates of the maximum amount that could be borrowed in each biennium.

Under the constitution, general obligation debt for capital projects is permitted, provided that it is approved by a majority of the General Assembly and by a majority of the voters in a referendum. Furthermore,

...No such debt shall be authorized by the General Assembly if the amount thereof when added to amounts approved by the people, or authorized by the General Assembly and not yet submitted to the people for approval, under this subsection

during the three fiscal years immediately preceding the authorization by the General Assembly of such debt and the fiscal year in which such debt is authorized shall exceed twenty-five per centum of an amount equal to 1.15 times the average annual tax revenues of the Commonwealth derived from taxes on income and retail sales, as certified by the Auditor of Public Accounts, for the three fiscal years immediately preceding the authorization of such debt by the General Assembly.

No debt shall be incurred under this subsection if the amount thereof when added to the aggregate amount of all outstanding debt to which the full faith and credit of the Commonwealth is pledged other than that excluded from this limitation by the provisions of this article authorizing the contracting of debts to redeem a previous debt obligation of the Commonwealth and for certain revenue-producing capital projects, less any amount set aside in sinking funds for the repayment of such outstanding debt, shall exceed an amount equal to 1.15 times the average annual tax revenues of the Commonwealth derived from taxes on income and retail sales, as certified by the Auditor of Public Accounts, for the three fiscal years immediately preceding the incurring of such debt.^{1/}

Table 4.25 applies the above provisions to projected revenues from income taxes on individuals and corporations and from the sales and use tax. The table shows that the present debt provisions will permit large new borrowings in the next three bienniums if the General Assembly and the voters wish to use the maximum authority. Only in the 1976-78 biennium, however, could the maximum debt that could be authorized and approved (\$268.0 million) completely substitute for general fund revenues as a method of financing projected capital outlays (\$245.2 million with \$224.5 million in baseline capital outlays and \$20.7 million in scope and quality capital outlays). In the last two bienniums, maximum debt approvals would cover only about 30 percent of projected capital outlays. Of course, any new debt would have to be serviced out of general fund revenues. Table 4.26 shows the additional debt service required in the next three bienniums if the maximum amount of general obligation borrowing were authorized and

^{1/} Constitution of Virginia, Article X, Section 9 (b)

TABLE 4.25--PROJECTED MAXIMUM GENERAL OBLIGATION BORROWING PERMISSIBLE
 UNDER THE CONSTITUTION, FISCAL YEARS 1975-76 TO 1979-80
 (Millions of Dollars)

Year General Assembly Meets ^{a/}	Projected Average Annual Sales and Income Taxes, Previous 3 Years	Calculation Base ^{b/}	Maximum Debt Which Could be Authorized For the Biennium ^{c/d/}	Outstanding at End of Fiscal Year			Overall Debt Limit ^{f/}
				Gross Debt	Sinking Fund ^{e/}	Net Debt	
1975-76	\$ 932.0 ^{g/}	\$268.0	\$268.0	\$349.0	\$ 34.6	\$314.4	\$1,071.8
1977-78	1,237.3	355.7	87.7	436.7	59.6	377.1	1,422.9
1979-80	1,676.7	482.0	126.3	563.0	102.9	460.1	1,928.2

^{a/} Assumes the bonds are approved in a referendum the fiscal year following authorization by the General Assembly. Thus, borrowing authorized at the 1976 session of the General Assembly and approved in fiscal year 1976-77 would be available for spending in the 1976-78 biennium.

^{b/} Twenty-five percent of 1.15 times the average annual tax revenues from the Individual and Fiduciary Income Tax, the Corporate Income Tax, and State Sales and Use Tax for the three years immediately preceding the authorization.

^{c/} This figure is equal to the calculation base less debt approved in the three preceding fiscal years.

^{d/} There is some controversy as to how to interpret the language in the constitution. Questions concern (1) assuming a bond issue has been authorized and approved, should calculations be determined by date of authorization or by date of approval (we used date of approval) and (2) when the constitution refers to sales tax is this limited to the sales and use tax or does it include other sales taxes such as those on automobiles, liquor, and cigarettes. Also is the use tax portion of the sales and use tax included? (We used the sales and use tax but excluded other sales taxes). Our calculations would differ if we were to use other assumptions. For example, if the calculations were based on the date of authorization rather than the date of approval (and our other assumptions were not changed), then the maximum debt that could be authorized would be \$268.0 million (1975-76); \$87.7 million (1977-78); and \$394.3 million (1979-80). If this were the case, debt service estimates would have to be revised.

^{e/} Assumes a 5 percent annual amortization rate with payments beginning in the fiscal year following approval and sale of the bonds. Retirement payments made on the \$81 million issue of May, 1969 are included. For simplicity we assume that debt repayment would be made to a sinking fund. Actually, they may go directly for retirement. In either case the effect on net debt is the same. Amortization of the debt and even interest payments could begin after the fiscal year following the referendum on the bonds if their sale were delayed too long after approval; however, our assumptions do appear to be reasonable.

^{f/} 1.15 times the average annual tax revenues from the Individual and Fiduciary Income Tax, the Corporate Income Tax, and State Sales and Use Tax for the three years immediately preceding the incurring of such debt.

^{g/} Includes actual figures for fiscal years 1972-73 and 1973-74.

approved. If only the \$268.0 million were authorized and approved in the 1976-78 biennium for financing capital projects, the added debt service, given the same interest rate and sinking fund assumption as in Table 4.26, would be:

<u>Interest Payments</u> <u>(Millions)</u>	<u>Payments</u> <u>To</u> <u>Sinking Fund</u> <u>(Millions)</u>	<u>Total</u> <u>(Millions)</u>
\$14.0	\$13.4	\$27.4
25.8	26.8	52.6
22.9	26.8	49.7

TABLE 4.26.--DEBT SERVICE ON PERMISSIBLE GENERAL OBLIGATION BORROWING,
1976-78 TO 1980-82 BIENNIUMS^{a/}
(Millions of Dollars)

<u>Biennium</u>	<u>Interest</u> <u>Payments</u> ^{b/}	<u>Payments</u> <u>To</u> <u>Sinking Fund</u> ^{c/}	<u>Total</u>
1976-78	\$14.0	\$13.4	\$27.4
1978-80	30.4	31.7	62.1
1980-82	37.8	42.9	80.7

^{a/} This table does not include debt service on the already outstanding \$81.0 million issue of May, 1969.

^{b/} A 5.5 percent annual rate is assumed with payments beginning in the fiscal year following approval and sale of the bonds. Interest is calculated on the net debt as investment of sinking fund payments is assumed to partially offset interest expense.

^{c/} A 5 percent annual amortization rate is assumed with payments beginning in the fiscal year following approval and sale of the bonds.

Summary

Surplus baseline gaps are projected for the 1976-78, 1978-80, and 1980-82 bienniums. To refresh the reader's memory, the baseline gap is the amount by which projected revenue exceeds anticipated expenditures if all programs remain

unchanged and allowance is made only for expected population-workload variation and price change. The scope and quality gap (negative in the 1976-78 biennium and positive in the 1978-80 and 1980-82 bienniums) reflects the general fund surplus or deficit anticipated if, in addition to workload and price changes, programs are improved at the average annual rate of 6 percent for all general fund functions. Capital outlay projections assume a relatively stable relationship over time between general fund capital outlays and recurring expenditures. Historical evidence suggests this to be a reasonable assumption. The baseline gap with capital outlays provides the surplus anticipated if all conditions prevail as under the baseline gap and with the addition of capital outlays as suggested by historical experience. The scope and quality gap with capital outlays reflects deficit balances in each biennium. Under this projection each program is adjusted not only for population-workload changes and price changes, but also for additional program improvements as described under the scope and quality section. To these expenditures are added the historically implied baseline and scope and quality capital outlay requirements.

CHAPTER V

LOCAL GOVERNMENT FINANCES

Introduction

The purpose of this chapter is to outline the financial position of local governments in Virginia and to provide an indication of their future course. The reason for doing so is quite simple. No analysis of government can be done in a vacuum. What happens at one level of government may have lasting effects on another level. This is especially true of state and local fiscal aspects since the financial well-being of a state may be affected by the financial position of its local governments and vice versa.

Organization of the chapter is divided into two parts. The first section develops revenue and expenditure projections for local governments in Virginia through fiscal year 1981-82. The second part presents an analysis of certain sources of local revenue with primary emphasis on property taxes. Before we address these topics, however, a word of caution must be given. Projections in this chapter encompass all local governments in Virginia. To this extent they show only the average trend which may or may not be true for any specific locality. More will be said about this later with respect to central cities. At present, it is worth noting that central cities, urban counties, and rural communities can all have different fiscal outlooks.

Historical Summary

The first part of this chapter attempts to make revenue and expenditure projections for all local governments in Virginia. Before directing our attention to the future, however, it may be helpful to point out some recent trends that have taken place in local government finance over the past few years. For purposes of review, therefore, we develop the following two exhibits.

Table 5.1 presents a percentage breakdown of total local government revenue in Virginia by source for fiscal years 1967-68 to 1972-73. As illustrated here, local taxation (approximately 67 percent of which is property taxes) historically has been the greatest source of local revenue. On the other hand, it is clear that federal and state cash transfers have become increasingly important. In terms of total funds, intergovernmental transfers have risen relative to any other item over the last six years and now make up the largest portion of revenues at the local level.

TABLE 5.1.--PERCENTAGE DISTRIBUTION OF LOCAL GOVERNMENT REVENUES IN VIRGINIA, FISCAL YEARS 1967-68 TO 1972-73^{a/}

<u>Revenue Source</u>	<u>Percent of Total</u>					
	<u>1967-68</u>	<u>1968-69</u>	<u>1969-70</u>	<u>1970-71</u>	<u>1971-72</u>	<u>1972-73</u>
Taxation	46.4	45.0	45.2	45.5	44.3	42.7
Property taxes	32.6	31.1	31.3	31.9	30.1	28.8
Other taxes	13.8	13.9	13.8	13.6	14.2	13.9
Charges & miscellaneous revenue	13.1	12.4	12.6	12.5	12.6	12.3
Intergovernmental transfers	40.5	42.7	42.2	42.0	43.1	45.0
Federal transfers	4.9	5.2	5.8	5.6	5.6	8.7
State transfers	<u>35.6</u>	<u>37.5</u>	<u>36.4</u>	<u>36.4</u>	<u>37.5</u>	<u>36.3</u>
Total Revenue	100.0	100.0	100.0	100.0	100.0	100.0

Note: Totals may not add to 100.0 percent due to rounding.

a/ For dollar amounts see Table 5.5.

Source: U. S. Bureau of the Census, Governmental Finances in 19--, selected editions (Washington: Government Printing Office); U. S. Bureau of the Census, State Government Finances in 19--, selected editions (Washington: Government Printing Office).

Looking at the other side of the budget, Table 5.2 presents a breakdown of local government expenditures by purpose for fiscal years 1967-68 through 1972-73. As pointed out by this distribution, education is by far the largest single expense at the local level even though its importance relative to other functions has declined over the last six years (dropping from 52.5 percent of all local outlays in 1967-68 to 46.8 percent in 1972-73). Following educational costs, in order of rank, are debt service^{1/}, public welfare, and police and fire protection. In 1972-73, these three items accounted for roughly 27 percent of total spending by local jurisdictions.

TABLE 5.2.--PERCENTAGE DISTRIBUTION OF LOCAL GOVERNMENT EXPENDITURES
IN VIRGINIA FISCAL YEARS 1967-68 TO 1972-73^{a/}

Function	Percent of Total					
	1967-68	1968-69	1969-70	1970-71	1971-72	1972-73
Education	52.5	51.7	51.7	50.5	48.2	46.8
Highways	4.0	4.1	3.8	3.6	3.4	3.7
Public welfare	5.7	6.6	6.7	8.0	9.1	9.1
Health and hospitals	2.0	2.0	1.6	1.7	1.9	1.8
Police and fire protection	5.7	5.8	5.9	5.6	5.7	6.1
Sewerage and sanitation	5.0	5.3	4.1	4.0	4.7	4.8
Local parks and recreation	1.7	2.0	3.1	2.2	2.3	2.4
Financial administration & general control	3.2	3.3	3.2	3.3	3.3	3.8
Interest on general debt	4.5	4.0	4.0	4.0	4.3	4.1
All other general expenditures	9.8	9.8	10.1	11.3	10.9	10.0
Redemption of long term general debt	5.9	5.4	5.8	5.8	6.2	7.4
Total outlays	100.0	100.0	100.0	100.0	100.0	100.0

Note: Totals may not add to 100.0 percent due to rounding.

^{a/} For dollar amounts see Table 5.8.

Source: See Table 5.1

^{1/} The term "debt service" refers to interest on general debt and redemption of long-term general debt.

Revenue and Expenditure Projections

Projection Methodology

Although far from complete, the above analysis points out some of the more salient characteristics of local government finance in Virginia. In light of this information, we now devote our efforts to attempt a forecast of local revenues and expenditures. The methodology for making these projections is based on three underlying procedures. First, all assumptions about future prices and population caseloads are the same as those made in Chapter II and Chapters IV of this report. Second, the time period for analysis of historical data is limited to the 1960's.^{1/} Finally, any other assumptions with respect to the projections are specific, pertaining only to the revenue or expenditure item in question. These are discussed below in relation to each item.

Revenue Projections

Real Estate Taxes

Changes in the amount of real estate taxes collected by local governments can result from three different variables--changes in the market value of real estate; changes in the assessment ratio of real estate; and changes in the tax rate on the assessed value of real estate. Under the baseline projection methodology used throughout this report, only the first variable is considered. The tax rate used in these projections is held constant at \$.92 per \$100 of full

^{1/} The overall structure of local finance has changed over time especially with the adoption of the sales tax in 1966. Because of this, data before 1960 was thought to be of little value to the present analysis.

valuation (the 1973 weighted average true tax rate on real estate for all cities and counties in Virginia^{1/}). This treatment is consistent with the provisions of Senate Bill 597, passed in the 1975 session of the General Assembly, which will require all localities to begin to tax realty after 1976 on the basis of assessments made at 100 percent of fair market value.

With the tax rate and assessment ratio taken as given, the key projection factor for real property tax collections becomes the market value of land. This is projected by applying a 12 percent annual rate of growth to the 1973 estimated true value of real estate. The 12 percent rate represents slightly higher growth than the 11.0 percent average annual increase in true values over the past ten years. It was chosen to reflect the recent upsurge in land values caused by inflation.

After future market values are obtained, tax collections are forecast by multiplying future land values by the weighted average true tax rate. The products of this calculation are then adjusted to fiscal year collections by taking 49.1 percent of the total projected receipts for the two years contained within the fiscal year. This adjustment is consistent with the relationship that existed between property tax collections in fiscal year 1972-73 and the total of property tax collections for calendar years 1972 and 1973.

Public Service Corporation Levies

Property taxes on public service corporations are projected to be consistent with the so-called "Bemiss Act."^{2/} This law, passed in 1966, provides for

^{1/} The weighted average true tax rate was calculated by dividing the total of local levies on real estate for 1973 by the 1973 true value of real estate as reported by the Department of Taxation.

^{2/} Code of Virginia, Section 58-512.1.

eventual assessment of public service property at the same true rate as other types of property in the locality instead of the 40 percent assessment ratio which was previously used. The mechanism for achieving this goal is spread over a twenty-year period. It allows for 1/20 of the January 1, 1966, full value of this property to be assessed at the local ratio in calendar year 1967 and in each subsequent year for an additional 1/20 of this base to be added. Thus, by December, 1975, 9/20 of the 1966 base value (\$2.6 billion) will be assessed at the same local ratio as other types of property. During the adjustment period, any net additions to public service property above the 1966 base are also to be assessed at the prevailing local ratio.

The method used to coordinate projections with this act establishes the true value of public service property through fiscal year 1981-82. This is done by first apportioning the amount of the 1966 base that will be assessed at the present local ratio (the weighted average local ratio in 1973 was 28.6 percent) and the amount that will be assessed at 40 percent. After this is done, net additions to public service property are projected. These projections are made by blowing up the 1974 full value of this property (\$5.8 billion) by 10.2 percent annually, the average annual growth rate in the full value of public service corporation property over the last eight years. The difference between projected future values and the 1966 base represents the amount of net additions to public service corporation property.

Once all three components of future full values are obtained (see Table 5.3), the amounts are multiplied by the applicable assessment ratio to produce a total valuation for public service corporation property. Assessed values through 1975-76 are derived by assessing the adjusted portion of the 1966 base and the value of projected net additions by 28.6 percent (the weighted average local assessment

TABLE 5.3.--PROJECTED FULL VALUES OF PUBLIC SERVICE CORPORATION PROPERTIES,
1974 TO 1982
(Millions of Dollars)

Fiscal Year	1966 True Value of Public Service Corporation Property				Projected Net Additions to 1966 Base to be Assessed at Same Local Ratio as Other Types of Property ^{a/}	Projected Full Values	
	Amount	Value to be Assessed at Same Local Ratio As Other Types of Property Proportion	Amount	Value to be Assessed at 40% Proportion			
1974	\$2,590.7	8/20	\$1,036.3	12/20	\$1,554.4	\$3,168.9	\$5,759.6
1975	2,590.7	9/20	1,165.8	11/20	1,424.9	3,756.2	6,346.9
1976	2,590.7	10/20	1,295.4	10/20	1,295.4	4,403.6	6,994.4
1977	2,590.7	11/20	1,424.9	9/20	1,165.8	5,117.0	7,707.7
1978	2,590.7	12/20	1,554.4	8/20	1,036.3	5,903.2	8,493.9
1979	2,590.7	13/20	1,684.0	7/20	906.7	6,769.6	9,360.3
1980	2,590.7	14/20	1,813.5	6/20	777.2	7,724.3	10,315.0
1981	2,590.7	15/20	1,943.0	5/20	647.7	8,776.5	11,367.2
1982	2,590.7	16/20	2,072.6	4/20	518.1	9,935.9	12,526.6

^{a/} Projected net additions were derived by applying a 10.2 percent annual rate of growth to the 1974 full value of public service corporation properties.

Sources: "Full Values of Public Service Corporations in 1966, 1968, 1970, 1971, 1973, and 1974," special tabulations by the State Corporation Commission.

ratio in 1973) and by adding the sum of these amounts to the 40 percent assessment of the unadjusted portion of the 1966 base. The total of assessed values above are then taxed at a rate of \$3.31^{1/} per \$100 of valuation to get projected property tax collections which in turn are adjusted to fiscal year collections by the same method used for real estate taxes.

As for periods after 1975-76, public service corporation property taxes are projected to account for changes in the law which will require all localities to move to 100 percent assessments after 1976.^{2/} Under the new setup, public service corporation property will be separated into two classes for purposes of taxation. The first class will consist of all property which up to the year in question has been changed over to the local assessment ratio (i.e., the portion of the 1966 base value of public service corporation property which has been adjusted to the local assessment ratio under provisions of the Bemiss Act and all net additions to public service property after 1966). This class will be assessed at 100 percent of full value and taxed at rate equal to the effective rate of taxation applicable to other types of locally assessed property. For purposes of these projections, the rate of taxation used to calculate future property tax levies on this class of property is \$.92 (the 1973 weighted average effective true tax rate on real estate for all cities and counties in Virginia).

The second class of public service corporation property, on the other hand, will contain that portion of the 1966 base of utility property which continues to be assessed at 40 percent under provisions of the Bemiss Act. The value of this property is to be taxed at the local rate in effect prior to the change to

^{1/} The rate of \$3.31 equals the 1974 weighted average nominal tax rate on public service corporation assessments.

^{2/} Code of Virginia, Sections 58-512.1, 58-514.2 and 58-760 as amended by the 1975 session of the General Assembly.

100 percent assessment. Projections of these receipts are made by applying the 1974 weighted average tax rate on public service corporation property (\$3.31 per \$100 of assessed valuation) to the 40 percent assessed value of this class of property. The tax collections so derived are then added to the tax levies projected for the first class of public service corporation property to get total annual tax collections for each year of the projection period. These amounts are adjusted to fiscal year receipts by taking 49.1 percent of the total projected collections for the two calendar years contained within the fiscal year.

Tangible Personal Property Taxes

The method used to project tangible personal property tax revenues is quite similar to the technique that will be used to project expenditures. By analyzing historical data, we found that changes in tangible personal property tax collections could be approximated by corresponding changes in personal income and population. Thus, 1974 was set up as the base year and the following baseline approach was used.

$$\frac{\text{Tangible Personal Property Tax Revenues in Year 2}}{\text{Tangible Personal Property Tax Revenues in Year 1}} = k \left[\frac{\text{Personal Income}^{\text{a/}} \text{ in Year 2}}{\text{Personal Income in Year 1}} \times \frac{\text{Population in Year 2}}{\text{Population in Year 1}} \right]$$

where k is a constant equal to .980^{b/}

Property Taxes on Machinery and Tools

Property tax collections on machinery and tools are projected to grow by 7.6 percent annually. This figure represents the average annual increase in these revenues over the last seven fiscal years (exclusive of changes in the

a/ The population and personal income projections used in these calculations are shown in Chapter II and Chapter III.

b/ In the equation, k is figured on a constant tax rate of \$4.03 per \$100 of assessed value (the 1974 weighted average tax rate on tangible personal property for all cities and counties in Virginia).

tax rate). Only the recent past was chosen for analysis because we felt that any trend in these revenues could best be judged from figures taken after the 1966 enactment of the local option sales tax.

Merchants' Capital Levies

When rounded to millions of dollars, hardly any change has occurred in property tax collections on merchants' capital over the last five years. As a result, only a slight increase in this revenue is projected. The methodology used for the forecast is based on a historical trend.

Local Sales Tax

As of May 1, 1969, every county and city in Virginia imposed a 1 percent "add-on" sales and use tax. For future periods, revenues from this source are projected by taking one-third of the state's 3 percent sales and use tax projected in Chapter III and by adjusting this amount upward to account for certain discounts in the state tax which are not allowed by the localities.^{1/}

Other Taxes

For the most part, past collections of other local taxes (primarily business license taxes) have increased slightly faster than the growth in Virginia personal income. Thus, for future years, the forecast of other local taxes assumes a somewhat higher rate of growth than the projected annual percentage change in personal income as shown in Chapter III.

Charges and Miscellaneous Revenue

Because detailed data on charges and miscellaneous revenue were not available,

^{1/} One-third of the state's 3 percent sales tax equals roughly 97 percent of the local option tax.

this source of revenue is projected to grow by its average annual percentage change over the last ten years. The figure representing this amount is 10.0 percent.

Intergovernmental Transfers

No overall method was used to project cash transfers to local governments because it was felt that more accuracy would be obtained if transfers were broken down by the functions to which they were applied. The amounts listed as state cash transfers include any federal funds channeled through the state. Those referred to as federal cash transfers represent only direct payments from the federal government to localities.

State Cash Transfers for Education

The state transfers cash to localities to help pay the expenses of various educational programs. The largest portion of these receipts are apportioned through the Basic State School Aid Fund. Payments from this source accounted for \$310.2 million (54.5 percent of all state cash transfers for education) in fiscal year 1973-74 and included a supplemental appropriation of \$22.0 million passed by the General Assembly to meet the constitutional requirements for funding the standards of quality. Other major categorical items receiving state funds are vocational education, special education, and pupil transportation. Also included in the state cash transfers account is one-third of the state's sales and use tax distributed to localities on the basis of school age population. In fiscal year 1973-74, this payment amounted to \$110.2 million. Not apart of the transfer category, however, is that portion of state aid for education spent directly at the state level. Such is the case with state outlays for teachers' salary fringe benefits. Since this type of aid does not pass through local accounts, it is

not entered in the totals presented in the section.

Projections of future state cash transfers for education are developed by two procedures. For the short term (fiscal years 1974-75 and 1975-76) we calculate total state payments by summing the individual appropriations which have already been budgeted by the state as categorical aids to local school divisions. A major change in the distribution and amount of state funds occurs during this period because of the enactment of the new basic school aid formula for funding the standards of quality. The revised formula will allot funds on the basis of an expanded measure of each division's fiscal capacity to finance its public schools derived from an index of the division's relative ranking in terms of real estate values, personal income, and taxable sales per pupil and per capita. It also provides payments to help those localities that would otherwise be required to raise substantial amounts of local funding and those localities which would theoretically lose state receipts as a result of the new formula. In addition, the distribution provides new appropriations for compensatory education, education of the gifted and talented, and incentive grants. The effect of this program is expected to raise the degree of state participation in public education from its current level of \$569 million to \$664.5 million by the end of the two-year forecast.

As for more distant years, we make projections of state cash transfers for education from the projections of state general fund expenditures developed in Chapter IV. In accounting for federal funds passing through the state, we assume no growth for those federal grants which do not require matching state funds. For those categorical items which contain both state and federal assistance (e.g., vocational education) we allow for federal funds to grow in proportion to the projected increases in state outlays. This assumes that federal and state matching shares will remain constant over the projection period.

State Cash Transfers for Highways

Future projections of state cash transfers for highways were supplied by the Virginia Department of Highways. These payments include funds sent to municipalities with 3,500 or more population for maintenance on urban extensions of primary routes and other streets meeting certain engineering standards plus funds distributed to two counties (Arlington and Henrico) which perform their own construction and maintenance. They do not include the present 85 percent state share of new construction costs because these funds are not spent directly at the local level.

State Cash Transfers for Public Welfare

Since most public welfare programs in Virginia are carried out at the local level, large outlays show up as local government direct expenditures for public welfare. Yet, the majority of funding for these programs comes from either the state or the federal government. In 1972-73 nearly 89 percent of all local direct expenditures for this purpose were financed by funds received from the state.^{1/}

Future projections of state cash transfers for public welfare are made by calculating the federal, state, and local share of state-supported programs. These were adjusted in future years to take into account the effects of increased federal reimbursement for welfare administration and the complete federal take-over of aid to the blind, aid to the permanently and totally disabled, and old age assistance in January 1974. Once the adjusted shares were computed, the total local portion of each program was subtracted from the total projected cost of all welfare programs for the year in question. The difference so obtained represents that proportion of total expenditures financed by the state or by federal funds distributed through the state.

^{1/} Derived from Table 5.5 and Table 5.8. Includes any amount originating with the federal government but channeled through the state.

State Cash Transfers for General Support of Local Governments

State aid to localities for general support comes from five major sources-- A.B.C. profits; the state wine and spirits tax; state capitation taxes; excess fees paid to the state by certain county and city officials; and the motor vehicle carrier rolling stock property tax. Of the five, A.B.C. profits and the wine tax are the most significant. In fiscal year 1972-73, these two sources alone accounted for more than 97 percent of total state cash transfers for general local government support.

TABLE 5.4.--PERCENTAGE OF STATE CASH TRANSFERS FOR GENERAL SUPPORT SUPPLIED BY A.B.C. PROFITS AND WINES AND SPIRITS TAX, FISCAL YEARS 1965-66 TO 1972-73
(Thousands of Dollars)

<u>Fiscal Year</u>	<u>Total State Cash Transfers for General Support</u>	<u>A.B.C. Profits and Wine and Spirits Tax Distributed To Localities</u>	<u>% of Total State Cash Transfers for General Support</u>
1965-66	\$14,040	\$12,342	90.0
1966-67	13,811	13,390	89.7
1967-68	13,942	12,425	89.1
1968-69	13,927	12,885	92.5
1969-70	14,551	13,545	93.1
1970-71	16,858	15,830	93.9
1971-72	17,461	16,436	94.1
1972-73	18,383	17,979	97.8

Sources: U. S. Bureau of the Census, State Government Finances in 19--, selected editions (Washington: Government Printing Office); Report of the Comptroller, selected editions (Richmond: Department of Accounts).

Projections of general support aid are based on the assumption that future distributions of A.B.C. profits and wine and spirits tax collections will make up the major portion of total transfers as they did in the past. These two items, in turn, are projected on the basis of state revenue projections made

in Chapter III. In applying the distribution formulas to state totals, it is recognized that the state presently collects ABC profits and the wine and spirits tax during the fiscal year but distributes them to localities after the close of the fiscal year. After fiscal year 1976, however, ABC profits will be distributed to localities on a quarterly basis. Thus, in 1976-77 localities will experience windfall collections as they receive the 1976 fiscal year payment from ABC profits and three quarterly payments from ABC profits for fiscal year 1976-77. The projections of state cash transfers for general support of local governments account for this change.

State Cash Transfers for All Other Functions

State cash transfers for all other functions are projected by adjusting current payments for inflation and growth in population. We add to these amounts additional payments which will be distributed by the Department of Highways to aid cities which have to purchase local bus systems and to help those localities building fringe parking lots and bus shelters. Projections of this assistance were supplied by the Department of Highways.

Federal Government Cash Transfers

Since a large portion of federal aid to local governments is accounted for under state cash transfers, only a total figure is shown for federal disbursements paid directly to localities. Historically, most of this aid was made up of federal impact funds sent to local school divisions under Public Laws 874 and 815. Currently, however, this category also includes general revenue sharing monies which are being distributed by the Treasury Department.

To develop a forecast of direct federal payments to local governments in Virginia, we found it necessary to make two assumptions. First, we assume

that no new transfers of this type will be initiated over the period covered by our projections. Second, we make no provision for any change in the present method of allotting these funds such as the enactment of special revenue sharing. Based on these assumptions, therefore, we project future federal transfers by adjusting current payments for inflation and growth in population. The methodology for achieving this is the same as that previously used to project state expenditure items (see Chapter IV). Next, we add to projected federal grants the expected local share of general revenue sharing funds which were developed in Chapter III. In doing this, we make no allowance for the continuation of revenue sharing after 1976 when the present legislation expires. As a result, federal transfers for fiscal years 1977-78 through 1979-80 drop off sharply from the amounts projected for earlier years.

Summary of Revenue Projections

From fiscal years 1973-74 to 1981-82, total local government revenue is projected to grow at an average annual rate of 9.4 percent. During this time, intergovernmental transfers are not expected to grow as fast as other sources of local revenue. Thus, the trend that characterized the last half of the 1960's and the first part of the 1970's is not projected to continue through 1981-82. Instead, the projections show the movement to be reversed. From fiscal year 1973-74 to fiscal year 1980-81 local sources begin to make up a continuously larger share of the total revenue pie. Most of this change is due to increased tax collections as tax bases rise with inflation. The outcome is also influenced by the fact that we make no provision for change in the scope of state and/or federal aids from their present structure.

TABLE 5.5--TOTAL GENERAL REVENUES OF LOCAL GOVERNMENTS IN VIRGINIA
ACTUAL 1967-68 TO 1972-73; ESTIMATED 1973-74; PROJECTED 1974-75 TO 1981-82
(MILLIONS OF DOLLARS)

Revenue Source	Actual						Estimated ^{a/}		Projections						
	1967-68	1968-69	1969-70	1970-71	1971-72	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82
LOCAL SOURCES															
TAXES:															
Property taxes															
Real Estate	\$258.3	\$273.5	\$320.4	\$370.2	\$405.5	\$452.6	\$504.6	\$564.4	\$632.1	\$705.2	\$790.2	\$888.0	\$994.6	\$1,113.9	\$1,247.6
Public service corporations	39.3	40.0	44.5	48.6	50.4	54.4	57.7	61.8	67.1	72.0	77.6	84.5	92.2	100.8	110.2
Tangible personal property	47.4	49.4	57.0	67.6	76.7	88.1	99.8	106.7	119.4	137.9	155.6	170.8	188.4	208.9	231.2
Machinery and tools	8.8	9.2	10.8	13.0	13.7	14.7	16.4	17.4	20.2	21.7	23.3	25.1	27.0	29.0	31.2
Merchants capital	1.4	1.4	1.5	1.5	1.6	1.8	2.2	2.3	2.5	2.6	2.8	3.0	3.2	3.4	3.6
Total property taxes ^{b/}	355.2	373.5	434.2	500.9	547.9	611.6	680.7	752.6	841.3	939.4	1,049.5	1,171.4	1,305.4	1,456.0	\$1,623.8
Sales tax	55.9	65.0	72.0	78.6	89.0	96.4	115.6	127.3	145.9	166.8	189.6	209.6	232.9	260.3	290.6
Other taxes	93.7	102.0	119.7	135.0	168.7	199.7	223.7	242.0	274.7	322.5	369.2	410.9	459.4	517.3	580.9
Total taxes	504.8	540.5	625.9	714.5	805.6	907.7	1,020.0	1,121.9	1,261.9	1,428.7	1,608.3	1,791.9	1,997.7	2,233.6	2,495.3
CHARGES AND MISCELLANEOUS REVENUE	143.1	148.6	174.6	195.7	230.1	261.1	287.2	315.9	347.5	382.3	420.5	462.6	508.8	559.7	615.7
Total local sources	647.9	689.1	800.5	910.2	1,035.7	1,168.8	1,307.2	1,437.8	1,609.4	1,811.0	2,028.8	2,254.5	2,506.5	2,793.3	3,111.0
OTHER SOURCES															
STATE CASH TRANSFERS ^{c/}															
Education	296.9	339.5	368.5	397.3	446.7	500.8	569.0	624.2	664.5	741.2	779.0	812.3	848.1	887.2	920.4
Highways	17.6	18.5	18.8	19.5	20.5	31.2	32.5	33.1	34.9	35.5	36.1	36.7	37.3	37.9	38.5
Public welfare	43.9	49.9	74.9	95.9	146.2	171.1	167.8 ^{d/}	182.2	192.3	228.8	266.9	296.6	337.1	380.0	413.0
General support	13.9	13.9	14.6	16.9	17.5	18.4	19.8	19.1	21.7	36.8	22.1	22.7	23.4	24.0	24.7
All other functions	15.2	28.9	27.5	42.1	51.3	50.0	66.7	74.8	85.5	80.6	86.9	93.0	99.2	105.6	112.1
Total state transfers	387.5	450.6	504.3	571.6	682.2	771.5	855.8	933.4	998.9	1,182.9	1,191.0	1,261.3	1,345.1	1,434.7	1,508.7
FEDERAL CASH TRANSFERS	53.4	62.1	80.8	88.6	101.2	185.2	186.0	203.1	217.4	212.2	160.1	179.9	184.0	196.3	208.9
Total other sources	440.9	512.7	585.1	660.2	783.4	956.7	1,041.8	1,136.5	1,216.3	1,395.1	1,351.1	1,441.2	1,529.1	1,631.0	\$1,717.6
TOTAL REVENUE	\$1,088.8	\$1,201.8	\$1,385.6	1,570.4	\$1,819.1	\$2,125.5	\$2,349.0	\$2,574.3	\$2,825.7	\$3,206.1	\$3,379.9	\$3,695.7	\$4,035.6	\$4,424.3	\$4,828.6

a/ Estimates for 1973-74 contain a mixture of actual data and projections.

b/ The distribution of total fiscal year property tax collections between real estate taxes, public service corporation levies, tangible personal property taxes, machinery and tool taxes, and merchants' capital levies is estimated on the basis of annual levies as reported by the Department of Taxation.

c/ Includes any amount originating with the federal government but channeled through the state for distribution to local governments.

d/ The decline in public welfare transfers is caused by the federal takeover of aid to the blind, aid to the permanently and totally disabled, and old age assistance as of January, 1974.

Sources: U.S. Bureau of the Census, Governmental Finances in 19--, selected editions (Washington: Government Printing Office); Annual Report of the Superintendent of Public Instruction, (Richmond: State Board of Education); Annual Report of Department of Welfare and Institutions, selected editions (Richmond: Virginia Department of Welfare and Institutions); Report of the Department of Taxation, Fiscal Year Ending June 30, 19--, selected editions (Richmond: Department of Taxation) Report of Comptroller, Fiscal Year Ended June 30, 19--, selected editions (Richmond: Department of Accounts); "Statement to Show Estimated Payments to Counties Not in the Primary System and Estimated City Street Payments", letter from T. B. Omohundro, Jr., Virginia Department of Highways, June 18, 1975; Commonwealth of Virginia, Department of Taxation, 1973 Virginia Assessment/Sales Ratio Study (Richmond: Department of Taxation, 1975); U.S. Bureau of the Census, State Government Finances in 19--; selected editions (Washington: Government Printing Office).

TABLE 5.6--PERCENTAGE DISTRIBUTION OF PROJECTED LOCAL GOVERNMENT REVENUES IN VIRGINIA
FISCAL YEARS 1973-74 TO 1981-82

Revenue Source	Percent of Total								
	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82
Taxation	43.4	43.6	44.7	44.6	47.6	48.5	49.5	50.5	51.7
Property Taxes	29.0	29.2	29.8	29.3	31.1	31.7	32.3	32.9	33.6
Other Taxes	14.4	14.4	14.9	15.3	16.5	16.8	17.2	17.6	18.1
Charges and Miscellaneous Revenue	12.2	12.3	12.3	11.9	12.4	12.5	12.6	12.6	12.8
Intergovernmental Transfers	44.4	44.1	43.0	43.5	40.0	39.0	37.9	36.9	35.5
State Transfers	36.5	36.2	35.3	36.9	35.3	34.1	33.3	32.4	31.2
Federal Transfers	7.9	7.9	7.7	6.6	4.7	4.9	4.6	4.5	4.3
Total Revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Table 5.5.

Expenditure Projections

The technique used to project local government expenditures generally follows the baseline approach developed for the state expenditure projections in Chapter IV. Essentially, this method predicts the change in an expenditure item on the basis of changes in the population-workload ratio and the price ratio which in turn are derived from select populations and price indexes that correlate closely with the item. When the technique is used, no account is taken of scope and quality changes, and no allowance is made for the effects of increased borrowing on debt service costs. An adjustment for these factors will be made separately. Where it is felt that more accurate projections can be obtained, deviations from the baseline approach do occur. Because of this, the actual method used to project any one expenditure item is set forth in a complete subsection dealing with that item.

Education

The forecast of local government expenditures for elementary and secondary education follows the general baseline methodology. Population-workloads are estimated from the changes in future school enrollment projected by the State Department of Education. Price ratio factors are derived from the anticipated annual changes in the implicit price deflator for state and local government purchases of goods and services shown in appendix Table A.6. These factors were then applied to 1973-74 actual local outlays as reported in the 1973-74 Annual Report of the Superintendent of Public Instruction.

Highways

The technique of projecting local government expenditures for highways deviates somewhat from the general baseline method. This resulted because the use of population and price adjustments did not produce realistic figures.

One explanation for the above finding is that a large proportion of highway expenditures consist of capital outlays which are more erratic than recurring expenses. A more fundamental reason, however, is that highway expenditures may be more responsive to other variables such as the mileage of roads to be maintained or the density of traffic.

The alternative method which was chosen to forecast highway expenditures makes note of the fact that over the last few years cash transfers to localities for these purposes have approximated 35 percent of the total direct highway expenditures during the fiscal year. Therefore, this relationship was assumed to hold true and future highway expenditures were based on projected cash transfers supplied by the Virginia Department of Highways.

Public Welfare

Public welfare is by far the most difficult category to project for local governments. While the population-workload and price factor technique can be used, no overall ratio can be applied because of the diversity of programs and program recipients. Thus, the projection base must be broken down to individual programs. These are then added to obtain total welfare cost.

The actual method used to project local welfare programs is consistent with that used to project outlays for the state. Subsequently, the population factors and price indexes used for each program are the same as those listed in Table 4.1. The only difference in the two sets of projections is the dollar amount of the program costs and the scope of welfare activities at the two levels of government. Concerning this latter point, two programs are accounted for in local expenditures which are not included in state outlays. One of these is aid to Cuban refugees financed entirely by the federal government. The other is non-matched assistance paid by the localities.

An analysis of public welfare projections, shows that we account for a decline in total expenditures between fiscal years 1972-73 and 1973-74. The reduction in outlays during this period corresponds to the federal take-over of certain welfare programs on January 1, 1974.^{1/}

Health and Hospitals

Projections of local government expenditures for health and hospitals are derived from the application of the baseline projection methodology. Population-workloads are obtained from estimated changes in the total population of the state which is assumed to grow by 1.3 percent a year through 1979-80 and 1.2 percent thereafter. Price ratio factors are calculated from the annual projected changes in the medical service portion of the consumer price index. These are shown in appendix Table A.6. The combination of these two factors are then applied to base year expenditures in 1971-72.

Sewerage and Sanitation

Projections of local government expenditures for sewerage and sanitation follow the baseline methodology, however, we do treat capital outlay different from operational expenditures. For operational spending we calculate price factors from the projected percentage change in the implicit price deflator for state and local government purchases. This is then multiplied by the population caseload for sewerage and sanitation which is based on the anticipated change in total population of the state through 1982. For the capital outlay portion of this function, however, we use the same population workloads but base our price adjustments on the projected change in the

^{1/} On January 1, 1974, the Social Security Administration assumed the program costs of aid to the blind, aid to permanently and totally disabled, and old age assistance.

implicit price deflator for all government purchases of buildings. The reason for this is that we feel the latter index correlates more closely with the capital outlay associated with sewer construction.

Interest on General Debt

As mentioned earlier, the baseline projection approach for expenditures does not account for future increases in debt. One reason for this is that a change in the amount of outstanding debt partially reflects a need for funds which in turn is influenced by the size of a deficit or surplus. Thus, if one were to make an assumption about the future course of borrowings, he would also indirectly indicate a future trend in revenues and expenditures gaps. Consequently, to avoid the implication of such an assumption, no change in debt is projected. Rather, interest costs on general debt are carried at their current rate on existing debt stocks. In future periods, this amount is adjusted to include the effects of redemption payments.

All Other General Expenditures

The projections of local government direct expenditures for police and fire protection, for local parks and recreation, for financial administration and general control, and for all other functions are derived by applying population workloads (based on the estimated change in total population throughout state) plus price factors (calculated from the projected change in the implicit price deflator for state and local purchases of goods and services) to 1971-72 base year expenditures.

Redemption of Long-Term General Debt

For lack of other information, the redemption period for long-term general debt is assumed to be 18.5 years. This means that approximately 5.4 percent of 1972-73 long-term general debt outstanding will be redeemed annually over

the projection period. An equivalent rate of debt redemption existed for counties and cities in Virginia during 1971-72 as shown below.

TABLE 5.7.--RESERVATION FOR REDEMPTION OF DEBT BY
CITIES AND COUNTIES IN VIRGINIA, FISCAL YEAR 1971-72
(Thousands of Dollars)

	Gross Debt Outstanding at End of Fiscal Year	Reservation for Redemption of Debt	% of Gross Debt Outstanding
Cities	\$ 898,270	\$49,610	5.5
Counties	886,357	45,885	5.2
Total	\$1,784,627	\$95,495	5.4

Source: Report of Auditor of Public Accounts on Comparative Cost of City Government, Year Ended June 30, 1972, (Richmond: Auditor of Public Accounts, 1974), pp. 23-25, Report of the Auditor of Public Accounts on Comparative Cost of County Government, Year Ended June 30, 1972, (Richmond: Auditor of Public Accounts, 1974), pp.15,25.

Summary of Expenditure Projections

For fiscal years 1973-74 through 1981-82, total local government outlays (before borrowing) are projected to grow by an average annual rate of 6.6 percent. During this time, education, public welfare, police and fire protection, and sewerage and sanitation are expected to remain the major expenditure items. In fiscal year 1981-82, these four functions are projected to account for approximately 74 percent of total local budgets (see Table 5.9). This outcome, however, is predicated on the assumption that there will be no new borrowing. As a result, the actual share of these items will probably be somewhat less than 74 percent once new debt is floated.

TABLE 5.8.--BASELINE PROJECTIONS OF TOTAL LOCAL GOVERNMENT DIRECT EXPENDITURE (INCLUDING CAPITAL OUTLAY) IN VIRGINIA
ACTUAL, FISCAL YEARS 1967-68 TO 1972-73; ESTIMATED 1973-74; AND PROJECTED, FISCAL YEARS 1974-75 TO 1981-82
(Millions of Dollars)

Function	Actual						Estimated ^{a/}	Projected							
	1967-68	1968-69	1969-70	1970-71	1971-72	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82
Education	\$635.6	\$681.3	\$777.1	\$873.4	\$924.5	\$996.4	\$1,248.8	\$1,408.7	\$1,539.7	\$1,664.7	\$1,744.0	\$1,806.1	\$1,861.5	\$1,920.8	\$1,980.4
Highways	48.6	54.4	57.8	63.0	64.6	79.9	92.8	94.6	99.7	101.4	103.1	107.7	106.6	108.3	110.0
Public Welfare	68.9	86.3	100.9	137.4	174.3	192.7	189.0 ^{b/}	204.8	216.6	257.2	299.4	332.0	376.9	424.6	461.5
Health & hospitals	24.5	26.7	23.4	29.7	35.7	37.6	42.0	47.3	51.8	56.2	60.6	64.8	69.0	73.2	77.6
Police & fire protection	68.9	76.9	89.1	96.5	110.0	130.0	144.2	164.4	181.6	198.3	214.8	230.7	246.8	263.4	280.2
Sewerage & sanitation	60.0	70.3	61.4	69.9	89.1	103.0	115.6	134.8	151.4	167.7	184.0	199.8	216.1	232.9	250.4
Local parks & recreation	20.0	26.4	46.7	37.8	44.6	51.6	57.2	65.2	72.1	78.7	85.3	91.6	98.0	104.5	111.2
Financial administration & general control	38.7	42.7	47.9	56.9	63.4	80.4	89.2	101.7	112.3	122.7	132.8	142.7	152.7	162.9	173.3
Interest on general debt	55.0	52.5	60.5	68.6	82.6	87.0	75.5	71.5	67.6	64.0	60.5	57.2	54.1	51.2	48.5
All other general expenditures	118.5	129.4	152.7	195.9	209.4	212.0	235.1	268.0	296.2	323.4	350.3	376.2	402.5	429.5	457.0
Total direct expenditures	1,138.7	1,247.0	1,417.7	1,629.3	1,798.1	1,970.6	2,289.4	2,561.0	2,789.0	3,034.3	3,234.8	3,408.8	3,584.2	3,771.3	3,950.1
Redemption of long term general debt ^{c/}	70.9	71.4	86.5	100.1	118.2	156.9	116.5	110.2	104.3	98.7	93.3	88.3	83.5	79.0	74.8
Total local outlays	\$1,209.6	\$1,318.4	\$1,504.2	\$1,729.4	\$1,916.3	\$2,127.5	\$2,405.9	\$2,671.2	\$2,893.3	\$3,133.0	\$3,328.1	\$3,497.1	\$3,667.7	\$3,850.3	\$4,024.9

^{a/} Projections for 1973-74 contain a mixture of actual data and projections. Figures for education and public welfare represent actual expenditures as reported by the appropriate source. Figures for all other functions are derived by using the projection techniques.

^{b/} The decline in public welfare expenditures in 1973-74 was the result of federal take over on January 1, 1974 of three programs: aid to the blind, aid to the permanently and totally disabled, and old age assistance.

^{c/} Historical figures represent "long-term debt retired" as reported by the U.S. Department of Commerce, Bureau of the Census, in Governmental Finances in 19--, (selected editions).

Sources: U.S. Bureau of the Census, Governmental Finances in 19--, selected editions (Washington: Government Printing Office); Annual Report of the Superintendent of Public Instruction, selected editions (Richmond: State Board of Education); Annual Report of Department of Welfare and Institutions, selected editions (Richmond: Virginia Department of Welfare and Institutions).

TABLE 5.9.--PERCENTAGE DISTRIBUTION OF PROJECTED LOCAL GOVERNMENT EXPENDITURES IN VIRGINIA
FISCAL YEARS 1973-74 TO 1981-82

Function	Percent of Total								
	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82
Education	51.9	52.7	53.2	53.1	52.4	51.6	50.8	49.9	49.2
Highways	3.9	3.5	3.4	3.2	3.1	3.1	2.9	2.8	2.7
Public Welfare	7.9	7.7	7.5	8.2	9.0	9.5	10.3	11.0	11.5
Health & hospitals	1.7	1.8	1.8	1.8	1.8	1.9	1.9	1.9	1.9
Police & fire protection	6.0	6.2	6.3	6.3	6.5	6.6	6.7	6.8	7.0
Sewerage & sanitation	4.8	5.0	5.2	5.4	5.5	5.7	5.9	6.0	6.2
Local parks & recreation	2.4	2.4	2.5	2.5	2.6	2.6	2.7	2.7	2.8
Financial administration & general control	3.7	3.8	3.9	3.9	4.0	4.1	4.2	4.2	4.3
Interest on general debt	3.1	2.7	2.3	2.0	1.8	1.6	1.5	1.3	1.2
All other general expenditures	9.8	10.0	10.2	10.3	10.5	10.8	11.0	11.2	11.4
Redemption of long-term general debt	4.8	4.1	3.6	3.2	2.8	2.5	2.3	2.1	1.9
Total outlays	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: Details may not add to totals due to rounding.

Source: Table 5.8.

Summary of Baseline Projections

Table 5.10 presents the net result of baseline revenue and expenditure projections through fiscal year 1981-82. The projections show surplus gaps beginning in 1976-77 with the size of the surplus generally increasing in more distant years. The only exception to this trend occurs in 1977-78 when the amount of the surplus falls off due to the fact that we make no allowance for the reenactment of general revenue sharing. In addition, the amount of the positive gap in 1976-77 is accentuated by windfall collections resulting from a change in the state distribution of ABC profits from a year end to quarterly basis. This move is expected to add a one-time addition of \$14.1 million to local revenues.

In evaluating the surplus gaps, two factors are seen as major contributors to the favorable outlook for local government finances. The first is the projected decline in the rate of growth of expenditure items caused in part by the anticipated slowdown in inflation and population change. This allows a more stable local revenue base to catch up with outlays in future years. The second factor contributing to the positive gaps is the absence of any allowance for changes in scope and quality within the expenditure categories and the absence of any provision for increases in debt. Since these assumptions understate the most probable growth for expenditures, an adjustment for these considerations is accounted for in the following pages.

TABLE 5.10.--BASELINE PROJECTIONS OF LOCAL GOVERNMENT FINANCES IN VIRGINIA,
 ACTUAL, FISCAL YEARS 1967-68 TO 1972-73; ESTIMATED 1973-74; AND PROJECTED, FISCAL YEARS 1974-75 TO 1981-82^{a/}
 (Millions of Dollars)

	Actual						Estimated 1973-74	Projections							
	1967-68	1968-69	1969-70	1970-71	1971-72	1972-73		1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82
Revenue															
Tax revenue	\$504.8	\$540.5	\$625.9	\$714.5	\$805.6	\$907.7	\$1,020.0	\$1,121.9	\$1,261.9	\$1,428.7	\$1,608.3	\$1,791.9	\$1,997.7	\$2,233.6	\$2,495.3
Charges and miscellaneous revenue	143.1	148.6	174.6	195.7	230.1	261.1	287.2	315.9	347.5	382.3	420.5	462.6	508.8	559.7	615.7
Intergovernmental transfers	440.9	512.7	585.1	660.2	783.4	956.7	1,041.8	1,136.5	1,216.3	1,395.1	1,351.1	1,441.2	1,529.1	1,631.0	1,717.6
Total revenue	\$1,088.8	\$1,201.8	\$1,385.6	\$1,570.4	\$1,819.1	\$2,125.5	\$2,349.0	\$2,574.3	\$2,825.7	\$3,206.1	\$3,379.9	\$3,695.7	\$4,035.6	\$4,424.3	\$4,828.6
Expenditures															
Total direct expenditures	\$1,138.7	\$1,247.0	\$1,417.7	\$1,629.3	\$1,798.1	\$1,970.6	\$2,289.4	\$2,561.1	\$2,789.0	\$3,034.3	\$3,234.8	\$3,408.8	\$3,584.2	\$3,771.3	\$3,950.1
Redemption of long-term general debt	70.9	71.4	86.5	100.1	118.2	156.9	116.5	110.2	104.3	98.7	93.3	88.3	83.5	79.0	74.8
Total outlays	\$1,209.6	\$1,318.4	\$1,504.2	\$1,729.4	\$1,916.2	\$2,127.5	\$2,405.9	\$2,671.2	\$2,893.3	\$3,133.0	\$3,328.1	\$3,497.1	\$3,667.7	\$3,850.3	\$4,024.9
Surplus or deficit before borrowing	\$-120.8	\$-116.6	\$-118.6	\$-159.0	\$-97.1	\$-2.0	\$-56.9	\$-96.9	\$-67.6	\$+73.1	\$+51.8	\$+198.6	\$+367.9	\$+574.0	\$+803.7

^{a/} These projections do not account for any increase in borrowing or its effects on debt service costs.

Sources: Table 5.5 and Table 5.9.

Scope and Quality Considerations

Estimates of Scope and Quality

Quantitative estimates of changes in scope and quality are made for each category of expenditure by the same method as used in the state expenditure projections discussed in Chapter IV. The only alteration occurs in the case of highway expenditures. Since this category is projected from future state cash transfers, the method for establishing scope and quality factors had to be changed. The alternative approach achieves comparative results by compounding 1962-63 state cash transfers for highways by 2.1 percent a year (the average rate of growth in projected transfers) until 1972-73. The amount accumulated at that time is then used to project a hypothetical total for 1972-73 highway expenditures based on the initial assumption that state cash transfers would approximate 35 percent of total outlays. The proportion of actual highway expenditures in 1972-73 not accounted for by this method is then assumed to be the amount of expenditures caused by changes in scope and quality. This is stated as a percent of total expenditures and adjusted to an annual rate.

Table 5.11 shows a summary of the percentage changes in scope and quality for each functional category. The overall figure for total expenditures was obtained by adding the individual factors weighted by their percentage of the combined total of 1972-73 expenditures^{1/}.

^{1/} The scope and quality estimates are based on an analysis of total local government expenditures in the past. This methodology may be correct when intergovernmental flows are known and are accounted for on both the revenue and expenditure side. However, in applying these estimates to future projections, only those expenditures which are financed by local sources may be used as a base for projecting scope and quality change. The reason for this is explained in the next section.

TABLE 5.11.-- ESTIMATED INCREASE IN SCOPE AND QUALITY
OF EXPENDITURE PROGRAMS FROM 1962-63 TO 1972-73

<u>Function</u> ^{a/}	<u>Average Annual Percentage Increase in Scope and Quality</u>
Education	3.2
Highways	3.9
Public welfare ^{b/}	3.8
Health and hospitals	7.0
Police and fire protection	5.2
Sewerage and sanitation	5.1
Local parks and recreation	9.8
Financial administration and general control	6.6
All other general expenditures	<u>4.2</u>
Total	4.2

^{a/} Debt service costs do not fit into the conceptual framework of this model.

^{b/} Based on projected to actual costs of Aid to Dependent Children, Foster Care, General Relief, Hospitalization of the Indigent, and Administration.

Adjustments in the Projections for Scope and Quality

The scope and quality estimates just derived are assumed to be indicative of future improvements in the expenditure categories. In adding these estimates to baseline expenditure projections, only that proportion of total expenditures representing outlays to be financed from local sources is adjusted for such improvements. This means that in calculating the expenditure base for scope and quality increases, intergovernmental transfers are subtracted from total expenditures. This adjustment is required because any allowance for scope and quality based on total expenditures would raise the projected amount spent for certain programs originally financed by intergovernmental transfers, while no account is made for such an increase in the revenue projections. Thus, the net effect would be to overstate projected expenditures.

With the scope and quality estimates included, two things happen to local government projections as shown in Table 5.12. First, the deficits that were previously projected for fiscal years 1974-75 and 1975-76 become increasingly larger as compared to their former level. Second, the surpluses that were projected for fiscal years 1976-77 through 1981-82 are wiped out by higher expenditures. Both of these results demonstrate the compounding effect characteristic of changes in scope and quality for this projection model. When a program is improved, not only do more people begin to receive its benefits, but also, present recipients receive greater benefits than they had been getting in the past. This twofold expansion causes expenditures to mount very rapidly given continual change in program content.

TABLE 5.12.--BASELINE PROJECTIONS OF LOCAL GOVERNMENT FINANCES IN VIRGINIA, ADJUSTED FOR CHANGES IN SCOPE AND QUALITY, FISCAL YEARS 1973-74 TO 1981-82
(Millions of Dollars)

<u>Fiscal Year</u>	<u>Revenues</u>	<u>Expenditures Including Scope and Quality Change</u>	<u>Surplus or Deficit</u>
Estimated			
1973-74	\$2,349.0	\$2,425.6 ^{a/}	\$ -76.6
Projections			
1974-75	2,574.3	2,751.3	-177.0
1975-76	2,825.7	3,048.7	-223.0
1976-77	3,206.1	3,369.4	-163.3
1977-78	3,379.9	3,689.0	-309.1
1978-79	3,695.7	3,971.8	-276.1
1979-80	4,035.6	4,268.8	-233.2
1980-81	4,424.3	4,591.9	-167.6
1981-82	4,828.6	4,923.2	-94.7

^{a/} No adjustment is made for scope and quality changes in education and public welfare expenditures in fiscal year 1973-74, because they represent actual figures as reported by the appropriate agency.

Adjustments in the Projections for Borrowing

So far, no mention has been made of borrowing. It should be remembered, however, that debt financing for capital outlays is an integral part of most local governments' operations and that some allowance for its effect ought to be made. To do this, Table 5.13 is constructed to show what would happen with an 8.4 percent annual increase in long-term general debt outstanding. This figure represents the average annual growth in long-term debt for Virginia local governments over the last ten years, so it should provide a reasonable growth rate for analysis.^{1/}

In the table, the increase in this debt from one fiscal year to another is treated as an inflow of funds from borrowing. Redemption payments are computed by taking 5.4 percent of the increase in debt beginning one year after that amount is incurred. Interest costs are calculated on the amount of net long-term general debt outstanding (long-term general debt minus the amount redeemed during the year). Both elements of the additional debt service costs are then subtracted from the inflow of funds to derive the net inflow of funds which would be available to finance capital outlays.^{2/} Over the entire period, this adjustment would provide an additional \$1,369.1 million in funds for local governments.

^{1/} The methodology assumes that projected capital outlays will be large enough to warrant an 8.4 percent rate of borrowing. Certainly, this is the case at present.

^{2/} The increases in debt service costs are subtracted from borrowings to simplify the analysis and to provide the net effect on projected deficits and surpluses. It is realized that borrowings must be used exclusively for capital outlays while interest expense and redemption costs are paid from general funds.

TABLE 5.13.--NET INFLOW OF FUNDS AVAILABLE TO FINANCE CAPITAL OUTLAYS WITH AN 8.4 PERCENT ANNUAL INCREASE IN DEBT, FISCAL YEARS 1973-74 TO 1981-82
(Millions of Dollars)

Fiscal Year	Inflow of Funds from Borrowing ^{a/}	Additional Redemption Costs Associated With Borrowing	Additional Interest Costs Because of Borrowing	Net Inflow of Funds Available to Finance Capital Outlays ^{b/}
1973-74	\$ +181.3	\$... ^{c/}	\$ +6.7	\$ +174.6
1974-75	+196.5	+9.8	+17.9	+168.8
1975-76	+213.0	+20.4	+29.5	+163.1
1976-77	+230.9	+31.9	+41.4	+157.6
1977-78	+250.3	+44.4	+53.9	+152.0
1978-79	+271.3	+57.9	+66.9	+146.5
1979-80	+294.1	+72.6	+80.6	+140.9
1980-81	+318.8	+88.5	+94.8	+135.5
1981-82	+345.6	+105.7	+109.8	+130.1
Total	\$+2,301.8	\$+431.2	\$+501.5	\$+1,369.1

a/ The inflow of funds from borrowing represents the change in long-term general debt outstanding when an 8.4 percent annual growth is applied to the 1972-73 amount outstanding, \$2,158.1 million.

b/ Projected deficits or surpluses would be reduced or increased by the amounts listed here.

c/ Under the assumptions, no additional redemption cost will be incurred on the 1973-74 increase in debt. Redemption payments for this amount will begin in 1974-75.

Comparison of Revenues and Expenditures

The fiscal outlook for projected local government finances can be summarized with mixed conclusions. Certainly for the near future, fiscal years 1974-75 and 1975-76, the financial picture looks rather bleak. Rapidly expanding expenditures during these years will, most assuredly, hit local governments hard. Thus, pressure will mount for them to raise taxes, to find other sources of aid (particularly from other levels of government) and to rely heavily on borrowing. A short-run balancing of revenues and

expenditures could result from any one or combination of these factors. Over the longer run, however, the financial situation will depend greatly on the rate of expansion in programs which the local governments administer and the possible rise in tax rates not considered in these projections. If changes in scope and quality keep pace with those of the recent past, the financial picture may continue to result in deficits through 1981-82. On the other hand, if program improvements are restrained in the face of deficits, some relief may begin to appear in the latter years. Factors that contribute to this more favorable trend are the projected slowdown in the rate of inflation and its effects on public service costs, the projected slowing of population growth, and the decline in other population variables such as local school enrollment.

Measurements of Central City Finances

The previous analysis applied to all local governments, and trends for the entire group may not be applicable to each government. To underline this fact, in this section we develop some data for the eight central cities (Alexandria, Hampton, Newport News, Norfolk, Portsmouth, Richmond, Roanoke, and Lynchburg).

Table 5.14 shows data for fiscal year 1972-73, the latest year available. Central city per capita revenues from own sources were almost 40 percent higher than the state average for all local governments, and total revenues were 39 percent higher. Total direct expenditures per capita, on the other hand, were 42 percent higher in central cities than for the state as a whole. In fact, the central cities spent more on a per capita basis in all functional areas except education--a difference largely accounted for by lower educational capital outlays in the slow-growing central cities.

Table 5.15 provides some data for analysis of revenue and expenditure trends. From fiscal years 1962-63 to 1972-73, central city per capita revenues from own sources rose 176 percent, slightly higher than the statewide average for all local government. Overall, including intergovernmental revenue, central city per capita revenues increased by 254 percent versus 213 percent for the comparable statewide measure. Analysis of the data shows that central city per capita revenues grew faster in all major categories. Only for miscellaneous taxes did per capita revenues for central cities not keep pace with that of all local governments.

With respect to per capita general direct expenditures, total outlays increased by 225 percent in the central cities compared to 141 percent for all local governments. Of the nine expenditure items listed, education, public welfare, highways, health and hospitals, and interest on general debt grew faster in the central cities.

As already noted, per capita revenues from own sources grew only slightly higher in central cities than it did for all local governments. A related question, however, is what happened to local tax bases during the 1960's. To answer this, we analyzed two major components of local tax bases--taxable retail sales and the true value of taxable real estate. From 1967 to 1974, adjusted per capita retail sales increased by 92 percent in the central cities compared to 97 percent for all local governments. And from 1962 to 1973, per capita property values rose 142 percent in central cities versus 178 percent statewide.

In summary, during the previous decade, central cities fared rather poorly. Their per capita revenues grew only slightly faster than for all local governments, but expenditures grew faster. And to compound the problem, per capita values for two principal elements in local tax bases--retail sales and the value of real estate--grew slower in central cities than elsewhere.

TABLE 5.14--COMPARISON OF FINANCES FOR ALL LOCAL GOVERNMENTS
AND CENTRAL CITIES IN VIRGINIA, FISCAL YEAR 1972-73

	Total Amounts (Millions of Dollars)		Central City Amounts as a Percent of Amounts for All Local Governments	Per Capita Amounts ^{a/}		Central City Per Capita Amounts as a Percent of Per Capita Amounts for All Local Governments
	All Local Government	Central Cities		All Local Governments	Central Cities	
General Revenue						
Taxes:						
Property	\$611.6	\$173.9	28.4	\$128.35	\$152.50	118.8
Sales and gross receipts	96.5	32.2	33.4	20.25	28.24	139.5
Other	199.5	98.1	49.2	41.87	86.03	205.5
Charges and miscellaneous revenue	261.1	86.8	33.2	54.80	76.12	138.9
Total general revenue from own sources	1,168.7	391.0	33.5	245.27	342.89	139.8
Intergovernmental revenue:						
From state and local governments	771.5 ^{b/}	222.8	28.9	161.91	195.39	120.7
From federal government	185.2	92.2	49.8	38.87	80.86	208.0
Total intergovernmental revenue	956.7	315.0	32.9	200.78	276.24	137.6
Total revenue	\$2,125.4	\$706.0	33.2	\$446.04	\$619.14	138.8
General Direct Expenditures						
Education	\$996.4	\$229.2	23.0	\$209.11	\$201.00	96.1
Highways	79.9	30.6	38.3	16.77	26.84	160.0
Public welfare	192.7	104.3	54.1	40.44	91.47	226.2
Health & hospitals	37.6	14.4	38.3	7.89	12.63	160.1
Police & fire protection	130.0	57.5	44.2	27.28	50.43	184.9
Sewerage & sanitation	103.0	37.4	36.3	21.62	32.80	151.7
Local parks & recreation	51.6	22.6	43.8	10.83	19.82	183.0
Financial administration & general control	80.4	23.5	29.2	16.87	20.61	122.2
Interest on general debt	87.0	31.6	36.3	18.26	27.71	151.8
All other general expenditures	212.0	119.3	56.3	44.49	104.62	235.2
Total direct expenditure	\$1,970.6	\$670.4	34.0	\$413.56	\$587.92	142.2
Exhibit: 1972 population						
All local governments	4,765,000					
Central cities	1,140,300					

Note: Details may not add to totals due to rounding.

a/ Based on 1972 population estimates by Tayloe Murphy Institute, University of Virginia.

b/ Intergovernmental revenues from local governments are netted out.

Sources: U.S. Bureau of the Census, City Government Finances in 1972-73, GF73 No. 4, (Washington: Government Printing Office, 1974), pp. 58-59; U.S. Bureau of the Census, Governmental Finances in 1972-73, GF73 No. 5, (Washington: Government Printing Office, 1974), pp. 38-39; Tayloe Murphy Institute, University of Virginia, "Estimates of the Population of Virginia Counties and Cities: July 1, 1972 and July 1, 1973," October, 1974.

TABLE 5.15--TRENDS IN FINANCES OF ALL LOCAL GOVERNMENTS AND CENTRAL CITIES IN VIRGINIA, FISCAL YEARS 1962-63 TO 1972-73

	Total Amounts (Millions of Dollars)				Percentage Change 1962-63 to 1972-73		Per Capita Amounts ^{a/}				Percentage Change 1962-63 to 1972-73	
	All Local Governments		Central Cities		All Local Governments	Central Cities	All Local Governments		Central Cities		All Local Governments	Central Cities
	1962-63	1972-73	1962-63	1972-73			1962-63	1972-73	1962-63	1972-73		
General Revenue												
Taxes:												
Property	\$227.8	\$611.6	\$74.9	\$173.9	+168.5	+132.2	\$54.50	\$128.35	\$64.71	\$152.50	+135.5	+135.7
Sales and gross receipts	...	96.5	...	32.2	...	...	...	20.25	...	28.24	...	...
Other	59.8	199.5	36.1	98.1	+233.6	+171.7	14.31	41.87	31.19	86.03	+192.6	+175.8
Charges and miscellaneous revenue	100.2	261.1	32.8	86.8	+160.6	+164.6	23.97	54.80	28.34	76.12	+128.6	+168.6
Total general revenue from own sources	387.8	1,168.7	143.8	391.0	+201.4	+171.9	92.78	245.27	124.23	342.59	+164.3	+176.0
Intergovernmental revenue:												
From state and local governments	179.6	771.5	48.1 ^{b/}	222.8	+329.6	+363.2	42.97	161.91	41.56	195.39	+276.8	+370.1
From federal government	28.2	185.2	10.4	92.2	+556.7	+786.5	6.75	38.87	8.98	80.86	+475.9	+800.4
Total intergovernmental revenue	207.8	956.7	58.5	315.0	+360.4	+438.5	49.71	200.78	50.54	276.24	+303.9	+446.6
Total revenue	\$595.6	\$2,125.4	\$202.3	\$706.0	+256.8	+249.0	\$142.49	\$446.04	\$174.77	\$619.14	+213.0	+254.2
General Direct Expenditures												
Education	\$365.6	\$996.4	\$85.1	\$229.2	+172.5	+169.3	\$87.46	\$209.11	\$73.52	\$201.00	+139.1	+173.4
Highways	83.0	79.9	13.2	30.6	-3.8	+131.8	19.86	16.77	11.40	26.84	-15.6	+135.4
Public welfare	41.9	192.7	19.6	104.3	+360.0	+432.1	10.02	40.44	16.93	91.47	+303.6	+440.3
Health & hospitals	10.6	37.6	4.6	14.4	+254.7	+213.0	2.54	7.89	3.97	12.63	+210.6	+218.1
Police & fire protection	41.5	130.0	21.7	57.5	+213.3	+165.0	9.93	27.28	18.75	50.43	+174.7	+169.0
Sewerage & sanitation	32.5	103.0	14.6	37.4	+216.9	+156.2	7.78	21.62	12.61	32.80	+177.9	+160.1
Local parks & recreation	10.5	51.6	5.7	22.6	+391.4	+296.5	2.51	10.83	4.92	19.82	+331.5	+302.8
Financial administration & general control	22.5	80.4	8.0	23.5	+257.3	+193.8	5.38	16.87	6.91	20.61	+213.6	+198.3
Interest on general debt	34.9	87.0	9.2	31.6	+149.3	+243.5	8.35	18.26	7.95	27.71	+118.7	+248.6
All other general expenditures	74.6	212.0	28.0	119.3	+184.2	+326.1	17.85	44.49	24.19	104.62	+149.2	+332.5
Total direct expenditures	\$717.6	\$1,970.6	\$209.7	\$670.4	+174.6	+219.7	\$171.67	\$413.56	\$181.17	\$587.92	+140.9	+224.5
Exhibit:												
1962 population												
All local governments	4,180,000											
Central cities	1,157,500											
1972 population												
All local governments	4,765,000											
Central cities	1,140,300											

Note: Details may not add to totals due to rounding.

^{a/} Based on 1962 and 1972 population estimates from Tayloe Murphy Institute, University of Virginia.

^{b/} Breakdown of transfers from federal government and from other localities was not available for fiscal 1962-63.

Sources: U.S. Bureau of the Census, Governmental Finances in 19--, selected editions (Washington: Government Printing Office); U.S. Bureau of the Census, City Government Finances in 19--, selected editions, Washington: Government Printing Office); Tayloe Murphy Institute, University of Virginia, "Estimates of the Population of Virginia Counties and Cities: July 1, 1972 and July 1, 1973; University of Virginia, Tayloe Murphy Institute, "Annual Population Estimates, Virginia Cities and Counties, 1960-1970."

TABLE 5.16.--COMPARISON OF SELECTED REVENUE BASES
FOR CENTRAL CITIES AND ALL LOCAL GOVERNMENTS

	<u>Taxable Retail Sales</u>			<u>Per Capita^{a/}</u>		
	<u>Total</u>					
	<u>1967</u>	<u>1974</u>	<u>Percent Change</u>	<u>1967</u>	<u>1974</u>	<u>Percent Change</u>
Central Cities	\$1,942,231,531	\$3,614,965,778	86.1	\$1,646	\$3,158	91.9
(State)						
Total	\$5,410,625,893	\$11,596,293,204	114.3	\$1,200	\$2,363	96.9

	<u>True Property Tax Base</u>			<u>Per Capita^{b/}</u>		
	<u>Total</u>					
	<u>1962^{c/}</u>	<u>1973^{d/}</u>	<u>Percent Change</u>	<u>1962</u>	<u>1973</u>	<u>Percent Change</u>
Central Cities	\$4,632,273,700	\$10,995,479,000	137.4	\$4,002	\$9,671	141.7
(State)						
Total	\$18,117,483,000	\$57,952,019,000	219.9	\$4,334	\$12,046	177.9

Exhibit:

1967 population		1962 population	
State total	4,508,000	State total	4,180,000
Central cities	1,179,900	Central cities	1,157,500
1974 population		1973 population	
State total	4,908,000	State total	4,811,000
Central cities	1,144,700	Central cities	1,137,000

a/ Per capita figures for 1967 are based on Tayloe Murphy Institute estimates and 1974 figures are based on unpublished data by the U.S. Bureau of the Census.

b/ Per capita figures for 1962 and 1973 are based on Tayloe Murphy Institute estimates.

c/ True property values for the state in 1962 were supplied by the Department of Taxation. For central cities, full values were calculated by dividing 1962 assessed values by the true assessment ration.

d/ True property values for 1973 were supplied by the Department of Taxation.

Sources: Taxable Sales in Virginia Counties and Cities, selected editions (Richmond: Department of Taxation); "1962 Estimated True (Full) Value of Locally Taxed Property in Virginia Counties, Cities, and Towns Constituting Special School Districts," special tabulations by the Department of Taxation; "1973 Virginia Assessment/Sales Ratio Study," Department of Taxation (Richmond: February, 1975); University of Virginia, Tayloe Murphy Institute, "Estimates of the Population of Virginia Counties and Cities: July 1, 1972 and July 1, 1973; University of Virginia, Tayloe Murphy Institute, "Annual Population Estimates, Virginia Cities and Counties, 1960-1970."

Local Revenue Issues

This part of the chapter provides a concise analysis of local revenue issues with primary emphasis on the real property tax and recent reform efforts. The real property tax is the single most important source of local revenue for Virginia's counties and cities, accounting for approximately 45% of locally raised revenue, and in certain rural jurisdictions its significance is much greater, ranging up to 80% or more of local revenues. Following the discussion of the real property tax, there are brief discussions of other local revenue issues.

The Real Property Tax

Terminology

To assist in understanding the property tax, it may be helpful to review terminology. Property is first appraised to determine its true market value. It has been the custom in Virginia and elsewhere to assess the appraised value at some percentage less than 100 percent before the local property tax is levied on the assessed value. Legislation passed by the 1975 General Assembly, however, requires that all assessments of real estate shall be made at 100 percent fair market value, effective January 1, 1976. After that date, assessed values should be representative of the appraisal of fair market value.

Rates

The only meaningful way to compare tax rates is to compare them based on true values of property. The Department of Taxation conducts annual surveys which provide this information. For 1973, the survey indicated that true tax rates varied from \$0.18 per \$100 of true value in Surry County to \$1.65 in

Richmond City. The weighted average rate of \$0.92 was strongly affected by the heavily populated urban areas of the state. As shown in Appendix Table A.7, the majority of the localities had rates lower than the weighted average. Reflecting this, the median rate was \$0.72. By national standards, this was a low rate. According to the 1972 Census of Governments, the median tax rate for 349 selected cities was \$2.10 per \$100 of true value.^{1/} Furthermore, a U. S. Department of Agriculture study of farm real estate taxation showed that in 1969, Virginia's average tax per \$100 of full value was \$0.68 compared with a weighted national average of \$1.12.^{2/}

Assessment Procedures

Although the property tax is the workhorse of local government, in many localities it is not being used to its full potential. Only 19 cities and 7 counties employ full-time assessors.^{3/} Many localities assess only as required by law--every four years for cities and every six years for counties. Often, this is too infrequent for an age marked by population change, new land use patterns, and inflation.

Assessment ratios vary from 4.4 percent of market value to 82 percent. The statewide weighted average is 22.5 percent. The practice of not assessing at full fair market value is nearly universal in the United States,

^{1/} U. S. Department of Commerce, Bureau of the Census, "Taxable Property Values and Assessment-Sales Price Ratios", 1972 Census of Governments, volume 2, number 2 (Washington: Government Printing Office, 1973) p.17

^{2/} U. S. Department of Agriculture, Economic Research Service, "Farm Real Estate Taxes" RET-10 (February, 1971), pp.16-17.

^{3/} The cities are Alexandria, Charlottesville, Chesapeake, Covington, Danville, Fairfax, Hampton, Lynchburg, Newport News, Norfolk, Petersburg, Portsmouth, Richmond, Roanoke, Salem, Staunton, Virginia Beach, Waynesboro and Williamsburg. The counties are Albemarle, Arlington, Chesterfield, Fairfax, Henrico, Prince George, and Prince William.

and in recent years Virginia's assessment ratio has been close to the national.^{1/} Nevertheless, there are strong arguments against such a procedure--it reduces taxpayer understanding of the property tax and makes appeal difficult.

Another problem with underassessment is that it may artificially restrict borrowing when borrowing is limited to a certain percentage of assessed property values in the area. In Virginia, with a few exceptions, no city or town may issue general obligation bonds to an amount which exceeds 18 percent of the assessed valuation of the real estate subject to taxation.

A characteristic of property assessment in Virginia (and in other states as well) is that assessment ratios within a community may vary widely. There are usually two reasons for this--first, different classes of property such as nonfarm residential property and agricultural land are intentionally assessed at different ratios, and second, property within the same class is assessed at different ratios either intentionally on a value basis or unintentionally as a result of poor assessment practices. Whatever the reason for differing assessment ratios, the end result is a windfall for the property owner benefiting from an assessment ratio below the average for his area and an extra burden on the property owner who receives an above average assessment.

For 1973, the Department of Taxation has widened the scope of their assessment-sales ratio study to provide a breakdown of the ratios for residential, agricultural, and commercial classes of real estate as well as the aggregate. Several problems were encountered in preparing these measures. For example, since many localities do not classify property for their land books, the

^{1/} In 1971, the national weighted average assessment ratio was 32.7 percent compared to 33.8 percent (as measured by the census) for Virginia.

ratios for the classes cannot be combined to arrive at a weighted aggregate for the locality. Therefore, the aggregate figure sometimes reflects the number of sales used for each type of property rather than the total amount of property of each class in a locality. Another problem is the scarcity of sales of various kinds of property. This can severely limit the size of the sample and make some of the resulting ratios of questionable quality.

In spite of these obstacles, the figures do demonstrate the wide variation of assessment levels by class of property both among different localities and within localities. Table 5.17 shows the range of assessment ratios in the counties and the cities. Not only is there a wide range among localities for any class of property, but also there is a disparity among the ratios for the different classes of property. In one county, the assessment ratio for single family residential property is more than triple that for agricultural property and in many other areas the ratios for residential property range from 30% to 80% higher than on agricultural property. Generally, commercial properties are assessed higher than residential properties which in turn are assessed higher than agricultural properties.

These assessment ratios are derived by comparing sales prices with assessments for a sample of sales for each class of property in each locality. The figure presented is the median value of all the ratios in the sample. Ideally, all the ratios in the sample should cluster closely around the median. However, often the values are widely dispersed, showing a lack of uniformity in assessments. The Department of Taxation has computed a measure of assessment variation by class of property for all counties and cities. A reasonable standard of assessment quality would be a coefficient of dispersion of less than 10 percent. However, the frequency distribution in Table 5.18, shows that only 8 localities met this criterion for residential property, none met it for agricultural

TABLE 5.17.--RANGE AND MEDIAN ASSESSMENT-SALES RATIOS
FOR VIRGINIA COUNTIES AND CITIES, TAX YEAR, 1973

Class of Property	Assessment-Sales Ratios	
	Counties	Cities
Single-Family Residential		
Range	4.5% - 30.4%	11.0% - 81.8%
Median	14.6%	31.6%
Agricultural		
Range	3.1% - 39.2%	... ^{a/}
Median	9.05%	... ^{a/}
Commercial-Industrial		
Range	5.1% - 35.6%	9.5% - 86.0%
Median	15.3%	30.8%

Note: The multi-family residential classification is not included in the above table because only 6 counties and 12 cities had sufficient sales of multi-family properties to prepare an assessment-sales ratio measure.

^{a/} Only three cities (Chesapeake, Nansemond, and Virginia Beach) had sufficient sales of agricultural land to prepare an assessment-sales ratio measure.

Source: Commonwealth of Virginia, Department of Taxation, 1973 Virginia Assessment/Sales Ratio Study, (Richmond: Department of Taxation, 1975) pp. 19-21.

TABLE 5.18.--FREQUENCY DISTRIBUTION FOR 1973 COEFFICIENTS OF DISPERSION OF ASSESSMENT RATIOS BY CLASS OF PROPERTY

Coefficient of Dispersion (Percent)	Single Family Residential			Agricultural			Commercial			Aggregate		
	Counties	Cities	Total	Counties	Cities	Total	Counties	Cities	Total	Counties	Cities	Total
5 to 9.9	1	7	8	...	...	...	1	...	1	1	5	6
10 to 14.9	8	17	25	...	...	...	1	1	2	5	15	20
15 to 19.9	8	8	16	3	...	3	1	5	6	6	9	15
20 to 24.9	17	4	21	6	...	6	6	4	10	11	6	17
25 to 29.9	16	1	17	10	1	11	2	7	9	13	2	15
30 to 34.9	13	1	14	15	1	16	10	2	12	12	1	13
35 to 39.9	12	...	12	14	1	15	4	6	10	20	...	20
40 to 44.9	4	1	5	9	...	9	4	2	6	10	1	11
45 to 49.9	7	...	7	13	...	13	2	4	6	5	...	5
50 to 54.9	4	...	4	9	...	9	10	...	10	8	...	8
55 to 59.9	1	...	1	6	...	6	4	2	6	4	...	4
60 to 64.9	1	...	1	1	...	1	3	1	4	...	...	...
65 to 69.9	1	...	1	2	...	2	2	1	3	...	...	...
70 to 74.9	1	...	1	2	...	2
75 and over	1	...	1	2	...	2	5	3	8
Total	95	39	134	90 ^{a/}	3 ^{a/}	93 ^{a/}	57 ^{a/}	38 ^{a/}	95 ^{a/}	95	39	134

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^{a/} In some localities the size of the sample of sales data was too small to permit calculation of assessment ratios and coefficients of dispersions for some classes of property. In these cases the totals for the frequency distribution will be less than the total number of localities.

Source: Commonwealth of Virginia, Department of Taxation, 1973 Virginia Assessment/Sales Ratio Study, (Richmond: Department of Taxation, 1975) pp. 19-21.

property, and only one met it for commercial property. Overall 6 localities met this test for the aggregate, and all but one of these were cities and all but one had full time assessors.

Real Property Tax Reform

A comprehensive study of the real property tax was conducted through the Governor's Office in 1973 and reported to the 1974 Session of the General Assembly. The Revenue Resources and Economic Commission was assigned the responsibility for reviewing the final recommendations of this study and developing appropriate measures for implementing its findings. To carry out this task, the Commission sponsored an educational seminar and four public hearings. Utilizing public comment and staff research, the Commission formulated a set of nine recommendations which were translated into legislative bills introduced in the 1975 General Assembly Session.

The Commission's recommended legislation dealt primarily with measures to promote and improve public understanding of the real property tax and to improve the quality of the appraisal and assessment functions across Virginia. Each of the nine Commission sponsored bills was passed by the 1975 General Assembly, some in amended form. A summary of each of the nine Commission sponsored bills plus other real property tax legislation which passed but was not sponsored by the Commission follows:

- Senate Bill 522 - Requires each tax jurisdiction to inventory all exempt and immune real property and publish annually the fair market value, assessed value, and total tax due if such property were not exempt or immune
- Senate Bill 553 - Allows any tax jurisdiction to require biennial reapplication for retention of exempt status of real property.

- Senate Bill 557 - Requires that notice of any assessment change be transmitted to the owner of the reassessed property.
- Senate Bill 558 - Provides for public disclosure of certain assessment records and allows a taxpayer upon request to inspect property appraisal cards and examine the working papers used in the assessment of the taxpayer's property.
- Senate Bill 559 - Establishes within the Department of Taxation a continuing education program for local assessment personnel including a basic course and an advanced course designed to meet full certification requirements of the International Association of Assessing Officers with State reimbursement for local assessing officers who participate.
- Senate Bill 560 - Provides for annual assessment-sales ratio studies and their publication by the Department of Taxation.
- Senate Bill 561 - Requires local assessing officers to maintain property appraisal cards or sheets and include on the cards or sheets the appraised value of the property and the calculations used in determining assessed value.
- Senate Bill 599 - Requires that tax jurisdictions assess real property at 100% fair market value beginning January 1, 1976 and lower the tax rate proportionately to the increase in assessment such that tax levies do not increase due to the assessment change. Public service corporation property which is included in the twenty-year equalization program shall be taxed as a separate category of property until the equalization program is complete.
- Senate Bill 601 - Requires the State Tax Commissioner to establish a classification system for real property for inclusion on local land books with the cooperation and counsel of local assessing officers.

In addition to the legislation sponsored by the Commission, other bills relating to the real property tax were passed by the 1975 General Assembly. A summary of these bills follows:

- Senate Bill 208 - Provides for the taxation of leasehold interests in real property excluding government property and the terms under which leasehold interests are to be assessed.
- Senate Bill 600 - Provides that when an annual assessment or periodic reassessment results in an increase in real property tax collections of 8 percent or more in a tax jurisdiction, excluding new construction and improvements, that the jurisdiction shall reduce its nominal tax rate proportionately. If a jurisdiction wishes to maintain or increase its nominal tax rate where an 8 percent or

more increase in real property tax collections has occurred, it must hold a public hearing.

Additional Reform Efforts

In addition to the legislative measures recommended by the Commission, there were other recommendations contained in the Governor's Property Tax Reform Study which the Commission either recommended for further study or deferred to a later date. Major issues which could be considered in efforts to provide additional property tax reform are:

- (1) Methods to improve review and appeal procedures at both local and state levels.
- (2) The shortening of the assessment cycle which currently is 6 years in counties and 4 years in cities.
- (3) The imposition of a state severance tax on minerals in lieu of the current property tax on minerals in the ground with return of the proceeds to local taxing jurisdictions.
- (4) The evaluation of alternatives to the current property based service charge on exempt property.
- (5) The study of the feasibility of statewide mass appraisal.

Besides the above considerations, some attention could be given to property tax relief plans for the elderly such as circuit-breaker proposals. The next section of this report describes the property tax relief measures that currently exist in Virginia.

Property Tax Relief

There are three types of property tax relief currently available to the citizens of the Commonwealth:

- (1) The General Assembly may grant tax exemptions to various benevolent, charitable, nonprofit, or historical **organizations**.
- (2) Localities may grant property tax deferrals or exemptions to low income elderly property owners.
- (3) Localities may assess agricultural, horticultural, forest, or open space property on the basis of its use value rather than its market value.

A brief discussion of each type of relief follows:

At present, the following types of property are exempt from local property taxation in Virginia: state-owned property; property owned by religious organizations that is used exclusively for religious worship or for the residences of their ministers; nonprofit private and public cemeteries; the property of public libraries and nonprofit educational institutions; and other property designated by the General Assembly because it is used for religious, charitable, patriotic, historical, benevolent, cultural, or public park and playground functions. The purpose of these exemptions is to subsidize and, therefore, encourage organizations that benefit the public welfare. However, a locality with a heavy incidence of tax exempt property may face a serious revenue loss.^{1/} In order to alleviate the tax burden on other property owners who must pay for the government services these tax exempt properties receive, the General Assembly has passed legislation which allows localities to impose a charge for services provided to tax exempt properties except that used for religious worship or for the residence of the minister of any church or religious body.

Since many elderly persons have fixed incomes which do not rise with the rapid changes in cost of living, they may find themselves unable to pay the taxes on their homes - especially in urbanizing areas. Beginning in tax year 1972, a local government was allowed to grant real property tax exemptions or deferrals on the dwellings of low income property owners 65 and over subject to the following conditions:

1. The combined income of the owners and their relatives living in the dwelling may not exceed \$10,000. The first \$4,000 of income of relatives other than spouse of the owner, is not included in this total.

^{1/} In 1973, the estimated value of exempt properties in Virginia were \$11 billion or 18% of total real property value.

2. The net combined financial worth of the owner and spouse, excluding the dwelling and one acre of land, may not exceed \$35,000.
3. The owners must follow prescribed filing requirements and lose the exemption or deferral if their income or worth changes and exceeds the limits.

The localities may set lower net worth and/or income figures.

At present 22 cities and 27 counties have passed ordinances allowing tax relief for the elderly. Their ordinances vary widely and each must be reviewed separately to arrive at the amount of tax relief granted in that area.

Finally, in many urbanizing areas, land once used for farming, forestry, or open space is being sold for more intensive uses. Aside from the lure of high land prices, some feel that increasingly higher taxes take such a large bite out of the farmer's or forester's profit margin that he must sell his land and move to a less developed area. In order to preserve some of these land uses in urban areas, the locality may assess agricultural, horticultural, forest, and/or open space land at its use value rather than its fair market value. In this way, these land owners in urban areas will receive lower assessments while their land continues in a permitted use. When they sell the land or change to a non-qualifying use, they must pay the difference between the taxes on the fair market value assessment and those they paid on the use value assessment for the previous five years plus 6 percent interest per year. To qualify for use value assessment, the land must meet standards set by the Commissioner of Agriculture and Commerce for agricultural and horticultural land, by the Director of the Department of Conservation and Economic Development for forest land, or the Director of the Commission on Outdoor Recreation for open space land.

While the intent of the bill is to aid bona fide farmers and foresters, there is some concern that it will benefit real estate speculators instead. The prescribed standards mentioned above have sought to prevent this. In addition, members of the State Land Evaluation Advisory Committee, which publishes the range of use value for each locality, is observing the effects of the law to note any loopholes that may develop.

For 1975, 12 localities - Albemarle, Chesterfield, Clarke, Fauquier, Frederick, Hanover, James City, Loudoun, Prince William, Petersburg, Suffolk, and Virginia Beach have use value taxation ordinances in effect.

The Tangible Personal Property Tax

In tax year 1973, local tangible personal property tax collections comprised about 8 percent of local general revenue from own sources.^{1/} Types of property included under this classification are livestock, motor vehicles, animal drawn vehicles, bicycles, farm implements and mechanics' tools, felled timber and timber products, agricultural products in the hands of a purchaser (not a producer), household furnishings, musical and radio instruments and equipment, works of art, jewelry, ships and floating property not required to be assessed by the State Corporation Commission, aircraft, ponies and riding horses owned and used for pleasure, and other items of a similar nature not specifically enumerated by law. However, localities may exempt some or all classes of household goods and personal effects, and, as of a 1974 survey by the Department of Taxation, only 11 counties and 1 city continue to tax them.

^{1/} Derived from Department of Taxation, Annual Report 1973-1974 (Richmond, 1974), page 44; and U. S. Bureau of the Census, Governmental Finances in 1972-73, (Washington: Government Printing Office, 1974) page 33.

Nominal tax rates on tangible personal property vary from \$1.30 to \$9.30 per \$100 of assessed value, but since both the assessment ratios and the bases for assessment vary, these rates are rarely comparable. For instance, the 1974 edition of Tax Rates in Virginia Counties and Urban Counties lists 9 different bases for assessment used in the various localities surveyed, including original cost, blue book, red book, fair market value, depreciated cost, book value, etc. Apply to these bases, assessment ratios ranging from 10 to 100 percent, and a true hodgepodge of effective rates results.

In addition to the lack of comparability among localities, evasion constitutes another problem with the personal property tax. Motor vehicles probably account for the bulk of revenue from this source since they are difficult to hide and easy to assess. Audit investigation on other types of property is most unlikely, making the tax widely evaded. In 1973, the assessed value per capita of tangible personal property for all counties and cities was only \$487^{1/}--an indication of widespread exclusion and evasion.

If greater comparability is desired, several measures could be initiated at the state level to reach this goal including:

- a) Exempting household effects statewide
- b) Making taxable only those items not easily evadable
- c) Prescribing uniform assessment standards (for example, denoting one set of values in the Blue Book as those to be used by all localities for assessing automobiles).

Tax on Machinery and Tools

The machinery and tools of manufacturing, mining, processing, reprocessing, radio and television broadcasting, and dairy farms constitute a separate

^{1/} Derived from Department of Taxation, Annual Report 1973-1974 (Richmond, 1974) p.44, and the 1973 population according to the Tayloe Murphy Institute of the University of Virginia.

classification for property taxation by localities. The tax rate may differ from that on tangible personal property but may not exceed it. In tax year 1974, local levies on machinery and tools amounted to \$16,062,121 or 1.4 percent of fiscal year 1972-73 local revenues from own sources.^{1/}

Again, lack of comparability is a major problem with this tax. As reported by the Division of Industrial Development in the 1974 edition of Local Taxes on Manufacturers in Virginia, there are three main types of values on which assessments of machinery and tools are based: original cost, depreciated cost (book value), and fair market value. Assessment ratios may be one percentage for a locality or a schedule of percentages based on age. In addition, the assessment methods used for valuing machinery and tools are often imprecise and inequitable. Local assessors may lack professional skills required to value industrial property and are likely to be overly cautious in valuing assets of large firms that are principal employers in the area.

If comparability of this tax among localities is generally desired, it could be achieved by having the legislature require the use of one type of valuation and one assessment ratio, or, less rigorously, a preferred method could be arrived at by professional assessors of this type of property and used as the state model. Localities could use it or not as they choose, but it would provide a serviceable guide to many local assessing officers.

^{1/} Derived from Department of Taxation, Annual Report 1973-1974 (Richmond, 1974) page 44; and U. S. Bureau of the Census, Governments' Finances in 1973-73, (Washington: Government Printing Office, 1974) page 33.

The Tax on Mobile Homes

In 1970, the Census reported that 3.1 percent (46,514 units) of the total year round housing units in Virginia were mobile homes. This type of housing has shown substantial growth since 1960 when it accounted for 1.5 percent (17,257 units) of all the year round units. In terms of distribution, 82 percent of the mobile homes in 1970 were located in the counties. They comprised 4.3 percent of the counties' housing supply as compared to 1.4 percent of the supply in the cities.

Due to the growth in popularity of mobile homes the methods of taxing this type of unit have been subject to increasing inspection and criticism. Controversy exists between those who feel that mobile homeowners do not pay their own way and those who feel that they pay an excessive amount of taxes per \$100 of assessed value for their homes compared to what owners of conventional homes pay. As a result of the growing controversy over the way in which mobile homes were taxed, the 1974 General Assembly in House Joint Resolution 106 directed the Virginia Advisory Legislative Council "... to make a study and report on all tax laws affecting mobile home owners and owners of mobile home parks".^{1/} Among the recommendations made by the Virginia Advisory Legislative Council (VALC) was one to "... provide that the ratio of assessment and the rate of taxation for mobile homes shall be the same as that applicable to real property and that such tax may be prorated if such mobile home has been within a locality for less than one year".^{2/}

^{1/} From Mobile Home Taxation, Report of the Virginia Advisory Legislative Council To the Governor and the General Assembly of Virginia, Richmond 1975.

^{2/} Ibid.

The VALC recommendations were translated into legislation in House Bill 1307 in the 1975 General Assembly Session, which passed both houses of the legislature and was signed into law by the Governor. The provisions of this act are similar to the VALC recommendation cited above, that "... the rate of levy on a mobile home ... shall be the same as the rate of levy on real estate".

Consumer Utility Taxes

All cities and counties and certain towns are allowed to impose a consumer's tax on electric, gas, water, and telephone bills. Currently, 32 cities, 29 counties, and 35 towns levy consumer utility taxes. Electricity, gas, and telephone service are the most frequently taxed but some localities also levy a tax on bottled gas and water service.

The consumer utility tax is levied as fixed percentage against the basic utility charge and added to the consumer's utility bill. Most localities do not levy the utility tax against the consumer's entire bill but have a dollar ceiling beyond which the tax does not apply or a lower rate applies. This is particularly true of residential consumers but is less true with respect to commercial or industrial users. In many localities there is no ceiling for the commercial or industrial tax and the rates apply to the entire utility bill. Appendix Table A.9 shows the current level of utility tax rates for residential and other users in 1975.

The 1972 session of the General Assembly passed legislation limiting local consumer utility taxes to a rate of 20%, unless a locality had higher rates in effect on January 1, 1972. In the latter case the locality was allowed to continue to tax at its prior rate but was not permitted to raise

that rate.^{1/} For residential consumers, the 20% rate could be levied only against the first \$15 of a consumers utility bill, thereby limiting the tax to \$3 per billing period (usually monthly). For commercial and industrial consumers, no ceiling or dollar cut-off point was set, thus the tax could be levied against the entire bill.

In terms of equity, it may be desirable to try to bring more uniformity to local taxation of energy sources. For example, the current structure of utility taxes tends to discriminate against commercial and industrial users of electricity and natural gas in those localities which have high rates and no limitation on the tax, as opposed to users of fuel oil which are subject to the 4 percent sales tax. This is less of a problem for residential consumers since there is a dollar ceiling on the application of the tax as set by state law. Nonetheless, the incidence of the tax impacts more heavily on the users of electricity and natural gas between the range of utility bills in which most consumers are likely to fall. For instance, electricity and natural gas consumers will pay a tax of \$3 if they use as much as \$15 of service per billing period at the maximum tax rate allowed by law applicable in several Virginia localities. Fuel oil users, on the other hand, who are subject to the 4 percent sales tax would not pay a tax bill of \$3 until their consumption of fuel oil reached a level of \$75 per month. Under these conditions, the utility tax would appear to be regressive in that it more heavily affects the low to moderate consumers of electricity and natural gas and would seem to be discriminatory in that it favors the consumption of fuel oil. Beyond \$75 per month, however, the users of fuel oil would bear a greater tax burden and would pay proportionately higher effective rate of taxation.

^{1/} Presently, 23 jurisdictions tax utilities at a rate of 20% or more.

Thus, only on a \$75 bill in our illustration would the tax rates on different users of energy be equalized.

Any attempt to bring uniformity to the taxation of energy sources through consumer utility taxes may be very costly to certain localities in terms of foregone revenues. As Table 5.19 shows revenues from consumer utility taxes averaged 11.1 percent of locally raised revenues in Virginia cities^{1/} during fiscal year 1972-73 with the range being from 2 percent to more than 15 percent of local revenues. On the other hand, there is a definite problem of inequitable taxation between energy sources and consumers of different types of energy and in this period of energy crisis which the state and nation find themselves, it may be worthwhile to try to remedy these inequities.

^{1/} Nine cities are not included in this analysis. Of these, six (Bedford, Bristol, Danville, Galax, Norton and Radford) did not levy a consumer's utility tax in fiscal 1972-73 and three (Clifton Forge, Petersburg, and Portsmouth) did not provide a separate break out of consumer utility tax revenue in their audit reports.

TABLE 5.19.--LOCAL CONSUMER UTILITY TAX REVENUE FOR VIRGINIA CITIES,
FISCAL YEAR 1972-73

<u>City</u>	<u>Consumer Utility Tax Revenue</u>	<u>Total Revenues From Local Sources</u>	<u>Percent Consumer Utility Tax Revenue To Total Revenues From Local Sources</u>
Alexandria	\$ 3,689,523	\$ 44,315,493	8.3%
Buena Vista	20,335	1,042,923	2.0
Charlottesville	1,030,679	10,751,549	9.6
Chesapeake	2,491,750	19,084,902	13.1
Colonial Heights	122,440	3,027,360	4.0
Covington	203,356	1,818,850	11.2
Emporia	64,305	826,572	7.8
Fairfax	240,240	8,737,384	2.8
Falls Church	191,777	4,538,488	4.2
Franklin	93,557	1,495,573	6.3
Fredericksburg	193,748	4,062,298	4.8
Hampton	690,913	26,302,973	2.6
Harrisonburg	193,471	4,146,189	4.7
Hopewell	223,105	4,903,272	4.6
Lexington	158,259	1,317,535	12.0
Lynchburg	1,472,698	14,855,005	9.9
Martinsville	205,189	3,964,610	5.2
Newport News	2,883,606	36,477,205	7.9
Norfolk	12,607,816	86,070,289	14.7
Richmond	11,117,000	96,414,652	11.5
Roanoke	4,110,432	26,999,388	15.2
Salem	104,107	4,577,259	2.3
South Boston	99,254	1,398,986	7.1
Staunton	645,985	4,541,042	14.2
Suffolk ^{2/}	542,177	7,060,375	7.7
Virginia Beach	4,249,217	35,685,280	11.9
Waynesboro	135,429	4,027,566	3.4
Williamsburg	114,861	3,024,209	3.8
Winchester	243,889	4,914,334	5.0
Totals	\$51,828,641	\$466,381,561	11.1%

^{1/} Nine cities are not included. Of these six (Bedford, Bristol, Danville, Galax, Norton, and Radford) did not levy a consumer's utility tax in fiscal year 1972-73 and three (Clifton Forge, Petersburg, and Portsmouth) did not provide a separate break out of consumer utility tax revenue in their audit reports.

^{2/} Includes Suffolk and Nansemond.

Source: Individual audit reports for Virginia cities, fiscal 1972-73.

CHAPTER VI

STATE AID TO LOCALITIES

Introduction

This chapter explores major ways of providing fiscal relief to local governments. There are two major policy approaches--either provide additional state aid or permit new local taxes. Both approaches draw from the same tax base--the tax resources in the state. Additional state aid means that these resources flow through the state government. On the other hand, allowance of new local taxes means that the resource flow is at the local level of government.

State Aid for Education

Total Spending

Before examining state aid for public elementary and secondary education, it will be helpful to look at all funding for education in 1973-74, the latest year for which comprehensive data are available. Local funds provided almost half (49.5 percent), state funds represented 40.7 percent, and the remaining 9.8 percent were federal (see Table 6.1). Most of the federal funds and virtually all of the state funds were used for net current expenditures. In contrast, slightly under two-thirds of the local funds were used for net current expenditures with the balance devoted to capital outlay and debt service.

The federal funds came in the form of numerous categorical aid programs, but most of the money was in compensatory aid, federal impact, and school

TABLE 6.1--SOURCES OF FUNDS FOR VIRGINIA PUBLIC SCHOOLS, 1973-74
(Millions of Dollars)

	Total		Source of Funds					
	Amount	Percent	Federal		State ^{b/}		Local	
		Total	Percent	Amount	Total	Amount	Total	Amount	Total
Total expenditure ^{a/}	\$1,321.5	100.0	\$129.3	9.8	\$538.0	40.7	\$654.2	49.5
Less: capital outlay	136.8	100.0	9.9	7.2	0.8	0.6	126.1	92.2
Current expenditure	1,184.7	100.0	119.4	10.1	537.2	45.4	528.1	44.6
Less: Debt service	98.9	100.0	...	...	...	...	98.9	100.0
Debt retirement	64.5	100.0	...	...	...	...	64.5	100.0
Interest	34.4	100.0	...	...	...	...	34.4	100.0
Net current expenditure	1,085.8	100.0	119.4	11.0	537.2	49.5	429.2	39.5

Note: Detail may not add to totals due to rounding.

^{a/} Excludes administrative activities of the State Department of Education.

^{b/} The \$110.2 million state sales tax distribution was treated as state funds.

Source: Superintendent of Public Instruction, Annual Report, 1973-74 (Richmond, 1974), pp. 200-201,206.

lunch programs. There is now some uncertainty about the form and level of funding that these programs will assume in future years.

The remainder of this section is concerned with state funding and the major changes that were made for the 1974-76 biennium.

The 1973-74 System of State Aid

For 1973-74 the major types of state aid were the basic school aid fund, the local share of the state sales and use tax, and state paid fringe benefits. Together these programs accounted for \$9 out of every \$10 of state aid. The remainder of the aid was for transportation of pupils, special education, vocational education, teacher education and teaching scholarships, libraries, and other categorical programs.

Basic School Aid Fund

For 1973-74, the basic school aid fund comprised the largest single component of state aid. It was distributed on the basis of average daily membership (ADM) and fiscal capacity as determined by the true value of real estate. However, the distribution formula was constrained so that no locality received less than 54 percent^{1/} of the cost of salaries based on the state minimum salary scale for state-aid support teaching positions. The end result was that roughly 70 percent of the 1973-74 basic school fund was essentially flat grant money, and the remainder represented equalization funds.

The 1973 General Assembly, armed with new federal general revenue sharing funds and under the spur of state constitutional requirements for funding educational standards of quality,^{2/} appropriated \$24.7 million to

^{1/} The formula stipulates 60 percent but the 1973-74 estimated state share was reduced by 10 percent.

^{2/} Constitution of Virginia, Article VIII, Section 2.

supplement the basic school aid fund. The entire amount represented equalization aid, and of the 135 school divisions, 33 received nothing. The supplemental appropriation represented a new approach to state aid. Although there were some special wrinkles in the formula the main elements were the establishment of \$628 per student in ADM as the necessary amount for school divisions to spend to assure provision of a quality education and the provision of state aid to meet this standard once a required level of local effort had been met. If the sum of three components--1) local spending at a rate equivalent to 80¢ per \$100 true value of real estate; 2) regular basic school aid funds; and 3) the local share of the state sales tax--did not equal or exceed \$628 per pupil, then the state provided the necessary supplement. An important feature of the new formula was that it required a local expenditure effort equivalent to 80¢ per \$100 of true value. The majority of the county school divisions (53) and 1 city had to increase spending from local sources in order to meet the new standard.

Sales and Use Tax

The local share of the state sales and use tax is distributed on the basis of the number of children between the ages of 7 and 19. It is to be used "... for maintenance, operation, capital outlays, debt and interest payments, or other expenses incurred in the operation of the free public schools ..."^{1/} In this discussion, and in the state's budget and other financial records, the funds are treated as state aid to localities. However, the statute requires that for purposes of determining local effort the sales tax distribution "... shall be considered as funds raised from local sources ..."^{2/} This clause was inserted to help several localities comply

^{1/} Code of Virginia, 58-441.48 (d).

^{2/} Ibid.

with appropriation act language requiring each locality to provide from local resources not less than 30 percent of total expenditures (excluding capital outlay and debt service) for school operation.

The sales and use tax accounted for roughly one-fifth of state aid in 1973-74. Distribution favors those areas with a high percentage of school-age population and is unrelated to direct measures of fiscal capacity.

State Payments for Teacher's Fringe Benefits

The state pays the employers' portion of retirement costs for full-time professional and clerical employees of local school boards. For 1973-74, this assistance applied to all full-time instructional personnel and was not limited to state-aid teaching positions. Furthermore, the aid applied to total salaries paid from state and local funds and was not limited to that portion of a salary attributable to the state minimum salary scale.

Although this aid represented about 11 percent of total state funding during 1973-74, the payment is frequently overlooked because it never appears in local accounts. As for its impact, the 1973-74 method of funding fringe benefits favored the high fiscal capacity areas. Since they tend to pay high salaries and have low pupil-teacher ratios, they generally received proportionately more state aid in fringe benefits than did the lower fiscal capacity areas.

Major Changes in State Aid For The 1974-76 Biennium

The 1973 supplement to the basic school aid fund was a temporary measure for improving state aid to localities. For the 1974-76 biennium it was necessary to develop a new formula, since the Attorney General ruled that the use of old basic school aid formula did not conform to the state

constitutional requirements for funding the actual cost of a quality education.^{1/} The design of the new aid program for 1974-76 incorporates the basic logic of the 1973 legislation but includes other considerations as recommended by the second report of the Task Force on Financing the Standards of Quality.^{2/} Major concepts incorporated into the new system include: (1) a new measure of local fiscal capacity which includes local personal income and taxable sales in addition to the true value of real estate; (2) a new formula that incorporates the new local fiscal capacity measure as well as the standards of quality cost per pupil; (3) aid for compensatory education; (4) incentive grants for localities that spend more than the required local share of the standards of quality cost; (5) recognition of the differences in local costs, particularly as these costs relate to exceptional pupils; and (6) a new method for funding teacher fringe benefits at the state level. These items are discussed below in relation to the major types of state aid.

Basic School Aid Fund

Under the new standards of quality program, the basic school aid fund now consists of a basic appropriation for regular day school activities plus an additional allotment for compensatory education, special education, vocational education, education of the gifted and talented, teacher education and staff improvement, general adult education, and incentive grants. The fund also includes monies for drivers' education, sick leave with pay for teachers, and for maintaining libraries and other teaching materials in public schools which had previously been funded as separate categorical items.

^{1/} Letter from Attorney General Andrew P. Miller to Delegate W. Ray Smith dated February 7, 1973.

^{2/} Commonwealth of Virginia, Second Report of the Task Force on Financing The Standards of Quality for Virginia Public Schools, (Richmond: July, 1973)

Basic Operations' Appropriation

The largest single component of the basic school aid program is the basic appropriation for regular day school activities. It accounts for 83 percent of the 1974-75 appropriation under this item and in terms of total state aid is roughly equivalent to the old basic school aid fund. Major changes in the distribution of the basic appropriation are as follows:

1) A New Measure of Local Fiscal Capacity--In addition, to the true value of real estate used in the old basic school aid formula, the measure of local fiscal capacity for distributing the basic operations' appropriation includes personal income and taxable sales (see Table 6.2). The effect of this change raises the relative capacity of central cities and the majority of small urban areas and lowers the relative capacity of most rural areas and developing suburban areas. As for established suburban areas, the result is roughly a 50-50 split between those communities having more or less capacity under the new composite measure. These outcomes reflect the concentration of personal income and retail sales in the urban areas.

A key decision in the construction of the new measure of fiscal capacity was the choice of a standardizing unit. As shown in Table 6.2, both population and ADM were selected. In terms of the distribution of funds, capacity per capita measures favor those localities with a low ratio of public school children to total population--a characteristic of areas with colleges, military installations, heavy proportions of working age or elderly residents, or large percentages of private school enrollment. Capacity per ADM, on the other hand, favors those areas with a high ratio of public school enrollment to total population. The logic for including both of these units into a single measure of fiscal capacity rests on the assumption that in a crude way, per capita capacity allows for the noneducational costs of local government which must be financed from local fiscal capacity while per ADM amounts

TABLE 6.2--CALCULATION OF THE LOCAL COMPOSITE INDEX OF FISCAL CAPACITY

$$\begin{aligned}
 & \left[\frac{\text{Local True Value of Real Property}}{\text{Local Average Daily Membership}} \right] + \left[\frac{\text{Local Personal Income}}{\text{Local Average Daily Membership}} \right] + \left[\frac{\text{Local Taxable Retail Sales}}{\text{Local Average Daily Membership}} \right] = \text{Average Daily Membership Composite Index} \\
 & \frac{\text{Total Local True Value of Real Property Statewide}}{\text{Total Average Daily Membership Statewide}} + \frac{\text{Total Personal Income Statewide}}{\text{Total Average Daily Membership Statewide}} + \frac{\text{Total Taxable Retail Sales Statewide}}{\text{Total Average Daily Membership Statewide}}
 \end{aligned}$$

$$\begin{aligned}
 & \left[\frac{\text{Local True Value of Real Property}}{\text{Local Population}} \right] + \left[\frac{\text{Local Personal Income}}{\text{Local Population}} \right] + \left[\frac{\text{Local Taxable Retail Sales}}{\text{Local Population}} \right] = \text{Per Capita Composite Index} \\
 & \frac{\text{Total Local True Values of Real Property Statewide}}{\text{State Population}} + \frac{\text{Total Personal Income Statewide}}{\text{State Population}} + \frac{\text{Total Taxable Retail Sales Statewide}}{\text{State Population}}
 \end{aligned}$$

$$\frac{.66 \times \text{Average Daily Membership Composite Index} + .33 \times \text{Per Capita Composite Index}}{2} = \text{LOCAL COMPOSITE INDEX}$$

Note: The composite index is calculated for the most recent period in which all required data are available. For the 1974-75 school year, 1971 data will be used.

* The constants (.5, .4, and .1) represent the average share of local revenues gathered from real property taxes, charges and miscellaneous revenue, and the 1 percent local option sales tax, respectively. Personal income figures are used in the above equation as a proxy for the tax base associated with local charges and miscellaneous revenue because detailed information on the latter tax source is not available. For an examination of the correlation between personal income and charges and miscellaneous revenue, see "Measuring Local Fiscal Capacity to Finance Public Education in Virginia," by Dr. John L. Knapp of the Tayloe-Murphy Institute, University of Virginia (February, 1973).

emphasize the role of education in local budgets. As for the effects, central cities plus college and military areas are the primary beneficiaries of the use of the per capita measures while established suburban areas benefit most from the inclusion of the ADM amounts.

2) A New Standards of Quality Cost--For 1973-74, the standards quality cost per pupil was derived by calculating the required statewide number of instructional, administrative, and support personnel based on specific pupil-employee objectives set by the Department of Education. These amounts were then multiplied by the state minimum salary scale for each class of personnel to get total salary costs. Added to this amount was an additional allowance for support costs not included in the salary component which was estimated from the actual operating expenses that local school boards experienced during 1970-71. The total of these two items was then divided by total ADM for the state to arrive at the standards of quality amount per pupil. This was set at \$628 per student in ADM.

Under the new standards of quality program for 1974-75, the computations for calculating the basic per pupil cost have been simplified. The new personnel standard provides for state reimbursement of eligible positions on the basis of 48 professional positions (limited to directors of instruction, supervisors, principals, assistant principals, teachers, visiting teachers, librarians, and counselors) per 1,000 students in ADM. The total number of eligible positions are then multiplied by a single weighted average salary for instructional personnel to determine the total salary component. This amount is added to an allowance for other supporting costs and divided through by total ADM to estimate the basic per pupil cost of the program. For 1974-75, this is determined by multiplying a state established salary of \$10,046 by 51,496 reimbursable positions with an allowance of \$205 per pupil for other

instructional costs. The total of these two elements make up the basic cost of \$687 per pupil to be funded during the 1974-75 school year.

3) A New Formula--The new formula for distributing the basic appropriation of the basic school fund is calculated by multiplying the average daily membership of each school division by the standards of quality cost per student. The sales tax returned to the division on the basis of school age population for the calendar year preceding the fiscal year is then deducted and the remaining amount is multiplied by the new local index of fiscal capacity to determine the state and local share. The following example illustrates the method of distribution for 1974-75:

County	1974-75 ADM	Column 2 x \$687	1974 Sales Tax Returned	Col. 3 less Col. 4	Index	Required Local Share Col. 4 x Col. 6	Basic State Share Col. 5 less Col. 7
1	2	3	4	5	6	7	8
Accomack	6,171	\$4,239,477	\$717,800	\$3,521,677	.41	\$1,443,888	\$2,077,789

In calculating the basic grant above, it is provided that no locality shall be required to raise its total operations expenditure for education beyond a certain limit. For 1974-75, the limit is 10 percent plus one-third the difference between 10 percent and the total percentage increase in operation expenditures as required by the formula. In addition, to protect localities from sudden changes in state funding, the basic appropriation also carries a no loss provision. This assures localities that unless they experience a loss in average daily membership, their share of state funds under this appropriation will not be reduced below the amount they received in 1973-74 from the basic school aid fund. The supplemental fund, and the categorical grants for drivers' education, teachers sick leave, and maintaining libraries and other teaching materials. For 1974-75, an appropriation of \$16.8 million was made in addition to the \$312.6 million appropriated for the basic distribution to guaranty this assurance.

Aid for Compensatory Education

During 1973-74, the federal government made available \$35.7 million to Virginia for the education of children from poverty backgrounds who were performing poorly in reading and other basic skills. Beginning 1974-75, the state started a similar program as part of the basic school aid fund to provide aid to local school divisions for fifth and sixth grade students who participate in a supplemental skill development program in reading and mathematics approved by the Department of Education. The amount of the reimbursement for each school division in 1974-75 is expected to be roughly \$300 times the number of 1972-73 fourth grade pupils who scored at or below the twelfth percentile, national norm, on the Science Research Associates Achievement Tests of Reading. The appropriation for 1975-76 provides for \$300 times the number of 1972-73 fourth graders who scored at or below the twelfth percentile plus 80 percent of those who participated in the skill development program in the prior year. Localities which are expected to benefit from this aid are mainly the central cities and rural areas where most of the children who will be eligible for this aid are located.

In evaluating the state's approach toward providing aid for a compensatory education program, two possible arguments against using test scores to distribute funds are (1) that "it rewards failure" and (2) that the test scores are unreliable. Considering the merits of these arguments, the first assertion appears weak if the test scores are used in the early years as a diagnostic device to measure the skills with which the schools have to work. Whether reading scores taken from fourth graders can provide a suitable indication of these skills, however, remains to be seen. As for the second argument, if correct, it makes a case for improved tests rather than their abandonment. It is along these lines that the Department of Education is looking into the

possibility of whether criterion-referenced tests can more adequately measure the skills development of Virginia's students.

Incentive Grants

Another new concept incorporated into the basic school aid fund for this biennium is an allowance for incentive funds. Payments under this appropriation will provide aid to those localities whose operation expenditures exceed the required local expenditure as computed under the basic appropriation formula. During 1974-75, \$3.8 million will be available for distribution under this item - an amount which is expected to match 2 1/2 percent of the additional operation expenditures incurred by local school divisions. For 1975-76, incentive funds will be increased to \$8.3 million which is anticipated to represent roughly 5 percent of the excess expenditure. The main beneficiaries of these grants will probably be the large central cities and the established suburban areas because of their relatively higher salary scales and greater supporting costs. Although these grants are envisioned to distribute aid to those localities who make an extra effort toward providing a quality education, their payment in part will reflect the differential in the structure of local prices. To this extent, they will compensate for the naive assumption that all localities across the state can purchase the ingredients of a quality educational system for the same price (\$687 per pupil). The amount of reimbursement for those localities who have to pay higher costs, however, will be small.

Aid For Special Education, Gifted And Talented Students, And Vocational Education

In the past, local school boards have been aided for providing education to exceptional types of students through separate categorical grants from the state. As a result, no attempt was made to relate the costs of these

programs to the appropriations provided for regular day school students. In contrast to this approach, the new system of educational finance recognizes the fact that children of various degrees of exceptionality and aspirations require different levels of expenditure and attempts to reimburse localities for 100 percent of the additional costs of these programs over and above the regular day school allotment. To provide for this assistance, appropriations totaling \$36.6 million were included in the 1974-75 basic school aid fund to aid localities in the instruction of special education students, gifted and talented students, and vocational education students. These funds are distributed on a flat grant basis according to the number of full-time equivalent students in each category and the amount of reimbursement varies with the condition of exceptionality and/or the content of the individual program. For special education, these amounts range from \$90 in excess cost for students with speech handicaps to \$850 in excess expenses for multiple handicapped children. For vocational education, the range goes from no additional cost for classroom instruction in business exploration, general business or beginning typewriting, to an excess expense of \$300 for students engaged in the training of food occupations, auto mechanics, bricklaying, building trades, cabinetmaking, commercial foods, machine shop, power mechanics, industrial maintenance mechanics, mine machine repair, printing, sheet metal, welding, auto body repair, and diesel mechanics. Payments for gifted and talented students, on the other hand, are set at \$30 per pupil for 1974-75 and \$40 per pupil for 1975-76. In addition, the number of students eligible for reimbursement under the gifted and talented grant is limited to 3 percent of the total number of pupils in ADM in each locality for each year of the biennium.

Teacher Fringe Benefits

As mentioned earlier, the state in the past has paid 100 percent of the employer's share of Virginia Supplemental Retirement System, Social Security, and group insurance benefits for teachers and clerical personnel employed by local school boards. For 1975-76, however, the payment for Social Security benefits will be limited, for professional and instructional staff, to the employer's cost of 48 positions per 1,000 students in ADM and the employer's cost of instructional salaries not to exceed an average of \$10,528. This change will restrict the amount of funding to the number of state aid positions and the amount of reimbursable salaries required by the new personnel standard. The logic for making this change follows the line of reasoning that the state should concentrate its funds primarily on the components required to meet the minimum quality program. The impact of this move will probably affect the high fiscal capacity areas more than any other type of locality in the state. Since they tend to pay high salaries and have low pupil-teacher ratios, they have generally received proportionately more state aid in fringe benefits than the lower fiscal capacity areas.

Additional Reform Measures

The reform measures instituted for the 1974-76 biennium go a long way toward providing for a more equitable distribution of state funds for education. Improvements to the new system, however, could be made on two fronts. First, the new aid formula makes little recognition of the differences in local costs. Nonetheless, the notion that a single SOQ cost is applicable to the entire state is naive. Because of other job opportunities and the effect of urban living costs on labor supply, urban areas must pay higher teacher salaries than rural areas. Land costs and construction costs are also

likely to be higher in urban areas.^{1/} For these reasons, an effort should be made to build crude cost index factors to apply to different areas within the state.

Second, the new system of state aid makes no provision for the costs incurred by local school divisions for capital outlay and/or debt service. In 1973-74, these expenses constituted roughly 19 percent of total local expenditures for education and were financed almost entirely from local funds. A more comprehensive distribution of state aid could account for the fact that localities (especially those in rapidly developing areas) make a substantial effort in the form of capital spending. Additional state aid, even at the modest amount, of 10 percent of capital outlays would have provided an extra \$13 million for local school buildings and equipment during 1973-74.

State Aid For Welfare^{2/}

On January 1, 1972, the state assumed the local share of welfare assistance costs for old age assistance, aid to the permanently and totally disabled, aid to families with dependent children, and aid to the blind. However, all of these programs with the exception of aid to families with dependent children were taken over completely by the federal government on January 1, 1974. This change left localities responsible for their share of administration costs and public assistance costs for the three state-local programs--general relief, foster care, and hospitalization of the indigent. In addition, localities will continue to be responsible for part of the costs of the federally sponsored day care and work incentive programs.

^{1/} See "Equal Dollars, Unequal Help--States Should Make Allowances for School Cost Differentials," Search (The Urban Institute), Vol. 3, No.1 (January-February, 1973), pp. 1-4.

^{2/} For more information on this subject see Chapter IV, pp. 318-319.

One alternative would be for the state to take over the local assistance costs for the three state-local programs. Had this been done in fiscal year 1973-74, the cost would have been \$9.4 million with a large proportion of the assistance provided to central cities with high welfare loads. This alternative would continue to leave localities responsible for their share of all administration costs. In fiscal year 1973-74 their share would have been \$7.8 million if based on 20 percent of administrative costs. Take-over of the local share of day care services and work incentive programs would have cost an additional \$906,373 in fiscal year 1973-74.

A more far-reaching proposal would be a complete state take-over of local welfare costs. This could be accomplished with a continuation of the existing local administrative structure, a move toward regionalization, or full absorption of administration by the state government. An approach which would continue the existing local administrative structure would have cost the state approximately \$11.7 million in fiscal year 1973-74. This estimate assumes the circumstances prevailing as of January 1, 1974 when the federal government became responsible for all administrative and program costs for old age assistance, aid to the permanently and totally disabled, and aid to the blind.

The \$11.7 million figure is probably a low estimate since if the state were to take over full costs there would be a rise in benefit levels as all communities were brought up to state standards.

Uncertainty about the future role of the federal government is a factor that cannot be ignored. A fundamental change in the welfare system could eliminate local, and possibly state, burdens for this large and fast growing sector.

State Aid for Highways

Highways are primarily a state function in Virginia, yet certain types of local governments--municipalities of 3,500 or more, and Arlington and Henrico counties--make large outlays financed from their own resources. In 1972-73 these local governments spent \$86.3 million but received aid of \$32.1 million.^{1/} Thus, for localities operating their own systems, roughly three out of every five dollars of expenditures for highways came from local sources. In contrast, many counties have virtually no highway costs because the state provides for all maintenance and construction.

Additional aid to local governments that maintain their own highway systems would be a significant form of aid because highway expenditures are one of their more important costs of government. The present payments of \$2,500 per lane mile for urban extensions of primary routes and \$1,500 per lane mile for certain other streets could be increased and given a closer relationship to actual costs of maintenance. Furthermore, state aid could be provided for traffic police, and the state's share of new construction costs could be increased from the present 85 percent.

A more far-reaching proposal would be to merge the highway fund into a transportation fund and make funds available for helping localities with the cost of subsidizing other forms of transportation such as bus and rapid transit systems.^{2/}

^{1/} See Table 6.3. The data were taken from a survey conducted by the Institute of Government at the University of Virginia. Although the survey uses prescribed procedures of the United States Bureau of Public Roads, it relies heavily upon the accuracy of local reporting. Localities in Virginia do not use a standardized accounting framework so there are differences in how costs are charged. For example, one locality might charge to "utility expense" street work associated with installation of utilities; another locality might charge this to "road construction expense."

^{2/} Beginning 1973-74, approximately \$5.5 million was distributed to those cities which had to purchase local bus systems and roughly \$6.0 million was provided for those localities building fringe parking lots and bus shelters. This and future aid will be administered by the Department of Highways.

TABLE 6.3--HIGHWAY FINANCES OF VIRGINIA LOCALITIES, FISCAL YEAR 1972-73

Item	Localities Operating Their Own Systems				Total	91 State Supported Counties	Total, All Localities
	Municipalities			Arlington and Henrico Counties			
	Under 5,000	5,000 to 49,999	50,000 and Over				
Receipts:							
Total receipts from local sources ^{a/}	\$2,645,762	\$11,523,545	\$17,721,961	\$ 5,161,413	\$37,052,681	\$10,532,242	\$47,584,923
Total receipts from state government	<u>1,165,593</u>	<u>8,001,562</u>	<u>17,154,593</u>	<u>5,739,219</u>	<u>32,060,967</u>	<u>169,539</u>	<u>32,230,506</u>
Total	<u>\$3,811,355</u>	<u>\$19,525,107</u>	<u>\$34,876,554</u>	<u>\$10,900,632</u>	<u>\$69,113,648</u>	<u>\$10,701,781</u>	<u>\$79,815,429</u>
Disbursements:							
Total direct highway disbursements for capital outlay	\$ 475,873	\$ 5,325,841	\$15,394,443	\$ 1,774,853	\$22,971,010	\$ 83,018	\$23,054,028
Total direct highway disbursements for maintenance ^{b/}	1,640,124	7,200,283	14,620,710	3,446,167	26,907,284	113,520	27,020,804
Interest on debt ^{c/}	9,469	484,415	3,074,851	622,887	4,191,622	...	4,191,622
Other ^{e/}	<u>1,461,981</u>	<u>5,233,698</u>	<u>10,069,105</u>	<u>3,772,475</u>	<u>20,537,259</u>	<u>10,505,243</u>	<u>31,042,502</u>
Total direct highway disbursements ^{b/}	\$3,587,447	\$18,244,237	\$43,159,109	\$ 9,616,382	\$74,607,175	\$10,701,781	\$85,308,956
Intergovernmental transfers ^{d/}	189,208	1,344,481	3,049,809	...	4,583,498	...	4,583,498
Debt redemption	<u>34,700</u>	<u>583,389</u>	<u>5,256,397</u>	<u>1,284,250</u>	<u>7,158,736</u>	<u>...</u>	<u>7,158,736</u>
Total disbursements	<u>\$3,811,355</u>	<u>\$20,172,107</u>	<u>\$51,465,315</u>	<u>\$10,900,632</u>	<u>\$86,349,409</u>	<u>\$10,701,781</u>	<u>\$97,051,190</u>

a/ Includes net receipts from parking facilities and indirect street functions (street cleaning, street lighting, sidewalks, and storm sewer and drainage facilities).

b/ The original report did not classify interest on debt as a direct highway disbursement.

c/ The \$31,042,502 total for all localities was composed of estimated costs for undistributed highway equipment, general administration and engineering, highway and traffic police, and miscellaneous disbursements.

d/ Composed mainly of the localities' share of state road construction expenditures.

Source: Institute of Government, University of Virginia, "Cost of Financing Virginia Municipal Highways, Fiscal Year Ended June 30, 1973," (Charlottesville, University of Virginia, 1975).

The cost of expanded state participation would depend on the program selected, but to give some order or magnitude, a switch from the present 2 to 3 state - local ratio of financing to a 1 to 1 ratio would have cost the state about \$11 million in fiscal year 1972-73. This amount would have been released for additional road spending or for other uses by localities.

State Aid For Health

The State Department of Health now operates all local health departments with the state bearing the major share of their costs (the state share varies from 55 percent to 82 percent of the costs depending upon local ability to pay as measured by the true value of real property). Generally, the central cities pay larger percentages of cost than rural areas. A new method of deriving local shares could be developed which would pay the same share for all localities. The logic for this proposal would be that the present formula is a poor measure of ability to pay if one considers the differential incidence of public health loads and differing expenditure burdens of various localities. Moreover, expenditures on health provide benefits beyond local boundaries so there is an argument for greater state participation. Ninety percent funding by the state in 1973-74 would have required an additional \$12.4 million.^{1/}

^{1/} Expenditure data for fiscal year 1973-74 was supplied by L. Thayer, Fiscal Director of the Department of Health.

Revenue Sharing

The term "revenue sharing" is now popularly associated with the federal program, but the concept also applies to state government. In Virginia, we already have revenue sharing with the sales and use tax, A.B.C. profits, and the wine and spirits tax. Although additional revenue sharing could be applied to many sources of revenue, we concentrate on the two largest sources, the individual income tax and the sales and use tax.

Individual and Fiduciaries Income Tax

If the individual income tax rates were increased enough to produce additional revenues, as discussed in Chapter III, consideration might be given to sharing part or all of the addition with local governments. Such a step would be very similar to a local income tax if the basis for distribution were taxpayer residence, the principal difference being that the tax would be universal rather than optional.^{1/} If the shared revenues were distributed on the basis of some other factor, such as population, employment, incidence of poverty, or tax effort, there would be an element of geographic distribution with the extent determined by the allocator used.

In 1973, several states shared their income tax revenues. In Illinois, one-twelfth of net state individual and corporate income

^{1/} See the section on the local income tax for the advantages and disadvantages of this new local tax source. Obviously, they would respectively become the disadvantages and advantages of state revenue sharing through the individual income tax.

tax receipts were shared with localities on the basis of population. Michigan's revenue sharing plan distributed approximately 9 percent of individual income tax receipts, one-half to counties on the basis of population, and one-half to cities based on their tax effort times their population. New York also had a revenue sharing plan; 18 percent of individual income tax collections were distributed to localities on the basis of population with double weighting for cities. In Wisconsin, the revenue shared with the localities, approximately \$265.4 million, was distributed on the basis of population, general property tax effort and the value of public service corporation property. The two largest contributors to the \$265.4 million were the individual income tax (about 25 percent of its revenues) and the corporate tax (about 50 percent of its revenues).^{1/}

The Sales and Use Tax

Presently, all cities and counties in Virginia impose a 1 percent local option sales and use tax in addition to the 3 percent state levy. One-third of the state tax is distributed to localities on the basis of their proportion of the state's school-age population. The local option portion of the tax is collected by the state and returned to the locality from which it was collected.

Prior to and after its adoption, the distribution of the state sales and use tax has been a regular source of debate, primarily because of the difficulty in reaching a consensus on what constitutes an "equitable" distribution. Some possible meanings of equity in regard

^{1/} Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism, 1973-74 Edition (Washington, D. C.: Government Printing Office, 1974), pp. 79-81.

to the distribution of the sales tax are:

1. Revenues should be distributed to the localities where the taxpayers reside. This statement may be interpreted in two ways. In the first case, revenue would be distributed to each locality on an equal per capita basis. This would imply that the public needs of a locality are strictly determined by the number of people residing in that locality. A second approach would distribute revenue on the basis of the proportion of taxable sales made to residents of each jurisdiction. This distribution formula may be justified if the final incidence of the tax falls upon the ultimate purchaser. The main difficulty with this approach is measuring the taxable sales of residents, since most residents do not restrict their expenditures to one jurisdiction.
2. Revenues should be distributed to the locality that is the place of sale. This approach either assumes that the incidence of the tax is on the retailer or that a locality has a right to a tax collected within its boundaries.
3. Revenues should be distributed to the locality by some index of a locality's tax effort. This approach would reward localities that have a high effort while penalizing those with a low effort. Thus, localities that make greater use of their available resources will receive a larger amount of state aid.
4. Revenues should be distributed to the locality where there is a need for funds. This approach is hampered by the lack of a universal definition of need. Need can be legitimately measured in a number of ways, but the problem is that people will often measure need by the criteria which gives them the most aid. The problem therefore becomes one of agreement.

The above definitions of equity are irreconcilable. There is no universal guide to say which is correct, for all contain certain value judgments, and, to some extent, they represent an attempt to measure the unmeasurable. The present system uses criterion number 2 for the local option and number 4 for the local share of the state tax by assuming that the proportion of school-age population is a reasonable indicator of need.

There are a number of ways in which the distribution of the sales tax could be changed. If the present tax base and rates were not

altered, then the changes would involve the total proportion going to localities and/or the distribution among the localities. The present distribution could be changed to one based on place of sale or on a new index of need.

One alternative would combine elements of criteria 2 and 4. This proposal would guarantee an amount for each locality equal to 1 percent of its taxable sales. However, if this amount were less than the amount received by the locality under the existing formula (school-age population), it would continue to receive the larger amount. In this way the existing formula can be changed so that no locality would receive a smaller dollar amount of revenue. It is conventional wisdom that a distribution plan based on the place of sale helps localities that have high per capita taxable sales either because of high per capita income, large shopping areas, or a combination of the two. Consequently, localities with high per capita sales do not fare as well with a distribution on the basis of school-age population. The reverse is true for localities with low per capita sales.

The end result of this proposed distribution formula is that the total amount distributed to localities would be larger. In fiscal year 1973-74, the local share of state sales tax revenues would have been \$135 million compared with \$110 million under the existing plan. The \$25 million difference would have been financed from the state's general fund.

If the state sales and use tax were increased from 3 to 4 percent, the new revenues could be used for revenue sharing with the increase distributed on the same basis as the present local share of the state tax (school-age population) or on some new basis such as place of sale. If the revenues were distributed by taxable sales, the result would

be basically the same as an increase in the local option rate from 1 to 2 percent.^{1/} As noted above, distribution by place of sale would be very advantageous for those localities with high per capita taxable sales, which includes most central cities. If Alexandria, Charlottesville, Lynchburg, Norfolk, Richmond, and Roanoke had received their 1973-74 local share of the state tax on the basis of place of sale rather than school-age population, they would have received an additional \$13 million. The 1 percentage point addition to the sales tax allocated by place of sale would have provided them with an extra \$29 million. Most smaller cities and suburban counties with well developed shopping areas would also have gained. Offsetting these gains would have been lower amounts for the remaining areas.

The preceding remarks have applied to the existing tax base for the sales and use tax. Expansion of the base to include selected services such as barber shops, car washes, dry cleaners, and repair shops would have increased the yield by 10 percent. Conversely, exemption of food products now taxed would have reduced the yield from the present base by 23.9 percent.

^{1/} See the section on the local sales and use tax for the advantages and disadvantages of increasing this local tax source. Of course, they would respectively become the disadvantages and advantages of state revenue sharing through the sales and use tax.

New Local Tax Powers

The Local Individual Income Tax

Although the local individual income tax has had a limited history, beginning in Philadelphia in 1939, it has developed into an important revenue source for a large number of localities. Over 4,200 jurisdictions in ten states have adopted a local individual income tax (see appendix Table A.8). Although these numbers may overstate the actual importance of the tax, since two states, Ohio and Pennsylvania, account for over 3,700 jurisdictions, the number of localities utilizing individual income taxes has grown consistently. Of Virginia's neighboring states, Kentucky and Maryland have localities with local individual income taxes.

Local individual income taxes vary to some extent in the ten states, but they can be placed into two categories. The first is a payroll tax. This tax is a limited income tax covering only the earned portion of income - wages and salaries, or payroll, while allowing the unearned portion of income (i.e., dividends, interest, capital gains, rent, estates and trusts, etc.) to escape taxation. The second basic category is a comprehensive income tax that taxes all income in a manner similar to state individual income taxes. The tax may be administered by the individual locality itself or "piggybacked" onto the state tax. This section will discuss the advantages and disadvantages of income taxes, examine the local income tax plans of Indiana, Iowa, and Maryland and, finally, present the revenue implications of a local individual income tax in Virginia.

Advantages and Disadvantages of Local Income Taxes

Although there is some diversity in the specific local individual income taxes in the ten states, they all share a number of common advantages and disadvantages. One of the most important advantages of the local income tax is that it is a potentially large source of additional revenue for localities based on the ability-to-pay theory of taxation, a principle not applicable to many local sources of revenue. In addition, the taxation of income covers a base responsive to economic activity while the present workhorse of local revenues, the property tax, leaves much to be desired in this respect. The responsiveness to economic activity means that as income increases over time so will income tax revenues. Another factor that makes it a large source of revenue is its ability to reach commuters. This is especially important to the larger, central cities, which have individuals working in the city and using city services but residing elsewhere.

The local income tax leads to a diversification of the local tax structure. Most localities are heavily dependent on a few sources for most of their revenue (e.g., property tax, sales tax, license taxes, etc.). The inclusion of individual income taxation would allow a locality the option of turning to another source for revenues rather than increasing present taxes. Moreover, allowing localities to impose this tax would give them the opportunity to lower or eliminate other taxes, especially those that appear to be particularly onerous.

The local income tax also has a number of advantages in the administrative area if tied to the state base. A local income tax is a complex tax that requires a skilled and expensive enforcement apparatus. However, if the local tax is combined with and based on the state income tax, the tax becomes administratively efficient because the enforcement and administrative apparatus is already in place.

The local option nature of the tax also yields advantages. Since the individual locality could make the decision to utilize the tax, it would presumably be based on local needs and preferences rather than the needs of the entire state. This distinction in local needs would not be possible with a state income tax. Moreover, the locality could be free to select an appropriate rate of tax based on its own individual revenue needs.

A local income tax may be more acceptable to taxpayers because it could be more visibly tied to local needs. In addition, it could conceivably be tied to the mandatory reduction of other taxes. In this respect it may tend to make governing bodies more economical and efficient as the sole responsibility for imposing the tax rests squarely upon the locality. Local taxpayers would have a clear choice between no tax and no new government benefits or a tax and the resulting package of government goods and services.

On the other hand, local income taxes have a number of disadvantages. One major disadvantage results from the traditional, exclusive state use of income taxation. The individual income tax has become a major source of revenue for a number of states. Allowing localities to tax income would divest these states of their ability to utilize the full potential of their primary revenue source. In Virginia it would also reduce the state's borrowing powers, since locally imposed taxes would not be counted in the state's borrowing base. Although the income tax is a large source of revenue for the state, this would not be the case for every locality. Low income localities could not obtain the same revenue from the income tax as high income localities. Thus, the local income tax would not benefit all localities to the same extent.

Another disadvantage is the potential nonuniform adoption of the tax. In some states only a single locality or a few have enacted a local option income tax. This spotty enactment could lead to the migration of taxpayers away from these tax areas. In addition, those localities with the tax could aggregate nonuniformity by choosing varying tax rates.

Another major disadvantage of the local income tax concerns the treatment of commuters. As already mentioned, part of the attraction of the local income tax to central cities is that it reaches individuals working in the city but residing elsewhere. In most cases, if the locality of employment has a tax while the locality of residence does not, the commuter is subject to a lower rate of tax than is the resident who actually works in that locality. If the locality of residence also levies a local income tax, then there is the problem of which tax district is entitled to the tax.

The final disadvantage concerns possible administrative drawbacks. The first involves withholding for localities with different rates. Unless all localities adopt the tax and use the same rate, a large employer, with employees living in several surrounding jurisdictions, may find it difficult to apply a number of varying rates. If he used one rate, many employees would be inconvenienced by overwithholding or underwithholding. Another administrative problem concerns part year residents of a locality with an income tax. Which locality would receive the revenue? Also, would fractional years of residence between localities within the state cause any allocation problems? Finally, the use of the state base does provide administrative benefits to the locality but it does deprive localities of control over their income tax base. Future changes at the state level would affect local income tax revenues.

An Examination of Local Income Taxes

The Indiana Plan

In July, 1973, Indiana implemented a program designed to provide counties with an alternate source of revenue to finance governmental services at the local level, while at the same time attempting to lower their reliance on the property tax. This CAGIT (County Adjusted Gross Income Tax) program allows counties on a local option basis to impose a local income tax on adjusted gross income at one of three resident rates: 0.5 percent, 0.75 percent, and 1 percent. Nonresidents who work in a locality that imposes the tax are subject to a 0.25 percent rate on their adjusted gross income derived from that locality. If both home and work counties impose the tax, then the taxpayer is subject only to the tax levied by his home locality. The base of the local option income tax is the same as the state base. This conformity allows both taxes to be collected by the Indiana Department of Revenue. The Indiana individual income tax rate is a flat 2 percent of adjusted gross income.

The purpose of this local option income tax was not only to give counties an alternative source of revenue but also to allow localities to grant a significant amount of property tax relief without decreasing local governmental services. Depending upon the tax rate adopted, the locality must apply a specific percentage of its income tax revenue to property tax relief while the remainder is placed in the locality's general fund. Because part of the revenue from the local option income tax is used for the general fund, actual revenues to the locality would tend to increase over time.

The CAGIT plan limits a CAGIT locality's total property tax revenues to the 1973 amount minus the property tax replacement credit, (i.e., the amount of CAGIT revenue required to be used for property tax relief).

Thus, as revenue from the local income tax increases, property tax collections must decline. We must note that the effective rate of the property tax will decrease over time because total property tax collections will decline even as assessed values rise to reflect increased market value. The localities that choose not to adopt CAGIT have their total tax rate frozen to the 1973 level. This would not, however, place a limit on total collections; although the tax rate is frozen, the assessments are not.

The schedule and percentage of CAGIT revenues that must be used for property tax relief are shown below:

<u>Year and rate</u>	<u>Percent of CAGIT revenue used for property tax relief</u>
First year	
0.5% rate	50
0.75% rate	66 2/3
1.0% rate	75
Second year	
0.5% rate	50
0.75% rate	33 1/3
1.0% rate	50
Third and all subsequent years	
0.5% rate	50
0.75% rate	33 1/3
1.0% rate	25

As of July 1, 1975, a total of 38 of Indiana's 92 counties will have adopted the local income tax plan. Counties that wish to adopt the tax or to increase the existing rate of tax may do so only if the local county council so acts prior to April 1 of that year.

An additional feature of Indiana's new tax package is that revenue from an increased state sales and use tax is being used to finance a Property Tax Relief Fund.^{1/} This fund is used to reimburse all localities for a 20 percent credit allowed against local taxpayers' property tax liabilities. A taxpayer's property tax liability is defined as the property tax payable in a given year plus the amount that the tax due has been reduced by the application of county adjusted gross income tax revenues or federal revenue sharing funds to the extent such funds were included in the determination of the total county tax levy for the tax year.

In addition to having the standard advantages and disadvantages of local option individual income taxes, the Indiana plan has some unique features. A specified portion of the local revenue must be used to decrease local property taxes, thereby depriving the locality complete freedom in the use of local revenue. In this respect the plan has achieved its goal in those localities that have chosen to implement it. Property taxes have declined in those localities by the required amounts by substituting local income tax revenues.

Another noteworthy aspect of the Indiana program is the flat tax rate used by the localities. Although most local income taxes have flat tax rates, they are at variance with the progressive rate schedules of most state income taxes. In Indiana, a flat rate was authorized for localities largely because of the state's flat rate. We must note that a flat tax rate is not as responsive to changes in economic activity

^{1/} Indiana increased their sales and use tax rate from 2 percent to 4 percent in May, 1973. At the same time, Indiana exempted food products for home consumption from the tax base.

as a progressive tax. In addition, it does not follow the ability-to-pay principal as closely as a progressive tax. A flat rate local option tax could be offered for adoption to Virginia localities, and the state and local income tax combined would be progressive. However, the local option tax by itself would not be progressive.

We must also note that the localities adopting the plan have generally been outside the large urban population centers. This unexpected result can probably be attributed to a number of factors. The program is relatively new, and the number of counties adopting CAGIT is steadily increasing. Also, part of the money must be used to decrease property taxes. As a result, localities do not gain as much from a straight local income tax. Moreover, the local governments are under less pressure to find alternative revenue sources in Indiana than in practically any other state. For example, in state and local general revenue collected from own sources per \$1,000 of personal income, Indiana ranked 48th out of all the states and the District of Columbia in fiscal year 1972-73.^{1/}

The Iowa Plan

The Iowa plan for providing localities the option of a local income tax is similar in concept to Indiana. A local option individual income tax is made available to school districts to increase the quality of educational facilities and is an alternative to increasing property taxes.

The Iowa state school foundation program enacted in 1971 allows any of the 463 school districts to levy each year, for the school general fund, a foundation property tax of \$.54 per one hundred dollars

^{1/} U. S. Bureau of the Census, Governmental Finances in 1972-73, GF 73, No. 5 (Washington, D. C.: Government Printing Office, 1974), p. 45.

of assessed valuation on all taxable property in the district. Besides the foundation property tax levy, the district can levy an additional school district property tax. The districts are also entitled to receive state aid equal to the difference between the amount of foundation property tax collected in the district and the district cost or the state foundation base, whichever is less.

If a school board wishes to spend more than is permitted under this law, the board in an effort to increase the quality of education may hold a referendum on whether or not to finance the excess costs by a school district income surtax of a specified rate. If the higher budget and income surtax are not approved by the voters, the school board must reduce its proposed expenditures.

The surtax rate is determined by dividing the excess amount needed by the total amount of state individual income tax collected in the district. The quotient is the surtax rate to be imposed on the state individual income tax.

In comparison to the Indiana plan, the major area of difference is that the Iowa income tax is viewed not as an attempt to lower property tax revenues, but as an alternative to an increase in property taxes and then only for educational purposes in any of the 463 school districts. The advantage of the Iowa plan is that voters are given the option of increasing education expenditures through a local surtax on the state income tax base. The surtax, of course, is very similar to a "piggyback" tax. Because the surtax is based on the state's progressive income tax rates, it makes the local tax conform more closely to the ability-to-pay principal of taxation.

We should note that the procedure for adopting the local income tax is rather complex because of the necessary referendum for each small school district. In addition, because the surtax is determined by the

required education expenditures, the resulting rates can be different in each locality and in theory have no limit. Up to this point not one school district has decided to enact the local surtax for increasing expenditures on education.

The Maryland Plan

In 1967 Maryland modified its practice of sharing a portion of state income tax revenues by requiring all 23 counties and Baltimore City to adopt a "piggyback" type of local income tax based on state income tax liability. All 24 subdivisions were required to impose a local income tax of not less than 20 percent or more than 50 percent (in multiples of 5) of the state income tax. Administration of the tax is handled by the state, and the locality pays a pro rata share of the administration and collection expenses.

Maryland's state rate schedule is as follows:

<u>Taxable Income</u>	<u>Rate</u>
First \$1,000	2%
\$1,001 - \$2,000	3%
\$2,001 - \$3,000	4%
over \$3,000	5%

and taxable income closely parallels federal taxable income. The result for Maryland is a progressive income tax.

The Maryland local income tax plan is a pure form of income tax; the locality can select the rate of surtax and use the revenues for any purpose. The following table illustrates the actual rates that are imposed for a sample of the options:

<u>Taxable Income</u>	<u>Effective Tax Rate</u>			
	<u>20% Option</u>	<u>30% Option</u>	<u>40% Option</u>	<u>50% Option</u>
First \$1,000	.4%	.6%	.8%	1.0%
\$1,001 - \$2,000	.6%	.9%	1.2%	1.5%
\$2,001 - \$3,000	.8%	1.2%	1.6%	2.0%
over \$3,000	1.0%	1.5%	2.0%	2.5%

At the present time, 21 of the 24 localities impose the maximum 50 percent option. As the table shows, this would require rates ranging from 1.0 percent to 2.5 percent on taxable income over \$3,000. Only New York City and Philadelphia impose rates that are higher.

The tax is collected by the state at the time of filing for the state return, and taxpayer compliance is simplified because the tax is based on state liability. The commuter problem has been reduced because all localities have the tax. All taxpayers are thus liable to an income tax in the locality of residence.

The Maryland local income tax has afforded the localities the option of raising revenues through the income tax rather than further utilizing existing revenue sources. It appears that part of the local income tax revenue has gone to tempering the increase in property taxes. This decreased reliance in the property tax can be seen by observing the trend in the percentage of property tax revenues to total local revenues from own sources. In fiscal year 1965-66, before the local income tax was adopted, this percentage was 71.3 percent for Maryland; in fiscal year 1972-73 it had declined to 52.3 percent. For all local governments in the U. S. the percentage was 67.3 percent in fiscal year 1965-66. In fiscal year 1972-73 this reliance had declined slightly to 62.4 percent. To further highlight the decreasing reliance on property taxes in Maryland, the property tax revenues in Maryland grew at a slower rate than the national average from fiscal year 1965-66 to 1972-73.^{1/}

In an effort to place a limit on how much of the base the state will have to share, Maryland has restricted the maximum local share to

^{1/} U. S. Bureau of the Census, Governmental Finances in 1972-73, GF 73, No. 5 (Washington, D. C.: Government Printing Office, 1974), pp. 31-33.

50 percent of the state liability. It is important to note that all but 3 localities are at this limit. At the past session of the Maryland legislature there was pressure to raise this limit to 65 percent. This particular measure was defeated, but it does illustrate that in any local option income tax plan there will be pressure on the state to share a larger portion of the base.

Alternatives for Virginia

Before we discuss alternatives for Virginia, we must note that although the individual income tax is a major source of local revenues in ten states, it is not presently available to local governments in Virginia. Section 58-151.04 of the Code of Virginia prohibits local governments from imposing any tax or levy upon incomes. Thus, the adoption of a local option individual income tax in Virginia would require a modification of this section.

The examination of local individual income taxes, specifically those of Indiana, Iowa, and Maryland, has presented a number of options for consideration. In Virginia one plan that has received notice recently has been the Indiana CAGIT option that ties a flat rate, local option individual income tax to a mandatory reduction of property taxes. Of course if this link with property tax reduction were not desired, only the income tax part of the plan could be adopted. The requirement that a portion of local revenues be used for property tax relief could be implemented by placing a limit on property tax revenues and requiring that a portion of local income tax revenues be used to reduce local property taxes. The tax could be on a local option basis with the existing state and local administrative facilities handling the administration. Each locality would be free to decide if it wanted to tap this source of revenue.

Of course, Virginia's individual income tax is progressive; if a progressive local income tax were desired then a tax based on a certain percentage of state liability would be more appropriate. Such a tax would be similar to the local "piggyback" tax in Maryland. Table 6.4 presents the amount of revenue that would have been raised in 1972 if selected Virginia localities had adopted this type of local income tax. The table presents the revenue yield of a 10, 20, and 30 percent "piggyback" individual tax on state liability.

Local Corporate Income Tax

In addition to considering the local taxation of the income of individuals, we must also note the alternative of taxing corporate income locally. At present, only a few larger localities in Pennsylvania, Kentucky, and Ohio tax corporate income.

Although the local corporate income tax could yield substantial revenues in some of the larger localities of the Commonwealth, it has one major drawback -- determining the proportion of net income derived within the locality. The state uses a three-factor formula, based on sales, property, and wages and salaries, to allocate and apportion Virginia income from total income. The allocation problem is more difficult at the local level because of smaller geographical boundaries, lack of selected corporate records, and the potential cost of an effective program to enforce the provisions of such a local tax. Another drawback would be its negative impact on prospective industries considering Virginia sites and for Virginia industries contemplating expansion.

TABLE 6.4--REVENUE IMPACT OF VARIOUS LOCAL OPTION INCOME TAX RATES FOR
SELECTED LOCALITIES, TAX YEAR 1972

<u>County</u>	1972 <u>Income Tax Collection</u>	<u>Revenue Impact at Selected Local Option Rates</u>		
		<u>10 Percent</u>	<u>20 Percent</u>	<u>30 Percent</u>
Augusta	\$ 2,413,931	\$ 241,393	\$ 482,786	\$ 724,179
Buckingham	311,629	31,163	62,326	93,489
Chesterfield	8,270,346	827,035	1,654,069	2,481,104
Fairfax	68,708,573	6,870,857	13,741,715	20,612,572
Floyd	360,403	36,040	72,081	108,121
Lunenburg	394,933	39,493	78,987	118,480
Northumberland	462,420	46,242	92,484	138,726
Rappahannock	230,083	23,008	46,017	69,025
Wise	1,824,339	182,434	364,868	547,302
<u>City</u>				
Alexandria	15,328,200	1,532,820	3,065,640	4,598,460
Chesapeake	5,651,769	565,177	1,130,354	1,695,531
Norfolk	14,709,933	1,470,993	2,941,987	4,412,980
Norton	270,609	27,061	54,122	81,183
Richmond	19,201,354	1,920,135	3,840,271	5,760,406
Roanoke	6,593,548	659,355	1,318,710	1,978,064
Suffolk	2,317,971	231,797	463,594	695,391
Waynesboro	1,294,463	129,446	258,893	388,339
Virginia Total	\$364,516,929	\$36,451,693	\$72,903,386	\$109,355,079

SOURCE: Virginia Department of Taxation, Department of Taxation Annual Report, 1973-74,
(Richmond: November, 1974), p. 28.

Local Sales and Use Tax

Introduction

All localities impose a 1 percent local option sales and use tax that is collected by the state and returned to localities by place of sale. In fiscal year 1973-74, the localities of Virginia received \$113,028,109 in revenues. The revenues from this local sales tax are directly tied to the sales tax base, which depends on the level of economic activity in each locality. This relationship is clearly evident after an examination of the revenues in the different localities. In fiscal year 1973-74, the largest amount was received by Fairfax County and equalled \$11,785,841, or 10.4 percent of total local sales tax revenues. The other side of the spectrum was represented by King and Queen County, which received \$17,731, or 0.02 percent of total collections. Obviously, localities have a different view of the importance of the local option sales tax. Because the sales tax is one of the largest sources of revenue for most localities, many people suggest an increase in the local option rate as a viable method of providing additional revenue to localities.

The first section will examine the concept of a local option sales tax and the practices in other states. The next section will consider the advantages and disadvantages of such a concept. The final section will examine the revenue potential of such a measure statewide and for a select group of localities to provide a general idea of the relative amounts of revenue available to various localities.

Practices in Other States

An increase in the local option sales and use tax would involve

an increase in the maximum allowable rate that localities are allowed to impose. On September 1, 1966, the localities were provided the option of imposing a local sales and use tax of 1 percent. All of them made use of this option, and the result was a uniform statewide rate of 4 percent (3 percent state and 1 percent local). Even though 25 states have localities that impose some type of local sales tax, Virginia is one of the few states where there is a uniform, combined state and local sales and use tax rate in every locality. Among our neighboring states there is varying behavior. Kentucky, Maryland and West Virginia do not have local sales taxes. On the other hand, North Carolina and Tennessee allow localities to impose a local sales tax. In North Carolina, a large majority of counties levy a 1 percent local sales tax while in Tennessee about one-half of the counties levy a 1 percent local and a few municipalities levy a local tax of either .5 percent or 1 percent. In both these states the combined tax rate is neither uniform nor does it extend to every locality.

Advantages and Disadvantages

There is no question that an increase in the allowable local option sales and use tax rate would provide localities a sizable increase in revenues. There are, however, advantages as well as disadvantages to this alternative.

The sales tax is a relatively broad based tax reasonably responsive to economic activity. Over the years it has provided the Commonwealth a stable, albeit increasing, amount of revenue. These features are characteristics of an efficient tax and are certainly desirable when compared to some other revenue sources presently available to localities. The tax is desirable for administrative reasons as well. The tax relies on the state sales tax base and is collected

and administered by the state. Thus, the localities are free from any administrative, enforcement, or collection problems.

Another important advantage of the local option would be that only those localities that needed additional revenues would have to utilize this option. Those localities that feel no need to have additional revenues would be free to leave their rate unaltered. In addition, if the option were raised from 1 percent to 2 percent, localities could be allowed to accept only part of the additional option rate, thus raising only the necessary revenue in each particular locality. This provision would be slightly different from the present requirement that if localities choose to adopt the local option, they must implement the 1 percent rate.

The first disadvantage is the increase in the combined state and local sales tax rate. If the permissible local option rate were increased to 2 percent, the combined Virginia rate could become 5 percent. Not only would this make the option of increasing the state rate in the future much more difficult, but in the present time period it would place the combined rate near the highest in the region.

If the localities were allowed to adopt an increased rate and if some opted not to change or selected varying rates, the results would destroy Virginia's uniform sales tax rate structure. This situation would have several harmful effects. Merchants in nearby localities with different rates would have unfair advantages/disadvantages. Out-of-state sellers voluntarily registered to collect the tax might discontinue collections rather than segregate the locations of sale on their returns because varying tax rates are a bookkeeping burden on

sellers.^{1/}

Another major disadvantage of a local option sales tax is that it would raise substantial revenues in certain localities, especially urban ones, that have a higher level of economic activity, but would not raise large amounts of revenues in other localities. In addition, certain central cities where growth in retail trade is relatively slow and where fiscal burdens are concentrated would perhaps not be helped as much as other localities by this option. Finally, this additional local option would short change the state with respect to its borrowing power because such locally imposed taxes cannot be counted in the state's borrowing base.

Revenue Potential

The aggregate revenue potential of the local option sales tax is substantial. An increase in the local option rate to, say, 2 percent and its adoption would double the present revenue yield of the local option tax. In fiscal year 1973-74 revenues from the local option would have doubled from \$113,028,109 to \$226,056,218, and each locality would have received twice as much revenue from the local option tax. Table 6.5 presents the estimated revenue from this increased local option tax in fiscal year 1973-74 for a sample of 17 selected localities. This sample should hopefully present an idea of the revenue potential involved for various types of localities.

^{1/} Federal legislation is pending that would allow states with uniform tax rates to require out-of-state sellers to collect their tax (even though the seller had no place of business or salesmen located in that state). The legislation would not allow jurisdictions with varying tax rates to have this advantage. The federal legislation is aimed at enticing states to become uniform in their tax law. Should this legislation become law, Virginia could be denied large amounts of revenue if combined rates did not remain uniform.

TABLE 6.5 --REVENUE IMPACT OF A 2 PERCENT LOCAL
OPTION SALES TAX ON SELECTED LOCALITIES,
FISCAL YEAR 1973-74

<u>County</u>	Actual 1973-74 1 Percent Local <u>Option Revenue</u>	Estimated 1973-74 2 Percent Local <u>Option Revenue</u>
Augusta	\$ 702,226	\$ 1,404,452
Buckingham	101,961	203,922
Chesterfield	1,435,246	2,870,492
Fairfax	11,785,841	23,571,682
Floyd	87,704	175,408
Lunenburg	140,628	281,256
Northumberland	105,356	210,712
Rappahannock	44,907	89,814
Wise	700,773	1,401,546
 <u>City</u>		
Alexandria	3,811,977	7,623,954
Chesapeake	1,439,587	2,879,174
Norfolk	8,009,279	16,018,558
Norton	197,561	395,122
Richmond	9,445,924	18,891,848
Roanoke	3,787,599	7,575,198
Suffolk	840,967	1,681,934
Waynesboro	589,069	1,178,138
Virginia Total	\$113,028,109	\$226,056,218

License Taxes

Introduction

In Virginia certain businesses, professions, and occupations are subject to state and local license taxes. These license taxes perform a dual function, since they are used to regulate certain activities and/or to produce revenue. The various rates of tax on these activities differ between localities, but generally they are either a fixed fee, a percentage of gross receipts, or a combination of the two. State license taxes are usually on a fee basis, and total collections represent less than 1 percent of general fund revenues.

License taxes have been subject to widespread criticism in recent years. For example, the local license taxes based on gross receipts have been criticized because they often bear little relationship to the rates of return of the various businesses. They have also been viewed as discouraging to an otherwise desirable and profitable business activity in a locality because of extremely high rates. At the state level, the license taxes represent an insignificant proportion of state revenue and no longer provide principal regulatory influence; as a result, they are viewed as nuisance taxes.

This section will weigh the importance of local license taxes as a source of revenue. It will discuss the current inequities in the structure of the tax, outline the effects of the tax on the taxpayer and the community, and look briefly at the regulatory role of local license taxes. Variations in tax treatment of different classes of business and of businesses within the same class will be examined within localities, and the tax treatment of similar activities will be compared between localities. A discussion of alternatives to the local license

taxes will then follow. In addition, there will be a similar discussion of state license taxes and alternatives to them.

Local License Taxes

The Significance of License Taxes as a Revenue Source

Although the local business, professional, and occupational license taxes are not large revenue producers when compared to total revenues or to major revenue sources like the real property tax, they do provide substantial amounts of supplemental revenue to many localities. Table 6.6 shows the license tax revenue collected by Virginia cities and selected counties in fiscal year 1972-73 and compares it to total revenue raised locally.^{1/} License tax revenue represented approximately 7.8 percent of the locally raised revenues for cities and ranged from as little as 3.3 percent to as much as 16.1 percent of total collections. For the counties shown, license tax revenue ranged from less than 1 percent to more than 8 percent of total local revenue but represented a smaller proportion of county revenue than city revenue, or approximately 3.4 percent. While the ratio of revenues from these taxes to total local revenue is quite small in some localities, we must note that even a ratio of approximately 5 percent represents from \$2.5 to \$4.8 million in cities as large as Alexandria and Norfolk; a ratio of approximately 2 percent represents as much as \$4.5 million for a county the size of Fairfax.

Since license taxes in most localities are levied on gross receipts with only some regard for business costs and profitability, license

^{1/} Since license taxes are levied primarily in metropolitan localities, the counties selected for Table 6.6 represent those counties within Virginia standard metropolitan statistical areas (SMSA) known to levy license taxes.

TABLE 6.6--REVENUES FROM LOCAL BUSINESS, PROFESSIONAL, AND OCCUPATIONAL
LICENSE TAXES IN VIRGINIA CITIES AND SELECTED COUNTIES, FISCAL YEAR 1972-73

<u>City^{a/}</u>	<u>Business, Professional, and Occupational License Revenue</u>	<u>Total Local Revenue^{b/}</u>	<u>Percent Business, Professional, and Occu- pational License Revenue to Total</u>
Alexandria	\$ 2,506,942	\$ 44,315,493	5.7
Bedford	58,024	870,008	6.7
Bristol	229,012	2,900,008	7.9
Buena Vista	64,208	1,042,923	6.2
Charlottesville	853,234	10,751,549	7.9
Chesapeake	774,231	19,084,902	4.1
Clifton Forge	72,069	966,048	7.5
Colonial Heights	99,184	3,027,360	3.3
Covington	117,982	1,818,850	6.5
Danville	743,829	8,070,979	9.2
Emporia	84,301	826,572	10.2
Fairfax	552,720	8,737,384	6.3
Falls Church	363,920	4,538,488	8.0
Franklin	90,066	1,495,573	6.0
Fredericksburg	652,740	4,062,298	16.1
Galax	119,489	1,405,749	8.5
Hampton	1,552,512	26,302,973	5.9
Harrisonburg	420,507	4,146,189	10.1
Hopewell	269,394	4,903,272	5.5
Lexington	86,149	1,317,535	6.5
Lynchburg	1,443,392	14,855,005	9.7
Martinsville	329,191	3,964,610	8.3
Nansemond	187,425	4,287,674	4.4
Newport News	2,644,602	36,477,205	7.3
Norfolk	4,815,500	86,070,289	5.6
Norton	76,776	815,554	9.4
Portsmouth	1,518,979	23,393,681	6.5
Radford	61,933	1,479,940	4.2
Richmond	11,100,383	96,414,652	11.5
Roanoke	3,455,808	26,999,388	12.8
Salem	308,445	4,577,259	6.7
South Boston	136,655	1,398,986	9.8
Staunton	321,051	4,541,042	7.1
Suffolk	...	...	...
Virginia Beach	2,128,524	35,685,280	6.0
Waynesboro	324,859	4,027,566	8.1
Williamsburg	350,960	3,024,209	11.6
Winchester	539,090	4,914,334	11.0
Sub-Total	\$39,454,086	\$503,510,827	7.8

TABLE 6.6--REVENUES FROM LOCAL BUSINESS, PROFESSIONAL, AND OCCUPATIONAL LICENSE TAXES
IN VIRGINIA CITIES AND SELECTED COUNTIES, FISCAL YEAR 1972-73 (continued)

County	Business, Professional, and Occupational License Revenue	Total Local Revenue ^{b/}	Percent Business, Professional, and Occu- pational License Revenue to Total
Albemarle	\$ 138,623	\$ 8,347,057	1.7
Amherst	2,896	2,069,619	0.1
Arlington	4,865,346	68,881,561	7.1
Augusta	270,469	5,869,638	4.6
Bedford	1,628	3,659,019	0.04
Campbell	2,267	4,456,509	0.05
Chesterfield	516,520	28,478,321	1.8
Dinwiddie	15,649	1,873,709	0.8
Fairfax	4,514,213	215,127,390	2.1
Gloucester	54,314	1,830,685	3.0
Goochland	28,455	1,584,176	1.8
Hanover	2,146	4,838,878	0.04
Henrico	3,258,322	41,552,804	7.8
James City	163,228	3,010,258	5.4
Loudoun	2,300	11,319,484	0.02
Prince George	40,832	2,065,663	2.0
Roanoke	363,337	14,026,464	2.6
York	19,350	4,272,349	0.4
Sub-Total	\$14,259,895	\$423,263,584	3.4
Total	\$53,713,981	\$926,774,411	6.0

^{a/} Excludes those cities where a separate breakout of business, professional, and occupational license taxes was not available.

^{b/} Includes only locally raised revenues, such as real and personal property taxes, bank taxes, miscellaneous fees, and the local option sales tax, but does not include any revenues distributed to localities from the state or federal government.

SOURCE: Unpublished reports of the Auditor of Public Accounts, Commonwealth of Virginia.

taxes provide a stable source of local revenue. Recently the growth of license tax revenues has almost been assured because of the impact of inflation on gross receipts. However, the traits of gross receipts taxes that make them particularly difficult for localities to give up are the same traits that make them seem burdensome to the taxpayer.

The Equity Implications of Gross Receipts Taxes

There are several ways that we can analyze the equity of gross receipts taxes, but the analyses will differ depending upon which theory of taxation local governments choose to employ. One theory of taxation presumes that taxes should be based on the taxpayer's ability to pay. Based on this theory individuals or businesses with less income or profit should pay less tax than taxpayers with larger amounts of income or profit. This theory also declares that the tax liabilities of individuals or businesses should be equal when their incomes or profits are equal. Contrary to this theory, the other theory of taxation states that the amount of tax for each member of a community should be based on the proportion of public services that he has required relative to the rest of the community and to the cost incurred by government in providing the services. We can see that these two theories are not compatible with each other. For example, even though a business may have operated at a loss, it may have required extensive police and fire protection. The first theory would say that this business should pay no tax, but the second theory would maintain that the firm still had an obligation to pay for its share of public services.

If the structure of local business, professional, and occupational license taxes were predicated on the theory that tax liability should bear a relationship to the demand for and benefit derived from public

services, then some measure of these benefits would be necessary. Since it is extremely difficult to determine the exact value (i.e., benefits) of public services such as fire or police protection on a firm-by-firm basis, we must approximate their value by some other means. If we were to assume that benefits could be equated with business volume, there exist several possible bases for taxation. James B. O'Neal, Jr., who authored a manual in 1959 for use by Virginia municipalities in establishing a local license tax, has identified three volume-related bases--gross receipts, value added by handling, and classified gross receipts.^{1/}

Gross receipts refer to total money collected by a firm for the sale of goods and services. Because a tax based on gross receipts relies on a single factor and a single tax rate for all businesses, it is straightforward and relatively easy to administer. Although a gross receipts tax does base tax liability on the extent of market use, businesses view it with disfavor since it makes no allowance for the different profit margins, and thus ability-to-pay, inherent to various kinds of businesses.

A tax on the value added by handling, or gross receipts less the costs of input goods and services, bases tax liability on the value of the productive service provided by the individual or firm. Since the value added concept does compensate for various markup rates used by different businesses, it is more acceptable to many taxpayers in terms of ability-to-pay than a gross receipts tax. However, if the idea is to equate the value of benefits from public services to

^{1/} James B. O'Neal, Jr., Municipal License Tax Manual, Joint Report No. 13, (Richmond and Charlottesville: League of Virginia Municipalities and Bureau of Public Administration, University of Virginia, 1959), p. 5.

business volume, a value added tax begins to diverge from the cost-benefit theory of taxation. Furthermore, a tax based on value added by handling is more complicated to calculate; thus, it is a more difficult tax to administer.

Classified gross receipts partially combine features of each of the first two bases. A classified gross receipts tax differs from a straight gross receipts tax in that it employs various tax rates for different classes of business. The various tax rates are often determined by the relative differences in the ratios of value added to gross receipts (i.e., operating ratios, gross profit margins, or profitability) for classes of business that tend to have similar ratios. Classes of businesses whose value of productive services generally bears a larger relationship to gross receipts are taxed at a higher rate than classes whose ratio of value added to gross receipts is smaller. For example, under a classified gross receipts tax, a business class for which the ratio of value added to gross receipts is generally double the ratio of another business class might be subject to a tax rate twice the rate applied to the second business class. While this type of taxation appears to gain greater approval from taxpayers in terms of ability-to-pay than a straight gross receipts tax, it too deviates from the theory of taxation that calls for a relationship between tax liability and benefits from public services. The administrative advantage of a classified gross receipts tax is that even though various tax rates may be employed, they are levied on a single factor for all businesses.^{1/}

^{1/} James B. O'Neal, Jr., Municipal License Tax Manual, pp. 6-9.

Classified gross receipts taxes appear to be the most prevalent form of local license taxation in Virginia. As a result, we can surmise that local governments have tried to mix the cost-benefit theory of taxation with either the ability-to-pay theory or other extraneous factors. Gross receipts offer a proxy measure of public service benefits that local firms receive; however, the various tax rates levied on different classes of business cause the cost-benefit theory to be violated. This can be shown in the following example. Consider firm A and firm B in locality X each with gross receipts of \$200,000. Both use the market to the same extent, and each establishment is thus assumed to require about the same public services. If locality X levied a classified gross receipts tax on firm A at a rate of 30 cents per \$100 of gross receipts and firm B at a rate of 75 cents per \$100, firm A would pay a \$600 tax and firm B would pay \$1,500. Cost-benefit analysis would call for both firms to be taxed equally.

Table 6.7 shows the various tax rates and the taxable gross receipts for eight Virginia localities with classified gross receipts taxes. Because license taxes are primarily levied in metropolitan areas, the eight localities shown in the table represent a central city and a suburban county or city from each of the four major metropolitan areas of Virginia--Northern Virginia, Richmond, Tidewater, and Roanoke. The seven classes of business for which tax rates are given represent all but two of the broad classes in which O'Neal identifies similar operating ratios.^{1/} These seven seem to embrace most of the business and professional activities subject to local license taxation. The other two classes not shown are manufacturers and amusements; we did not include them because manufacturers were only subject to license

^{1/} James B. O'Neal, Jr., Municipal License Tax Manual, p. 30.

TABLE 6.7--A COMPARISON OF BUSINESS, PROFESSIONAL, AND OCCUPATIONAL
LICENSE TAX RATES IN SELECTED METROPOLITAN LOCALITIES, AS OF DECEMBER, 1974

<u>Business Class and Tax Rate</u>	<u>Arlington County</u>	<u>Alexandria</u>	<u>Henrico County</u>	<u>Richmond City</u>	<u>Norfolk</u>	<u>Virginia Beach</u>	<u>Roanoke County</u>	<u>Roanoke City</u>
Retail Merchants								
Fixed Fee	\$25.00	\$30.00	\$30.00	\$30.00	\$38.50	\$25.00	\$25.00	\$55.00
Tax Rate (Per \$100)	35¢	35¢	30¢	50¢	33¢	25¢	15¢	55¢
Taxable Gross Receipts	All receipts	Over \$8,570	All receipts	All receipts	Over \$3,000	Over \$2,500	All receipts	All receipts
Wholesale Merchants								
Fixed Fee	\$25.00	\$25.00	\$30.00	\$30.00	\$50.00	\$50.00	\$50.00	\$55.00
Tax Rate (Per \$100)	8¢	11¢	20¢	25¢	15¢	12¢	35¢	33¢
Taxable Gross Receipts ^{a/}	All receipts	Over \$22,727	Gross purchases over \$10,000 ^{b/}	All gross purchases	All gross purchases	Over \$2,500	Over \$3,000	All receipts
Professional Occupations								
Fixed Fee	\$25.00	\$30.00	\$30.00	\$30.00	\$38.50	\$25.00	\$25.00	\$20.00
Tax Rate (Per \$100)	1.00	60¢	75¢	1.58	77¢	73¢	15¢	1.10
Taxable Gross Receipts	All receipts	Over \$5,000	All receipts	All receipts	Over \$3,000	Over \$2,500	Over \$500	Over \$4,000
Personal Service Occupations								
Fixed Fee	\$25.00	\$30.00	\$30.00	\$30.00	\$38.50	\$25.00	\$25.00	...
Tax Rate (Per \$100)	65¢	35¢	30¢	50¢	38.5¢	50¢	15¢	...
Taxable Gross Receipts	All receipts	Over \$8,570	All receipts	All receipts	Over \$3,000	Over \$2,500	Over \$500	...
Business Service Occupations								
Fixed Fee	\$25.00	\$30.00	...	...	\$38.50	\$25.00	\$25.00	...
Tax Rate (Per \$100)	35¢	35¢	...	...	38.5¢	32¢	15¢	...
Taxable Gross Receipts	All receipts	Over \$8,570	...	...	Over \$3,000	Over \$2,500	Over \$500	...
Repair Service Occupations								
Fixed Fee	\$25.00	\$30.00	...	\$30.00	\$38.50	\$25.00	\$25.00	\$55.00
Tax Rate (Per \$100)	35¢	35¢	...	50¢	38.5¢	50¢	15¢	55¢
Taxable Gross Receipts	All receipts	Over \$8,570	...	All receipts	Over \$3,000	Over \$2,500	Over \$500	All receipts
Contractors and Contracting								
Fixed Fee	\$25.00	\$60.00 ^{d/}	\$30.00	\$30.00	\$38.50	\$50.00	\$25.00	\$55.00
Tax Rate (Per \$100) ^{c/}	35¢	...	15¢	19¢	19.8¢	17¢	15¢	17¢
Taxable Gross Receipts	All receipts	...	All receipts	All receipts	Receipts to \$500,000	Over \$5,000	Over \$1,000	All receipts

^{a/} Certain localities levy a tax on the gross purchases of wholesalers in place of a gross receipts tax. Those shown in this table include Henrico County, Richmond City, and Norfolk.

^{b/} Henrico County levies a 17¢ tax per \$100 of gross purchases in excess of \$5 million but less than \$10 million; a 15¢ tax per \$100 is levied on gross purchases in excess of \$10 million.

^{c/} The rates shown are for "non-fee basis" contractors. The rates for "fee-basis" contractors and the localities that levy them are as follows:
Henrico County, \$1.50 per \$100 of gross receipts; Richmond City, 1.58 percent of fees; Norfolk, 1.265 percent of fees.
In addition to the rate shown above the "non-fee basis" contractors in Norfolk, a tax of 1.1¢ per \$100 is levied on gross receipts over \$500,000.

^{d/} An additional \$60 is levied for gross receipts totalling more than \$25,000.

SOURCES: Paul K. Casey, Tax Rates in Virginia Cities and Selected Counties: 1974, Joint Report No. 32, (Richmond and Charlottesville: Virginia Municipal League and Institute of Government, University of Virginia, April, 1975), pp. 35-57; see also sections of local ordinances dealing with licenses.

taxes in one of the eight localities and because the rates for amusements varied depending upon the type of amusement.^{1/}

The preceding example of how various classes of business are treated differently within a locality and how the cost-benefit theory of taxation is violated could apply to any one of the eight localities shown in Table 6.7. Tax rates for the various classes of business within these localities vary by as much as 12 times each other. Businesses with equal gross receipts and thus with about the same apparent requirements for local services would have substantially different tax liabilities. We can demonstrate the differences in treatment if we compare the tax loads of various professions and businesses in a given locality. If we first compare the treatment of a retail merchant to a manufacturer within any of the eight localities, we note a substantial difference. Consider a department store and a manufacturer in the city of Roanoke each with gross receipts of \$1 million. The manufacturer is subject to no gross receipts tax, but the department store is taxed at 55 cents per \$100 of gross receipts and must pay \$5,555.^{2/} Secondly, assume that a barber and a physician both conduct businesses in the city of Richmond, and each has gross receipts of \$50,000 per year. The barber is taxed at the personal service rate of 50 cents per \$100 of gross receipts, but the physician is taxed at the professional occupation rate of \$1.58 per \$100. The tax liabilities of the barber and physician are \$280 and \$820, respectively. A final example weighs the treatment of contractors against the treatment of both repair and business services in the city of Alexandria. If a plumber (contractor),

^{1/} Alexandria levies a flat \$30 fee on manufacturers.

^{2/} Tax liabilities also include the fixed fees shown in Table 6.7.

an upholsterer (repair service), and a printer (business service) in Alexandria each have gross receipts of \$25,000, the plumber pays a tax of \$60 while the upholsterer and printer pay \$117.50, or almost double the tax liability of the plumber. In each case, two operations may have similar demands for services provided by local government, but one would pay less tax or even no tax for its share of benefits.

If the rationale behind a classified gross receipts tax is compensation for the differences in operating ratios among business classes and therefore a better relationship to the taxpayer's ability to pay, the logic is not altogether sound. Even with the various tax rates adjusted so that more profitable businesses are taxed more heavily, there is no provision for the various subclasses of businesses within a broad category that have profit margins above or below the operating ratio indicated for the category. We can show how classified gross receipts taxation fails to meet the ability-to-pay test with Tables 6.8 and 6.9. Table 6.8 has the operating ratios for the seven broad categories of business identified in the earlier table, and Table 6.9 further refines the ratios for various types of retail activity.^{1/} These data indicate that certain retail merchants are generally more profitable and probably better able to pay taxes than others. At the same time, if a locality were to tax retail merchants as a general class, which is the usual case, a grocer and a furniture retailer with equal gross receipts would bear disproportionate tax loads relative to their ability to pay. With local gross receipts tax

^{1/} The most refined data available in Statistics of Income for various subclasses of broad business activities are for retail merchants; although each of the other business classes could probably be broken down in a similar fashion, we chose retail merchants for this reason.

TABLE 6.8--RATIOS OF VALUE ADDED TO GROSS
RECEIPTS FOR SIMILAR BUSINESS ACTIVITIES, 1970

<u>Business Class</u>	<u>Percent Value Added to Gross Receipts</u>
Retail Merchants	28.1
Wholesale Merchants	17.7
Professional Occupations	92.9
Personal Service Occupations	61.4
Business Service Occupations	42.9
Repair Service Occupations	51.4
Contractors and Contracting	22.2

SOURCE: Internal Revenue Service, Statistics of Income: Business Income Tax Returns, 1970, (Washington: U. S. Government Printing Office, September, 1973), pp. 4-16 and p. 36.

TABLE 6.9--RATIOS OF VALUE ADDED TO GROSS RECEIPTS FOR
RETAIL MERCHANTS BY PRINCIPAL ACTIVITY AND IN GENERAL, 1970

<u>Principal Retail Activity</u>	<u>Percent Value Added to Gross Receipts</u>
Building Materials, Hardware, and Farm Equipment Stores	24.9
General Merchandise Stores	36.5
Food Stores	20.6
Drug and Proprietary Stores	30.5
Automobile and Truck Dealers	15.2
Apparel and Accessory Stores	37.0
Furniture, Home Furnishings, and Equipment Stores	35.2
ALL RETAIL STORES	28.1

SOURCE: Internal Revenue Service, Statistics of Income: Business Income Tax Returns, 1970, (Washington: U. S. Government Printing Office, September, 1973), pp. 11-13.

rates tied to general operating ratios for broad classes of businesses, there is probably little consolation to the grocer to know that he is subject to a lesser tax rate than a professional person or a business service enterprise.

We can make a similar analysis for the treatment of professionals. Listed below are the ratios of value added to gross receipts for four subclasses of the professional occupation group:^{1/}

	<u>Percent Value Added to Gross Receipts</u>
Physicians and Surgeons	96.6
Attorneys	95.9
Engineers and Architects	79.0
Certified Public Accountants	97.5

While three of the four professions appear to be almost equally profitable and thus to have equivalent abilities to pay, engineers and architects show less profitability. In localities where these four subclasses are taxed at a single rate for professional occupations, as is the usual case, engineers and architects would receive less than equitable tax treatment.

In addition to not providing for differences in the ability to pay of subclasses within a broad group, classified gross receipts taxation does not provide for the variations in profitability that correspond to various sizes of business. Table 6.10 shows the operating ratios by the extent of business activity for all retail merchants and for three subclasses. We again selected retail merchants because the

^{1/} Data source: Internal Revenue Service, Statistics of Income: Business Income Tax Returns, 1970, (Washington: U. S. Government Printing Office, September, 1973), p. 36.

TABLE 6.10--RATIOS OF VALUE ADDED TO GROSS RECEIPTS FOR VARIOUS
RETAIL ACTIVITIES AND IN GENERAL BY BUSINESS VOLUME, 1970

<u>Business Receipts</u>	<u>Percent Value Added to Gross Receipts</u>			
	<u>All Retail Merchants</u>	<u>Food Stores</u>	<u>General Merchandise Stores</u>	<u>Apparel and Accessory Stores</u>
\$0 - \$9,999	38.2	25.6	43.8'	38.1
\$10,000 - \$49,999	34.3	21.2	34.2	32.1
\$50,000 - \$99,999	32.0	20.0	25.2	33.0
\$100,000 - \$499,999	30.3	17.8	25.6	32.9
\$500,000 - \$999,999	27.4	17.5	27.6	25.0
\$1,000,000 - \$4,999,999	22.9	17.4	29.6	35.6
\$5,000,000 or more	27.9	14.5	13.9'	-*

* Not available.

SOURCE: Internal Revenue Service, Statistics of Income: Business Income Tax Returns, 1970, (Washington: U. S. Government Printing Office, September, 1973) pp. 21, 43-44.

data are subclassified in better detail than for any other major category of business. The table indicates that there are fluctuations in the profitability of given business activities as the use of the market increases. Generally, the ratios of value added to gross receipts decline for the businesses shown as business receipts increase to approximately \$500,000; thereafter, profitability may increase and then again decline. In any case, it is apparent that the differences in profitability caused by varying size for the business activities shown are often significant and may vary by as much as 30 percentage points.

Thus, a small fashion boutique with gross receipts under \$10,000 may be better able to pay taxes than a larger ready-to-wear store with receipts totalling \$500,000. Similarly, a neighborhood food mart with gross receipts equal to \$40,000 could have a higher profit margin than a nationwide grocery chain store whose receipts are \$1 million. Therefore, with respect to ability-to-pay the tax loads of the larger ready-to-wear and grocery chain stores are disproportionate to those of the smaller and more profitable boutique and neighborhood food mart.

We can view still other discrepancies in classified gross receipts taxation in terms of ability-to-pay if we consider other fluctuations in the profitability of various businesses. Various factors influence the profitability of individual businesses. Changes in economic activity affect market conditions for certain products or services, and changes in business costs affect prices. Inflation has had a significant impact on all taxpayers; however, when inflation carries prices upward, it also carries gross receipts upward, even though the business' costs may rise even faster, leading to a decline in profitability. We have shown how declining profitability affects the comparative tax loads of various business activities, but inflation could compound this problem because not all goods and services are subject to the same rates of inflation. Table 6.11 shows the consumer price indexes for various business activities. Comparing the percent increases from 1973 to 1974 for food at home and for apparel and upkeep, we note that their respective prices increased by 14.8 and 7.4 percent. This would indicate that inflation has had twice the impact on the gross receipts of grocers than it has had on clothing retailers, even though the two are both retail merchants and are usually taxed at equivalent

rates. The comparative increases in fees for medical attention and legal services from 1972 to 1973 are 3.3 and 8.9 percent, respectively. Again, since both professions are generally subject to the same tax rate, inflation has probably had a greater impact on attorneys. We can also examine the differences in the year-to-year effects of inflation. Table 6.11 indicates that for men's haircuts, which is a personal service, prices increased by annual rates of 3.0, 2.2, 6.1, and 8.7 percent from 1970 to 1974. Thus, the variations in effects of inflation within classes complicate tax treatment, and the year-to-year differences add further to the problem. Other factors that affect the profitability of individual businesses are the relative advantageousness of business locations (i.e., access to the market) within the community and the differing entrepreneurial abilities of owners. We only note these influences and point out that most of the same problems and inequities mentioned above apply.

TABLE 6.11 --CONSUMER PRICE INDEXES FOR VARIOUS GOODS AND SERVICES AND FOR ALL ITEMS BY CALENDAR YEAR, 1967=100

	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>
Food at Home	113.7	116.4	121.6	141.4	162.4
Furniture and Bedding	115.5	119.1	121.1	125.3	136.1
Apparel and Upkeep	116.1	119.8	122.3	126.8	136.2
Drugs and Prescriptions	103.6	105.4	105.6	105.9	109.6
Physicians Fees	121.4	129.8	133.8	138.2	150.9
Legal Services	124.7	135.5	148.6	161.8	175.5
Men's Haircuts	119.0	122.6	125.3	132.9	144.5
ALL ITEMS	116.3	121.3	125.3	133.1	147.7

SOURCES: U. S. Department of Labor, Monthly Labor Review, (Washington: January, 1972), pp. 114-119; MLR, (January, 1973), pp. 104-109; MLR, (January, 1974), pp. 112-117; MLR, (January, 1975), pp. 113-118; MLR, (April, 1975), pp. 109-114.

Another explanation unrelated to any theory of taxation for the classification of businesses for purposes of gross receipts taxation might be that it enables localities to use the available tax base to their advantage; if this is the intent of classification, it can lead to inequities that become discouraging to business. When a certain business activity is significant within a given locality, it becomes a logical source of sizeable amounts of revenue. Tax rates can be increased in order to capitalize further on the base that this business provides. An example of this kind of classification and the inequities that it can produce is the difference in treatment of the hotel/motel industry in the eight sample metropolitan localities that were shown in Table 6.7. In six of the eight localities hotels and motels are classified as separate businesses with the applicable tax rates specified in the local ordinances. These localities include the cities of Roanoke, Norfolk, Virginia Beach, and Richmond and the counties of Arlington and Henrico. In Alexandria and Roanoke county hotels and motels are included in the lists of taxable personal services and are taxed at the same rates as those given in Table 6.7 for that class. However, if we examine the tax rates for each of the six localities that classify hotels and motels separately, we find that in four of these localities the hotel/motel industry is taxed at the same rate as for personal services.

The two localities with different tax rates for hotels/motels are Arlington county and Virginia Beach, and we note that in these two localities the industry is probably more active because of tourism or federal government activity than in the other six localities in the sample. In Arlington county the difference between the hotel/motel rate and the personal service rate is substantial. While personal

service enterprises in Arlington county are taxed at 65 cents per \$100 of gross receipts, the hotel/motel industry is subject to a tax of \$4 per \$100 of gross receipts in excess of \$5,000, or more than six times the rate for other personal services. Of the \$7.2 million in license tax collections for calendar year 1974 in Arlington county, more than \$900,000 came from hotels/motels.^{1/} This represented almost 13 percent of total license tax revenues, even though the \$22.2 million in taxable gross receipts of Arlington county hotels/motels represented less than 2 percent of the total taxable gross receipts base for the period. In Virginia Beach the tax rate for hotels/motels is 46 cents per \$100 of gross receipts in excess of \$2,500 and compares closely to the personal service rate of 50 cents per \$100 of gross receipts in excess of \$2,500. License tax collections from hotels and motels in Virginia Beach amounted to approximately \$90,000 for fiscal year 1973-74 and represented about 3 percent of the \$2.8 million in total license tax revenues. The taxable gross receipts of hotels/motels in Virginia Beach were approximately \$40.0 million, which is roughly equivalent to the hotel/motel base in Arlington county and made up an estimated 4 percent of the total taxable gross receipts in Virginia Beach.

We can observe another instance where the reliance on a given business activity differs significantly between localities. We estimate that the taxable gross receipts of grocers in Henrico county were approximately \$133.6 million for fiscal year 1973-74, which is about double the

^{1/} Arlington county license tax data by business source were not available on a fiscal year basis. All data for calendar year 1974 rely on a computer print-out from the commissioner of revenue showing year-to-date totals and entitled Recapitulation of Licenses Issued by the Commissioner of Revenue and Monies Paid to the Treasurer of Arlington County During the Month of December, 1974.

amount we estimate for grocers in the city of Roanoke during the same period, or \$67.2 million. However, our estimates of tax collections from grocers are about the same share of total license tax receipts for each locality (10.4 percent for Henrico county and 10.1 percent for the city of Roanoke).^{1/} The reason is that the tax rate applied to retailers in Henrico county is 35 cents per \$100 of gross receipts, while in Roanoke city it is 55 cents per \$100, or almost double Henrico's rate. Thus, we can see how local governments rely differently on a given business base and how tax loads consequently differ between localities.

The Incidence and Effects of Gross Receipts Taxes

We can also discuss gross receipts taxes in the context of excise taxation, for even though the two are nominally different, gross receipts taxes may have effects similar to those of an excise tax on the taxpayer and the community in general. An excise tax levied on the manufacture or sale of a particular good generally influences the final price to the consumer, but the extent of the influence depends upon the degree of responsiveness (i.e., elasticity) of the quantities demanded and supplied to changes in the price. When demand and supply are both elastic to some degree, as is the usual case, the burden of the tax cannot be passed entirely from the seller to the buyer but must be shared between the two. If the final price of the good to the consumer increases as the result of an excise tax, he demands less of it; thus, the seller is forced to supply less and resources are shifted to the production of other goods not subject to the excise tax. When purchases

^{1/} Estimates of the share of total tax rely on data furnished by the local commissioners of revenue. Estimates of taxable gross receipts rely on the food at home component of the CPI shown in Table 6.11 and data from U. S. Department of Commerce, 1972 Census of Retail Trade: Virginia, (Washington, D.C.: U.S. Government Printing Office, October, 1974), pp. 25 and 42.

of the taxed good are reduced, consumers may demand more of other tax-free goods. Because resources have been shifted away from the taxed good, production of other goods could increase. If we assume that other goods are produced in a competitive system under conditions of increasing cost, the prices of other goods will rise as production expands. Therefore, consumers of both the taxed good and the other goods are forced to pay higher prices, and both suffer losses in real income and in the satisfaction that they derive from both goods. Furthermore, the tax has shifted the allocation of resources from one industry to another allowing one to benefit from expanded production and higher prices and the other to suffer from reduced production and a share of the tax burden.^{1/} Our discussion will now turn to the incidence of the gross receipts tax, the effects of the tax on prices of local goods and services, and the shifting of resources between localities.

We have noted some of the factors that make it difficult for businesses to transfer the burden of an excise tax to consumers of the taxed good. The burden of gross receipts taxes is even more difficult to transfer, because such efforts directly affect the tax base. While an excise tax is usually added to the price of a particular good at the time of sale, gross receipts taxes are levied on the sum of the values of all goods and services sold. Therefore, if businesses attempted to adjust their prices upward in order to recoup their estimated gross receipts tax liability, they would only increase the tax base and further add to total tax liability. For example, assume that a locality in which gross receipts for all retail merchants are \$1,000 million adopts

^{1/} Richard A. Musgrave and Peggy B. Musgrave, Public Finance in Theory and Practice, (New York: McGraw-Hill, Inc., 1973), pp. 426-432.

a license tax of 50 cents per \$100 (0.5 percent) of gross receipts. Total revenue would be \$5 million. Suppose that each merchant estimates his tax liability and increases his prices by 0.5 percent to provide for his anticipated tax bill and still retain the same level of profits. If we assume that price increases will not reduce or will reduce very slightly the quantity of retail goods demanded, the quantity of retail goods supplied would not change or would change insignificantly upon adoption of the tax. The gross receipts of all retail merchants would approach \$1,005 million, and the sum of all tax liabilities \$5,025,000. Under these circumstances the incidence of the tax would fall primarily on consumers, but retailers could never fully avoid bearing some share of the tax bill.

Assume now that consumer demand for retail goods declines as merchants increase prices. In this case there could be two other effects from the adoption of a 0.5 percent gross receipts tax. Gross receipts might either remain constant or decline, and tax liability would either remain at or fall short of \$5 million. In either instance, efforts to extract the entire tax from consumers would fail and would cause the merchants to lose sales and suffer reduced profits.^{1/} As a result, the quantity of retail goods available for purchase could decline even further as merchants left the locality and as potential retailers chose to establish businesses in other localities.

While each locality may have one or several businesses, professions, or occupations on which it relies substantially, these activities

^{1/} The question of who bears the ultimate burden of an excise or gross receipts tax is similar to the question of who bears the burden of the corporate income tax; there is no definitive answer to these questions. See the introduction to the corporate income tax section of Chapter III for a discussion of this subject.

generally became established in the area after consideration of a number of factors. Two such factors are a favorable market for the good or service and a favorable tax atmosphere toward the activity when compared to other potential locations. If we again examine Table 6.7, our analysis of the four metropolitan regions represented shows the general equivalence of tax rates for most business classes between neighboring localities. For example, we note that professionals and retailers in Virginia Beach are taxed at rates comparable to the rates for those same classes in Norfolk, and wholesalers are taxed at roughly the same rate in the city of Roanoke as in Roanoke county. These similarities are probably not coincidental but in all likelihood reflect the competition between neighboring localities to attract and to keep established businesses (i.e., to preserve the growth of the local tax base) within the community.

Where the differences in tax rates between neighboring localities are more sizeable, such as between Arlington county and Alexandria and between Henrico county and Richmond for professional occupations, several consequences can occur. For Arlington county and Richmond, the tax rate for professionals is approximately double that for professionals in Alexandria and Henrico county, respectively. These differences may be justified if the costs of local services are higher in one locality or if a more extensive range of public services is available. If there were no such differences it would be clearly advantageous to taxpayers in the professional occupation class to relocate to the locality with lower taxes. While a short exodus would probably not affect the demand for individual professional services to a great extent (i.e., that most clients or patients would probably not be greatly inconvenienced if they chose to retain the same services and to travel to nearby localities),

it would tend to limit the professional services available in the original community and to deplete its tax base. The reverse would occur in the community with the lower rates; the availability of professional services would increase, and the tax base would enlarge.

However, it may not be a simple or inexpensive matter to relocate an otherwise profitable enterprise solely for tax purposes. The previous example of the hotel/motel industry and its tax treatment in Arlington county demonstrates this problem. Even though the market potential may not be much different in nearby Alexandria, where the applicable tax rate would be less than one-tenth the rate in Arlington county, it would be almost impossible both physically and financially to move. Because of the fixed nature of the business, hotels and motels are unlikely to exodus; at the same time, prospective hotels and motels considering the metropolitan area are likely to choose another locality. Therefore, the locality that imposes substantially higher tax rates than its neighboring localities risks limiting the growth of its tax base from the exodus of business from the locality or from the reluctance of new business to enter it.

Interregional differences in tax rates might also influence the development of new businesses or the expansion of existing businesses. For example, even though tax rates in neighboring localities may be competitive, they may be considerably different from rates in other areas of the state. If we compare the tax rates for wholesalers listed in Table 6.7 for the Roanoke area to the rates for the same group in the Northern Virginia area, we can see the disparity in tax treatment. While the two localities in each area tax wholesalers at almost equivalent rates, wholesalers in the Roanoke area are taxed at rates almost three times the rates of the Northern Virginia localities. Moreover,

a locality with substantially higher tax rates is at a disadvantage both when compared to its neighboring localities and to other areas of the state. Suppose that a retailer is considering business locations in either the Roanoke area or the Tidewater area. The retailer would weigh the tax rates in the city of Roanoke against the much lower rates in either Roanoke county, Norfolk, or Virginia Beach. Thus, we can surmise that a locality with relatively high tax rates when compared to other localities with similar markets and about the same public services not only risks limiting the growth of its tax base, but it risks limiting the growth of economic activity for all localities in the area.

The Regulatory Role of License Taxes

In addition to their use as a source of revenue, local license taxes are used as a regulatory instrument; some local ordinances in fact refer to the tax as a payment in exchange for the privilege to transact business. To satisfy certain regulatory requirements of the community, localities assess various fixed fees, which are separate from the taxes on gross receipts. Fixed fees for the businesses and professional activities in Table 6.7 and others viewed as desirable and necessary to the community are generally nominal, and the amount of these fees is probably indirectly related to the costs incurred by local government in issuing licenses and performing periodic inspections.

Public sentiment may, however, require that certain market activities be regulated more heavily than others. Such activities are not subject to gross receipts taxes but are usually subject to much larger fixed fees whose objective is to curtail the activity. For example, Richmond requires an annual fixed fee of \$3,000 from fortune-

tellers and a weekly fee of \$450 from medicine vendors, and Arlington county assesses each massage parlor an annual fee of \$5,000.

It is difficult to determine where the revenue producing role of license taxes ends and the regulatory role begins, since regulation often is only implied by the subjectivity of the various fixed fees. However, the requirement that most activities be licensed enables localities to discourage certain activities with relative ease and provides an important local safeguard to the public welfare. Because both roles are so closely interwoven, attempts to modify or abolish license taxes must provide for each.

Alternatives to the Local License Taxes

As we have shown in Table 6.6, local license tax collections amounted to \$53.7 million in fiscal year 1972-73 for all cities and certain metropolitan counties. Alternatives to the current provisions therefore must be capable of producing the same amount of revenue for these localities. They must also retain about the same growth potential as the gross receipts taxes, since collections increase at a rate roughly equivalent to the inflation rate. In addition, alternatives should provide for the regulatory needs of the community. There are a number of alternatives that could fulfill these requirements. Several of these options would repeal the use of gross receipts taxes and substitute another tax on some other base. Each of them provides for the continuation of licensing for regulatory purposes but would separate that function from the revenue producing function. Other alternatives would provide uniform guidelines to restructure license tax provisions state-wide. We shall now discuss the merits and disadvantages of each of the alternatives.

Local Income Taxation--Because current law reserves exclusively for the state the authority to tax income, the use of classified gross receipts taxes by localities may be an indirect method of taxing income. If we accept the ability-to-pay theory of taxation as a model for alternatives, then the option that would best relate to it would be to abolish gross receipts taxes and grant localities the authority to tax income. An income tax would provide more equity to all the various classes and subclasses of businesses, professions, and occupations within the locality, since those with equal profits or income would pay equal amounts of tax. Moreover, an income tax would require those activities with higher levels of profits or greater incomes to pay more taxes than those at lower levels. Thus, current situations in which high volume, low profit businesses must pay large tax bills but are less able to pay than smaller, more profitable businesses would be corrected. In addition, if the structure of the local income tax were the same as for state tax purposes, taxpayers would be able to deduct certain business expenses when calculating their taxable income. Thus, it would provide more equity to activities whose profitability is affected by year-to-year fluctuations in business costs. Since a local income tax would provide uniform tax treatment to all classes of business within a locality, it would eliminate the reliance by localities on one or several business activities for large amounts of revenue. Finally, if each locality levied the income tax at the same rate, the interlocality differences in the tax treatment of similar classes of business would disappear, and the availability of some activities and services within localities or within certain areas of the state might increase.

There are two ways that localities could tax income. One would be to provide each locality with the option to levy and administer an income tax. The other would be to permit a local option "piggyback" income tax, whereby the state would administer and collect the tax and return the revenue to the localities. While each type of income tax could produce the desired equity and diminish interlocality differences, we must also consider the negative aspects of replacing the gross receipts taxes with a local income tax.^{1/} While a local income tax would provide uniform treatment to all members of the locality, it would transfer the burden of the current tax to a new set of taxpayers. Currently, all forms of business (i.e., corporations, partnerships, and proprietorships) must pay the local gross receipts taxes. If the localities were permitted to use only the individual income tax, the incomes of larger, corporate businesses would not be included in the tax base. However, the incomes of smaller partnership and proprietorship businesses and subchapter S corporations as well as the income of private individuals would be subject to the tax. The smaller businesses could claim that compared to larger businesses they receive inequitable treatment. In all likelihood, private individuals would object to the tax, since for them it would not replace any other visible tax. Thus, the tax bills of corporate businesses would be reduced, with small businesses and private individuals assuming the load.

If the state were to further expand local authority to permit taxation of corporate income, the income tax would capture all corporate businesses including manufacturers. In most localities,

^{1/} For a more detailed discussion of the advantages and disadvantages of the various types of local income taxes, see the section of this chapter that discusses this subject.

manufacturers are not currently subject to license taxes, or pay only a minimal fee. Thus, the tax could represent one more negative factor both for prospective industries considering Virginia sites and for Virginia industries contemplating expansion. Another problem with a local corporate income tax is that it would be difficult for firms to determine the proportion of net profits derived in local jurisdictions. Finally, unless the local corporate income tax were quite substantial it would not produce as significant an amount of revenue as would the individual income tax.^{1/}

A final argument against this alternative is that some localities might receive more revenue from it than from the gross receipts taxes, while others might receive less. If a local tax were placed on individual income, some suburban counties that are primarily residential would probably receive more revenue. On the other hand, cities with relatively more corporate businesses would suffer declines in revenues. We can see this if we examine the revenue impact of a "piggyback" income tax for the eight sample localities.^{2/} Table 6.12 shows collections from the license tax and the revenue potential of various "piggyback" taxes or a local option sales tax. A 10 percent "piggyback" tax would have produced less revenue than the license tax for each of the sample localities. With either a 20 or 30 percent tax each of the counties would have received more revenue, but Richmond, Norfolk, and Roanoke city would have lost revenue. A further increase in the "piggyback" tax rate, which could provide equivalent

^{1/} See the local income tax section of this chapter for more discussion of this subject.

^{2/} We use a "piggyback" income tax for this example because we do not have the data to develop revenue estimates for the other types of locally administered income taxes.

TABLE 6.12--A COMPARISON OF REVENUES FROM THE LOCAL LICENSE TAXES TO REVENUES FROM A LOCAL OPTION INCOME TAX OR SALES TAX FOR SELECTED METROPOLITAN LOCALITIES

Locality	Business, Professional, and Occupational License Revenue, Fiscal Year 1972-73	Revenue From a "Piggyback" Income Tax, Tax Year 1972			Revenue From a 1 Percent Local Option Sales Tax, Fiscal Year 1972-73
		10 Percent	20 Percent	30 Percent	
Arlington County	\$ 4,865,346	\$2,755,355	\$5,510,709	\$8,266,064	\$4,170,199
Alexandria	2,506,942	1,532,820	3,065,640	4,598,460	3,285,060
Henrico County	3,258,322	1,657,222	3,314,444	4,971,666	4,755,144
Richmond City	11,100,383	1,920,135	3,840,270	5,760,406	8,466,190
Norfolk	4,815,500	1,470,993	2,941,986	4,412,979	7,155,186
Virginia Beach	2,128,524	1,308,067	2,616,133	3,924,201	3,370,697
Roanoke County	363,337	603,679	1,207,358	1,811,038	1,368,163
Roanoke City	3,455,808	659,354	1,318,710	1,978,064	3,596,847

SOURCES: Unpublished reports of the Auditor of Public Accounts, Commonwealth of Virginia. Report of the Department of Taxation, Fiscal Year Ending June 30, 1974, (Richmond: November, 1974), p. 28. Report of the Department of Taxation, Fiscal Year Ending June 30, 1973, (Richmond: December, 1973), p. 35.

revenues to the cities, would benefit counties even more.

If the local license taxes based on gross receipts were repealed in favor of a local income tax, some provision would have to be made for the continued regulation of local business activities. With a local income tax fulfilling the revenue producing function, license fees could be levied solely for the privilege of transacting business in the locality and to provide local government with a convenient vehicle for regulation. In order to eliminate the possibility that license fees might again become exorbitant for businesses active in a community and thus again be used in a primarily revenue producing capacity, there could be some statewide constraint placed on them. This could be accomplished if the state stipulated that within all localities certain business, professional, and occupational activities are about equally necessary and desirable. These activities could be determined by legislative action or by a review board created for this purpose. The state could then furnish a catalog of these activities to all localities. Included in this catalog, for example, could be the seven classes of activities listed in Table 6.8 or any other activities that the decision making body set forth. Each locality could independently levy its own license fees with the only constraint being that all catalogued activities must pay the same fees. Any activity not listed in the catalog would not be subject to this fee constraint and would be required to pay whatever license fee the locality levied. New types of activities desiring to become listed in the catalog or those omitted from it could petition the decision making body for registry.

If a local income tax were permitted in localities that currently levy gross receipts taxes, it would provide a new tax base that is

large enough to produce substantial revenue. In addition to the revenue from the income tax, local revenue would be supplemented by the continued collection of the fixed fees for licenses.

Local Sales Taxation--A second alternative to the local license taxes based on gross receipts would be to replace them by increasing the local option sales tax rate from 1 to 2 percent. The advantage to this alternative is that disparities in tax treatment of businesses, professions, and occupations within localities would disappear, since these groups would no longer be required to pay either the gross receipts tax or at least nominally any replacement tax. If all localities that currently levy gross receipts taxes adopted the additional 1 percent tax, many interlocality differences would be diminished; this would encourage more uniform growth of business activities and services.

There are, however, several drawbacks to this alternative. We have noted that buyers and sellers share the burden of the gross receipts taxes. While most economists think that the burden of the sales tax falls solely on consumers, some argue that it too is shared between buyers and sellers. If this assumption is correct, a sales tax would not really transfer the burden of tax from one group to another. Regardless of who eventually pays these taxes, a sales tax is much more visible to the consumer than a gross receipts tax, and it would probably be met with consumer resistance. They would probably view it as a decrease in the tax load shouldered by business for which they must pay.

In addition, the structure of the current sales tax does not include the services of various professions and occupations, such as those provided by attorneys, barbers, or mechanics, in the tax base. If we assume that the incidence of both the gross receipts tax and the sales

tax falls on buyers and sellers of the taxed goods and services, then adoption of an additional 1 percent local option sales tax would redistribute the burden of the tax to buyers and sellers of tangible goods only.

A final argument against this alternative is that it might provide less revenue than the gross receipts taxes to some localities that have a relatively low volume of retail activity but a relatively high concentration of professional and occupational service activities, and vice versa. If we refer again to Table 6.12 we see that an additional 1 percent local option sales tax would have produced sufficient replacement revenue for the gross receipts taxes in six of the sample localities in 1972-73. However, in the city of Richmond and Arlington county, sales tax revenues would have fallen short of collections from the license taxes.^{1/}

As for the income tax alternative, some provision for the regulation of certain activities would be necessary. To provide for this function, the same state cataloging procedure as outlined earlier could accompany the sales tax alternative.

State Revenue Sharing--The third alternative to the local gross receipts taxes is to abolish them and initiate a state revenue sharing program to localities to replace the lost revenue. As for the first two alternatives, most of the inequities and interlocality differences would be eliminated. However, the extent of elimination would depend upon which state tax sources were used to replace the local revenue and whether the state desired to share its revenues with all localities or with only those localities that levy gross receipts taxes. The additional state revenues needed to fund either type of program could

^{1/} For more discussion of the pros and cons of a local option sales tax, see the section of this chapter that deals with this topic.

come from increases in the state income taxes, the sales tax, or a combination of both. There are various distribution formulas that could be used to allocate state revenues back to localities, but under each of them some localities would stand to pay more tax to fund the program than would be returned to them.^{1/} If the state shared its revenues with only localities that currently use gross receipts as a basis for license taxation, other localities that do not use them would contribute additional revenue but would receive none back.

Since the state individual income tax and sales tax are broad based, sufficient replacement revenue could be collected with a modification to the current state income tax schedule or an increase in the state sales tax. For example, the state individual income tax rate schedule shown below would have produced approximately \$69.2 million in additional revenues for the 1972 tax year:^{2/}

<u>Taxable Income</u>	<u>Tax Rate</u>
\$ 0 - \$ 3,000	2%
\$ 3,001 - \$ 5,000	3%
\$ 5,001 - \$10,000	6%
\$10,001 - \$15,000	7%
\$15,001 - \$20,000	8%
over - \$20,000	9%

An increase in the state sales and use tax rate from 3 to 4 percent would have produced approximately \$97.4 million for fiscal year 1972-73.^{3/}

^{1/} See the section of this chapter on state revenue sharing in which this topic is discussed in more detail.

^{2/} This is Schedule D of Table 3.18. For more discussion of this and other alternative state income tax rate schedules and their revenue potential, see the individual income tax section of Chapter III.

^{3/} Currently, 1 cent of every 3 cents collected by the state from the sales tax is returned to the localities on the basis of school age population. We assume that if the state sales tax were increased to 4 percent the state would continue to return the proceeds from 1 percentage point to the localities on this basis.

To provide for local regulatory requirements the state catalog of business activities could be used in conjunction with state revenue sharing.

Restructuring of Local License Taxes--Instead of abolishing the local license taxes based on gross receipts, there are two other alternatives that would restructure them to provide more equity. We have noted that when gross receipts tax rates are tied to the relative differences in operating ratios between broad classes of similar activities, there is a crude provision for profitability and thus ability-to-pay. Even though most localities currently levy classified gross receipts taxes, the tax rates for different classes of business often do not display the same relative differences found for operating ratios. We can see this if we refer again to Tables 6.7 and 6.8. The operating ratio for personal service occupations is about 66 percent of the ratio for professional occupations, and the ratio for repair service occupations is about 55 percent of the ratio for professionals. If localities truly conformed to the rationale behind classified gross receipts taxes, differences in the tax rates for these classes would reflect these same relationships. Upon examination of the rates shown for the localities in Table 6.7, we see that this is not always the case.

One of the two alternatives would be to categorize activities that have displayed similar operating ratios over some recent time period and require that local gross receipts tax rates for these classes reflect the same relative differences as in profitability. This mandatory classification could be required through legislative action or by granting authority to a gross receipts tax review board. If we refer once more to the seven classes of business shown in Table 6.8, state classi-

fication could, for example, require that in all localities the highest rate be applied to professionals, since they appear to be most profitable. State classification would mandate descending rates for the other classes, according to the rank order of their operating ratios. Thus, personal services would be taxed at a rate that is 66 percent of the professional rate, repair services would be taxed at a rate that is 55 percent of professionals, and so on. If desired, the classes shown in Table 6.8 could be subdivided or expanded so that tax rates could vary further for additional subclasses or classes with significantly different profitability. If a state review board were created, there could be a periodic review of the operating ratios for all classes to provide for possible changes in profitability over time. In addition, it could either modify or suggest legislative modification of the required relationships between local tax rates.^{1/}

If the state chose to retain its authority to tax income, this alternative would provide localities with an indirect albeit crude measure of income. Since it would provide mandatory guidelines to the localities, there would be some assurance to the various business classes that tax rates would attempt to reflect their general ability to pay. It would also guarantee that no one group would be subject to special treatment, since a rate increase or decrease for one class would have to be accompanied by similar changes for other classes. Furthermore, under this plan each locality could determine its own rates and enact changes as necessary. Since total revenues from the gross receipts taxes would probably not change substantially, most localities would

^{1/} We assume that creation of a state gross receipts tax review board with powers to require and periodically modify proportionate relationships in tax rates would present no constitutionality problems.

not risk losing sizeable amounts of revenue. Finally, the same set of taxpayers would continue to pay the tax.

There are certain disadvantages to this option. There would still be discrepancies in tax treatment when the relative profitability of an individual activity differed significantly from the proportionate differences set forth in the state guidelines. As we have noted, these differences occur for subclasses of broad groups, for similar businesses of different size, and when year-to-year fluctuations in business costs affect profitability. In addition, there would be some continuation of interlocality differences in treatment. Finally, unless the state catalog were also adopted, the regulatory role of the license taxes would still be commingled with the revenue producing role. However, if a state review board were created to determine a uniform local classification system, it could also perform the duties associated with the preparation of the state catalog.

The other alternative would also retain gross receipts as a local tax base but would restructure the tax along altogether different lines. Instead of classifying similar businesses and taxing each group at a different rate, it would abolish classification by legislative mandate and require that all local businesses, professions, and occupations within certain ranges of profitability be taxed equally. Under this plan gross receipts tax rates would increase as profitability increased. In a study of the Fairfax county gross receipts tax, Samuel A. Finz and William G. Hudgens propose this method of taxation.^{1/}

^{1/} Samuel A. Finz and William G. Hudgens, An Analysis of the Gross Receipts Tax in Fairfax County, Virginia, (Chicago: Municipal Finance Officers Association, March 16, 1975), pp. 4-7.

Finz and Hudgens, for example, developed a rate schedule for Fairfax county dependent upon various ranges of profitability as determined by the ratio of gross income to gross receipts. They determined the mean ratio for each range and then developed tax rates to reflect the relative differences between the means. Shown below are the ranges of ratios, mean ratios, and tax rates that Finz and Hudgens proposed for Fairfax county:^{1/}

<u>Gross Income to Gross Receipts Ratio Category (Percent)</u>	<u>Gross Income to Gross Receipts Mean (Percent)</u>	<u>Tax Rate Per \$100 Gross Receipts</u>
Loss to 14.0	2.00	\$.02
14.1 to 34.0	24.05	.22
34.1 to 44.0	39.05	.37
44.1 to 64.0	54.05	.51
64.1 to 89.0	76.55	.73
89.1 and above	90.00	.85

If gross receipts taxes were restructured to conform to this plan, the state could set forth local guidelines through a gross receipts tax review board. The board would require that local tax rates reflect relationships similar to those shown above or for other ranges of profitability.

One advantage of this alternative is that it more closely parallels the taxpayer's ability to pay than the classified gross receipts tax. Any activity, regardless of whether it is a business, profession, or occupation, whose ratio of gross income to gross receipts is more than the ratio for another activity would be subject to a higher tax rate, and activities with similar rates of return would be subject to the same tax rate.^{2/} Moreover, if rates are developed along these lines, high

^{1/} Samuel A. Finz and William G. Hudgens, An Analysis of the Gross Receipts Tax in Fairfax County, Virginia, pp. 8-9.

^{2/} We assume that it would not be unconstitutional to levy different tax rates on businesses of a similar nature, for the rationale behind this alternative is similar to that behind a graduated income tax.

volume, low profit businesses would continue to pay tax but probably at substantially lower rates than currently. There would also be a provision for activities that suffer from year-to-year changes in business costs, since tax rates would depend on the firm's profitability for the particular tax year. The same group of taxpayers that currently pays the tax would continue to do so, and each locality could determine its own rates and enact changes as necessary. Inasmuch as tax rates would be tied to ranges of profitability and not to classes of business, it would be highly unlikely that any group could be singled out for special treatment to provide a large share of the tax; thus, tax loads would be more equitably distributed among the business community.

If this alternative were adopted, several problems would still remain. Since tax rates would be dependent upon profitability, they would be highly flexible. Localities could experience substantial declines in revenues unless tax rates were sufficiently high. Tax collections could fluctuate widely from year to year, and localities could find it difficult to forecast the revenue from the tax. On the other hand, if tax rates were high enough to assure localities of a minimum amount of revenue, there would be the risk of overburdening all business activities. Under this plan there would also be some continuation of interlocality differences. Although this type of tax does provide a limited measure of ability-to-pay, it relies on gross rather than net income and is therefore not as good a measure as an income tax. We could argue then that a better indicator of profitability might be the ratio of net income to gross receipts and that gross receipts tax rates should be tied to these ratios. Finz and Hudgens also investigated this possibility in their study. They concluded that a tax structure based on this measure of ability-to-pay would not produce as much revenue as

one using gross income because of the substantial number of firms showing no net profit.^{1/} In addition, if we desired to structure the gross receipts tax in this way, then why not provide still more equity and permit a local tax on net income?

Since classification would be abolished under this alternative, the link between the regulatory role and the revenue producing role would have to be severed. To ensure that license fees served only the regulatory purpose, the state could adopt the catalog in concurrence with this option.

State License Taxes

At the state level business, professional, and occupational license taxes perform the same dual role observed among localities. They both produce revenue and regulate certain activities. However, neither of these roles is quite as important at the state as at the local level. License tax collections for fiscal year 1973-74 amounted to only \$3.3 million, or about 0.3 percent of total general fund revenues. We forecast that license tax collections for the 1976-78 biennium will represent only about 0.2 percent of general fund revenues and that by 1980-82 they will represent only 0.1 percent. Most state license taxes are low and often provide only minor regulatory influence when compared to those imposed by the localities and the efforts of other state agencies.

^{1/} Samuel A. Finz and William G. Hudgens, An Analysis of the Gross Receipts Tax in Fairfax County, Virginia, p. 5.

In 1966, when the sales and use tax became effective, many state license taxes were repealed, and their importance as a source of revenue immediately declined from approximately \$16 million to about the current level of collections. The primary reason for the decline in revenue was the abolition of the state license tax on retail merchants; prior to 1966, approximately 70 percent of state license tax revenues was paid by that group.

Table 6.13 shows total state license tax collections for fiscal year 1973-74 by the various business, professional, and occupational classes. We can see that the group currently contributing most to total license tax collections is contractors. They paid \$1.3 million, or almost 40 percent of total license tax revenues, in 1973-74. Vending machine operators comprise the next largest group, with their license tax payments totalling about \$0.5 million for fiscal year 1973-74, or 15 percent of collections. Six other groups each contribute over \$100,000 annually. These include attorneys, commission merchants and brokers, medical doctors, peddlers, real estate brokers, and tobacco retailers. The remainder of the tax is paid by about 50 assorted activities, which are listed in the table.

The state license taxes viewed as revenue producers and with only a limited regulatory function generate an overwhelming share of the collections. Typical fees for professional occupations, such as medical doctors, dentists, and attorneys, are \$10, \$15, or \$25. The fees for these professions depend upon the number of years in practice with relatively new practices paying the smaller fees. For contractors, state license fees range from as little as \$5 to \$250; these fees depend upon the gross amount of orders and contracts. Fees for the remainder of activities vary widely, but the majority of them probably do not present a burden to the taxpayer.

TABLE 6.13--STATE BUSINESS, PROFESSIONAL, AND OCCUPATIONAL LICENSE TAXES BY CLASSIFICATION, FISCAL YEAR ENDING JUNE 30, 1974

License Classification	Total Taxes, Penalties, and Fees ^{a/}	License Classification	Total Taxes, Penalties, and Fees ^{a/}
Amusements:		Junk Dealers in Second-	
Amusement Parks	\$ 2,672	Hand Paper and Canvassers	\$ 625
Carnivals, Shows, Circuses and Menageries	15,402	Labor and Emigrant Agents	-
Circuses, Carnivals, etc., held during agricultural fairs	-	Laundries	5,887
Coliseums, Arenas and Auditoriums	-	Livestock Dealers	20,309
Hobby-Horse Machines, Merry-Go-Rounds, and other like machines	2,548	Lodging Houses	3,515
Moving Picture Shows	33,018	Medical Doctors	108,065
Theatres, Public Performances, Exhibitions, etc.	12,061	Merchants on Trains	34
Antique Shows and Sales, and Other Shows and Sales	14,134	Merchants Placing Vending Machines	9,576
Architects	10,512	Optometrists	5,971
Attorneys at Law	116,263	Patent and Trademark Attorneys	1,750
Auction Sales of Jewelry, Etc.	928	Pawnbrokers	10,581
Auctioneers	32,055	Peddlers	120,290
Bowling Alleys	24,468	Photographers	22,382
Brokers:		Pistol Dealers	6,760
Stockbrokers	29,491	Police and Firemen's Pension, Etc., Associations	471
Dealing in options or futures	3,090	Pool and Billiard Rooms	35,970
Wholesale merchandise brokers	66,931	Pulpwood, Veneer Logs, Mine Props, and Railroad Crossties--Suppliers of	587
Coin-Operated Machines and Operators	537,678	Real Estate Brokers	109,585
Collection Agencies	3,845	Savings and Loan Associations	4,873
Commission Merchants and Brokers	149,389	Small Business Investment Companies	1,704
Common Criers	1,066	Soft Drinks (manufacturers of bottled carbonated beverages)	1,093
Contractors, Electrical Contractors, Plumbers and Steam Fitters	1,305,816	Storage and Impounding	19,594
Cotton and Peanut Dealers	3,997	Telephone and Telegraph (unincorporated)	2,049
Cotton Buyers, Wholesale	100	Tobacco Retailers	140,346
Cotton Factors	-	Tobacco Sellers at Wholesale	6,282
Credit Unions	31,537	Trading Stamps	37,506
Dentists	38,638	Undertakers	11,177
Engineers, Professional	6,525	Vendors of Medicines, Salves, Liniments, Etc.	2,833
Fortune-Tellers, Clairvoyants, and Practitioners of Palmistry & Phrenology	19,729	Veterinary Surgeons	3,433
Garages	12,791	Registration of Persons, Producers, or Mfrs. Subject to Forest Products Tax:	
Grain Dealers--Wholesale	12,034	Original Certificates at \$1.00 each	605
Horse and Mule Sales in Carload Lots	-	Duplicate Certificates at 25¢ each	5
Hotels	60,669		
Industrial Loan Associations	2,852	Total	\$3,269,476
Itinerant Merchants, Etc.	16,882		
Junk Dealers and Canvassers	8,474		

^{a/} Details may not add to total because of rounding.

SOURCE: Report of the Department of Taxation, Fiscal Year Ending June 30, 1974, (Richmond: November, 1974), p. 38.

While most state license taxes have not been extensively criticized as inequitable or oppressive to business, we can cite some of the same problems as for local license taxes. If we assume that state license taxes should adhere to the ability-to-pay theory of taxation, then state license taxes are in violation of this theory. For example, there is no reason why any group should pay less tax than another group with about the same ability to pay. On the other hand, there is no reason for state license fees to vary between classes if we assume that license fees are related to the costs of issuing licenses. Finally, some state fees actually vary depending upon the size of the locality as measured by population. Thus, the same arguments as for the local license taxes apply when two similar activities operate in different localities but pay different state license taxes in each. These differences in fees could further influence the concentration of certain types of business within localities of a given size.

Those license taxes that are primarily regulatory are limited in number but are usually quite large. For example, itinerant vendors must pay \$200 per month, and fortune-tellers must pay a \$500 fee annually for each locality in which they operate. The use of such large fees seems to be directed toward the regulation of certain market activities more than toward protection of the public. The rigorous, protective regulation of many activities deemed necessary for the public welfare is conducted chiefly by other state agencies and is completely independent of the primarily revenue producing function of state license taxation. The Department of Professional and Occupational Regulation serves as the administrative body for 20 separate state professional and occupational agencies, which respectively examine, certify, and regulate among others, the activities of barbers, hairdressers, veterinarians, and examiners of mines. Various other agencies, such as the State Board of Medicine, the State Board of Embalmers and Funeral Directors,

and the State Registration Board of Contractors, regulate those respective professions and occupations.

Because state license fees are generally not very large and do not provide a great deal of regulatory influence, they are viewed by many as nuisance taxes. For some of the activities that must pay only very small fees, the cost of administering the tax might even outweigh the revenue collected. Moreover, some of the activities that are subject to the state license taxes are often so sporadic that enforcement may be difficult and relatively costly.

For these reasons Virginia may wish to repeal all state license taxes. Since the regulation that state license taxes provide for activities such as itinerant vendors and fortune-tellers is primarily a local concern and is enforced mainly by the locality, abolition of the state license taxes would probably not diminish this function.^{1/} As noted earlier, many of the other professional and occupational activities for which state regulation is necessary are already regulated by various other state agencies. If the state were to abolish license taxes, the loss in revenues would be less than \$4 million per year. Assuming continuation of local licensing for only regulatory purposes, the absence of state fees might allow localities to increase some of their fixed fees on these activities, and to an extent their revenues, without any real increase to the taxpayer. As an alternative to complete and immediate elimination of state license taxes because of the reduction in revenues, license taxes could be abolished gradually over a 3 year period. Under such a plan, the state fees would be reduced by one-third each year until they were completely

^{1/} We note that some localities may rely to a certain extent on the application for and issuance of state licenses to provide them with information used in the enforcement of local license ordinances. However, other localities indicate that the collection of state license fees often is the result of collection of the local license taxes.

abolished by the fourth year, and revenues would only decline by a little over \$1 million per year.

Conclusion

The current structure of local license taxes produces inequities that make the tax disagreeable to businesses, professions, and occupations and can create interlocality differences in the availability of goods and services. There are several alternatives that would provide greater equity, reduce interlocality discrepancies in tax treatment, and fulfill both the revenue and regulatory requirements of local government. The local license taxes based on gross receipts could be repealed with replacement revenues coming from a local income tax, an increase in the local option sales tax, or a state revenue sharing program. If these alternatives are unacceptable localities could retain gross receipts as a tax base, but the state could require modifications in the application of the tax. One modification would be a state mandated classification system whereby all local tax rates would have to reflect the same relative differences as in profitability. The other modification would require that local tax rates be tied to various ranges of profitability so that all activities with similar rates of return would be taxed equally. To provide for regulation, mandatory guidelines could be set forth that would limit license fees for most ordinary market activities but would impose no constraint on fees for others.

At the state level, license taxes are not an important source of revenue, and the regulation that they provide is secondary to that of other state agencies and the localities. Thus, state license taxes could either be completely abolished or abolished in stages with limited fiscal impact.

Local Option Crown Tax

The possibility of a state crown tax was discussed in Chapter III. An alternative would be to make such a tax a local option in lieu of a statewide levy. Table 6.14 shows estimated 1973-74 collections for our 17 area sample, assuming the tax generated the average per capita amount of states levying such a tax and assuming all localities exercise the option.

We also discussed in Chapter III the revenue potential for Virginia of a state tax similar to the Washington litter tax. Our estimates indicate that if such a tax were established, collections would be approximately \$1.6 million. Alternatively, revenues from a local option litter tax at the same rate would be nominal for most localities.

TABLE 6.14--ESTIMATED REVENUE FROM A LOCAL
OPTION CROWN TAX, FISCAL YEAR 1973-74^{a/}

<u>Locality</u>	<u>Estimated Revenue</u>
Alexandria	\$ 254,000
Augusta	57,000
Buckingham	10,000
Chesapeake	145,000
Chesterfield	145,000
Fairfax County	987,000
Floyd	8,000
Lunenburg	13,000
Norfolk	561,000
Northumberland	10,000
Norton	14,000
Rappahannock	2,000
Richmond City	584,000
Roanoke City	212,000
Suffolk	80,000
Waynesboro	51,000
Wise	86,000
State	\$9,718,000

^{a/} State revenue estimated on the basis of \$2.02 per capita collections and using preliminary 1973 population figures. This figure was allocated to localities on the basis of the average of taxable food sales in calendar years 1973 and 1974.

Local Option Motor Fuel Tax

A local option motor fuels tax, such as 1 cent per gallon, would be a new departure for Virginia, since like most other states, motor fuel taxes are reserved for the state government and earmarked for highway spending. A local tax could be used as a source of general revenue or be earmarked for transportation or highway purposes. The yield of a given tax to a particular locality would depend on the area's volume of service station business adjusted for the tax policies in surrounding Virginia localities, and, where close to state boundaries, tax levels of neighboring states. As of January 1, 1975, a 9 cent per gallon rate applied in Virginia, North Carolina, and Kentucky. The rates in the other neighboring states ranged from 7 cents in Tennessee to 8.5 cents in West Virginia.

Local Option Motor Vehicle Sales and Use Tax

The Motor Vehicle Sales and Use Tax is presently reserved as a state tax; localities are prohibited from using it.^{1/} If the taxation of automobile sales was made consistent with the sale of many other items in retail trade (i.e., a 3 percent state tax with a 1 percent local option), there would be a substantial increase in revenues for the state and a new source for localities.

Assuming that all localities exercised a 1 percent option, that the tax would not be a significant deterrent to sales, and that the base were the same as now the tax would have provided \$44.3 million for local governments in the 1972-74 biennium.^{2/}

^{1/} See Code of Virginia, Section 58-685.25.

^{2/} Calculated by dividing actual state receipts in the 1972-74 biennium by one-half.

Rolling Stock Taxation

Background

The rolling stock of motor carriers of property in the Commonwealth is taxed ad valorem in one of two ways - through a state administered and collected rolling stock tax or through a locally administered and collected personal property tax.

Sections 58-618 to 58-626.1 of the Code of Virginia provide for a rolling stock tax of one dollar per hundred dollars of assessed value on intrastate common carriers in lieu of local personal property taxes. Proceeds from this State Corporation Commission (SCC) administered tax are prorated to the localities based on the mileage traveled over regular routes by each subject carrier.^{1/} In 1974, there were 16 motor carriers operating under intrastate common carrier freight certificates; these carriers paid \$136,390 in rolling stock taxes.^{2/} The owners of all other trucks, whether in for-hire or private use, are subject to personal property taxes, which are administered and collected in the locality of domicile.

The rolling stock tax recently has come under criticism from several sources. Some truckers assert that it constitutes differential treatment for one class of motor carriers, the intrastate common carrier. Fueling the charge of differential treatment is the procedure whereby most intrastate common carriers operate under more than one

^{1/} Data limitations prevent the inclusion of miles traveled over irregular routes.

^{2/} "A Statement of Rolling Stock and Taxes for the year 1974 for Motor Vehicle Carriers," State Corporation Commission, Commonwealth of Virginia, 1974.

authority. For example, if a motor carrier operates under an intrastate common carrier certificate, then the entire fleet of that firm is exempt from local personal property taxes and subject to the rolling stock tax. This situation could exist even though only a very small portion of the carrier's total operation may be as an intrastate common carrier. These critics argue that if the fleets of the intrastate common firms were subject to the local personal property taxes, the tax bill of these firms would be higher; therefore, the intrastate common carriers enjoy a competitive advantage.

Criticism also comes from some commissioners of revenue. These commissioners feel that the rolling stock tax is preempting them from a source of revenue and that repeal of this tax in favor of local property taxes would increase local revenues. Finally, the SCC views the tax with disfavor. Since the tax yielded only about \$136,000 in 1974, several parties within the SCC view it as a nuisance.

Investigating these criticisms, the Revenue Resources and Economic Study Commission employed two consultants in 1973 to examine the relative merits of the rolling stock tax and the personal property tax as a means of taxing the rolling stock of motor carriers of property.^{1/} The study was commissioned to investigate the equity and efficiency of the present dual system.

The consultants found weaknesses in the present system. Significant differences were found to exist across the state in the assessment and collection of personal property taxes on motor carriers of property.

^{1/} C. J. Gallagher and G. E. Hoffer, "A Comparative Analysis of the Rolling Stock Tax and the Personal Property Tax: Virginia, 1972." Revenue Resources and Economic Study Commission, 1973.

While urban areas generally used fixed depreciation schedules in assessing rolling stock, rural areas used a variety of assessment methods. Some commissioners of revenue indicated that they used no specific schedule but rather negotiated assessments or relied on published data. Some of these data proved to be nonexistent. Consequently, assessment of rolling stock varies significantly throughout the Commonwealth.

Many local commissioners of revenue complained that staff size precluded their determining what rolling stock was actually domiciled in their locality and thus subject to personal property taxation. Several commissioners related that a number of vehicles were escaping local taxation entirely. They noted that when they approached carriers, they were told that the vehicles in question were domiciled elsewhere and paid taxes there. These commissioners felt that carriers were playing one locality against the other.

All commissioners of revenue questioned said that they would welcome the opportunity to tax intrastate common carriers in the same manner that they currently assess all other private and for-hire carriers. Most commissioners recognized, however, that subjecting intrastate common carriers to local tangible personal property taxes would yield little additional revenues. The consultants estimated that the localities would collect up to an additional \$300,000 annually if the rolling stock of intrastate common carriers of property were subject to local personal property taxation.

Alternative to the Present System

Because of the problems and inequities that have been found to exist in the procedures currently used to tax motor carriers, we present one

possible alternative that would repeal the rolling stock tax as it applies to intrastate common carriers of property. In its place, these vehicles would become subject to the local personal property tax.

Using data supplied by the applicant on his registration card, the Division of Motor Vehicles (DMV) would notify each local commissioner of revenue of all vehicular rolling stock domiciled in his locality with the exception of any vehicle defined in the Code of Virginia as a pick-up truck not used for-hire. This would exempt all privately used trucks weighing less than 3-1/4 tons from the listing that the commissioner of revenue receives.

In addition to reporting the situs of each vehicle, DMV would report the purchase price of the vehicle when it was purchased new. DMV could obtain this figure either by requiring this data upon annual application for registration or by determining this price from the "Blue Book". Upon receiving this cost data, each commissioner would then apply his locality's depreciation schedule and tangible personal property tax rate and bill the owner of the rolling stock. Each taxpayer would remit payment to this local commissioner. All funds collected would remain in the locality.

This method of assessment would be more efficient and more equitable than the current one. It would redress the dual, discriminatory system that the Commonwealth presently uses. All rolling stock, except smaller, privately used vehicles, would be taxed in a similar manner and would be subject to local taxation. Any firms or individuals who presently escape local ad valorem taxation by playing one locality against the other would be unable to continue this practice. Any vehicle with a current Virginia registration would pay local property taxes to some political subdivision of the Commonwealth.

With intrastate common carriers of property subject to local personal property taxation, it is estimated that localities would receive up to \$300,000 in additional revenues annually. Whereas 279 localities receive distributions under the rolling stock tax, only 29 localities would receive property taxes from these carriers. They would be the 29 localities in which those carriers with intrastate common carrier certificates domicile rolling stock. Although elimination of the present rolling stock tax would deprive over 200 localities of some revenues, the amounts lost would be small, for in 1974 the total distribution to all localities was approximately \$136,000. Almost 50 percent of the localities losing revenue would lose under \$300 annually while no locality would lose over \$2,900 annually.

To facilitate determining a situs for every Virginia registered vehicle, DMV could be enjoined from issuing Virginia registrations unless the applicant specifies a domicile for his vehicle. This requirement is currently made of all applicants with in-state addresses; no less should be expected of out-of-state applicants.

This alternative is identical to the commission's recommendation on rolling stock taxation to the 1975 session of the General Assembly, House Bill No. 1063, which was defeated.^{1/}

^{1/} This bill was Exhibit 10 in Senate Document No. 13, the report of the Revenue Resources and Economic Commission to the 1975 session of the General Assembly.

A P P E N D I X T A B L E S

TABLE A.1--CLASSIFICATION OF CITIES AND COUNTIES

URBAN AREAS

Metropolitan Cities^{1/}--Alexandria, Bristol, Chesapeake, Colonial Heights, Fairfax, Falls Church, Hampton, Hopewell, Lynchburg, Newport News, Norfolk, Petersburg, Portsmouth, Richmond, Roanoke, Salem, Suffolk, Virginia Beach, and Williamsburg.

Metropolitan Counties^{2/}--the counties of Amherst, Appomattox, Arlington, Botetourt, Campbell, Charles City, Chesterfield, Craig, Dinwiddie, Fairfax, Gloucester, Goochland, Hanover, Henrico, James City, Loudoun, Powhatan, Prince George, Prince William, Roanoke, Scott, Washington, and York.

Small Urban Areas^{3/}--the counties of Albemarle, Allegheny, Augusta, Bedford, Carroll, Culpeper, Frederick, Grayson, Greensville, Halifax, Henry, Montgomery, New Kent, Pittsylvania, Pulaski, Rockbridge, Rockingham, Smyth, Southampton, Spotsylvania, Stafford, Tazewell, Warren, Wise, and Wythe, and the cities of Bedford, Buena Vista, Charlottesville, Clifton Forge, Covington, Danville, Emporia, Franklin, Fredericksburg, Galax, Harrisonburg, Lexington, Martinsville, Norton, Radford, South Boston, Staunton, Waynesboro, and Winchester.

RURAL AREAS^{4/}

The counties of Accomack, Amelia, Bath, Bland, Brunswick, Buchanan, Buckingham, Caroline, Charlotte, Clarke, Cumberland, Dickenson, Essex, Fauquier, Floyd, Fluvanna, Franklin, Giles, Greene, Highland, Isle of Wight, King and Queen, King George, King William, Lancaster, Lee, Louisa, Lunenburg, Madison, Mathews, Mecklenburg, Middlesex, Nelson, Northampton, Northumberland, Nottoway, Orange, Page, Patrick, Prince Edward, Rappahannock, Richmond, Russell, Shenandoah, Surry, Sussex, and Westmoreland.

1/ Cities classified as Standard Metropolitan Statistical Areas (SMSA's) by the U. S. Bureau of the Budget.

2/ Counties within SMSA's as defined by the U. S. Bureau of the Budget.

3/ Non-metropolitan cities and non-metropolitan counties with a city or town of 3,500 population and over within or on their borders.

4/ Counties without a city or town of 3,500 or more people within or on their borders.

TABLE A.2. -- STATE INDIVIDUAL INCOME TAXES: RATES, JULY 1, 1973

State	Net income after personal exemption	Rate (percent)	Federal tax deductible	Special rates or features
Alabama	First \$1,000	1.5	x	
	\$1,001-\$3,000	3		
	\$3,001-\$5,000	4.5		
	Over \$5,000	5		
Alaska	16 percent of the total Federal income tax that would be payable for the same taxable year at the Federal tax rates in effect on December 31, 1963.			
Arizona ^{1,2}	First \$1,000	2	x	
	\$1,001-\$2,000	3		
	\$2,001-\$3,000	4		
	\$3,001-\$4,000	5		
	\$4,001-\$5,000	6		
	\$5,001-\$6,000	7		
	Over \$6,000	8		
Arkansas	First \$2,999	1	A property tax refund or credit is provided for senior citizens. Reduced rates provided for low income taxpayers.
	\$3,000-\$5,999	2.5		
	\$6,000-\$8,999	3.5		
	\$9,000-\$14,999	4.5		
	\$15,000-\$24,999	6		
	\$25,000 or over	7		
California ¹	First \$2,000	1	The following rates apply to heads of households: First \$3,000..... 1% \$3,001-\$4,500..... 2 \$4,501-\$6,000..... 3 \$6,001-\$7,500..... 4 \$7,501-\$9,000..... 5 \$9,001-\$10,500..... 6 \$10,501-\$12,000..... 7 \$12,001-\$13,500..... 8 \$13,501-\$15,000..... 9 \$15,000-\$16,500..... 10 Over \$16,500..... 11 A resident renter credit is provided.
	\$2,001-\$3,500	2		
	\$3,501-\$5,000	3		
	\$5,001-\$6,500	4		
	\$6,501-\$8,000	5		
	\$8,001-\$9,500	6		
	\$9,501-\$11,000	7		
	\$11,001-\$12,500	8		
	\$12,501-\$14,000	9		
	\$14,000-\$15,500	10		
	Over \$15,500	11		
Colorado	First \$1,000	3	x	Surtax on income from intangibles in excess of \$5,000, 2 percent. Taxpayers are allowed a credit equal to 1/2 of 1 percent of net taxable income on the first \$9,000 of taxable income. ³ A \$7 tax credit is allowed each taxpayer and each dependent for sales tax paid on food. If there is no income tax liability the taxpayer can apply for a refund. A property tax credit or refund is also provided for senior citizens.
	\$1,001-\$2,000	3.5		
	\$2,001-\$3,000	4		
	\$3,001-\$4,000	4.5		
	\$4,001-\$5,000	5		
	\$5,001-\$6,000	5.5		
	\$6,001-\$7,000	6		
	\$7,001-\$8,000	6.5		
	\$8,001-\$9,000	7		
	\$9,001-\$10,000	7.5		
Over \$10,000	8			
Connecticut	Capital gains	6	
Delaware	First \$1,000	1.5	x ⁴	Excludes \$2,000 received by totally and permanently disabled persons, or by persons over 60 whose earned income for the tax year is less than \$2,500 and whose adjusted gross income (without reduction by this exclusion) is not over \$10,000 for the tax year (the above dollar amounts are doubled for qualified taxpayers filing jointly).
	\$1,001-\$2,000	2		
	\$2,001-\$3,000	3		
	\$3,001-\$4,000	4		
	\$4,001-\$5,000	5		
	\$5,001-\$6,000	6		
	\$6,001-\$8,000	7		
	\$6,001-\$20,000	8		

TABLE A.2. -- STATE INDIVIDUAL INCOME TAXES: RATES, JULY 1, 1973 (continued)

State	Net income after personal exemption	Rate (percent)	Federal tax deductible	Special rates or features
Delaware (Continued)	\$20,001-\$25,000	8.5		
	\$25,001-\$30,000	9		
	\$30,001-\$40,000	11		
	\$40,001-\$50,000	12		
	\$50,001-\$75,000	14		
	\$75,001-\$100,000	15		
	Over \$100,000	18		
Georgia	First \$1,000	1	Rates shown in table apply to married persons filing jointly and heads of households. The following rates apply to single persons: First \$750 1% \$751-\$2,250 2 \$2,251-\$3,750 3 \$3,751-\$5,250 4 \$5,251-\$7,000 5 Over \$7,000 6 For married persons filing separately, rates for married filing jointly apply to income classes half as large.
	\$1,001-\$3,000	2		
	\$3,001-\$5,000	3		
	\$5,001-\$7,000	4		
	\$7,001-\$10,000	5		
	Over \$10,000	6		
Hawaii ²	First \$500	2.25	Alternative tax on capital gains: Deduct 50 percent of capital gains and pay an additional 4 percent on such gains. The income classes reported are for individuals. For joint returns the rates shown apply to income classes twice as large. Special tax rates are provided for heads of households ranging from 2.25% on taxable income not over \$500 to 11% on taxable income in excess of \$60,000. A sales tax credit based on modified adjusted gross income brackets is provided, ranging from \$1 to \$21 per qualified exemption. Taxpayers are also provided credits for students attending institutions of higher learning (\$5 to \$50) and dependent children attending school in grades kindergarten to twelve (\$2 to \$20). The amount of credit is based on size of A.G.I. If a taxpayer's credits exceed his tax, a refund will be made.
	\$501-\$1,000	3.25		
	\$1,001-\$1,500	4.50		
	\$1,501-\$2,000	5.00		
	\$2,001-\$3,000	6.50		
	\$3,001-\$5,000	7.50		
	\$5,001-\$10,000	8.50		
	\$10,001-\$14,000	9.50		
	\$14,001-\$20,000	10.00		
	\$20,001-\$30,000	10.50		
	Over \$30,000	11.00		
Idaho ¹	First \$1,000	2.0	For a surviving spouse and a head of a household the rates shown apply to income classes twice as large. A \$10 filing fee is imposed on each return. A \$10 tax credit is allowed for each personal exemption for sales tax paid. For taxpayers 65 or over, a refund will be made if credits exceed tax. For the 1973 tax year only, an additional credit of \$5 is allowed for each personal exemption the taxpayer is permitted on his federal return, if such deduction is taken on his Idaho return.
	\$1,001-\$2,000	4.0		
	\$2,001-\$3,000	4.5		
	\$3,001-\$4,000	5.5		
	\$4,001-\$5,000	6.5		
	Over \$5,000	7.5		
Illinois	Total net income	2.5	
Indiana	Adjusted gross income	2	An income tax credit or rebate is provided for property taxes or rent payments of taxpayers age 65 and over or disabled, with income below \$5,000.

TABLE A,2. -- STATE INDIVIDUAL INCOME TAXES: RATES, JULY 1, 1973 (continued)

State	Net income after personal exemption	Rate (percent)	Federal tax deductible	Special rates or features		
Iowa	First \$1,000	0.75	x	Residents or nonresidents with net income of \$4,000 or less are nontaxable. If payment of the tax reduces net income to less than \$4,000 the tax is reduced to that amount that would result in allowing the taxpayer to retain a net income of \$4,000.		
	\$1,001-\$2,000	1.5				
	\$2,001-\$3,000	3				
	\$3,001-\$4,000	4				
	\$4,001-\$7,000	5				
	\$7,001-\$9,000	6				
	Over \$9,000	7				
Kansas	First \$2,000	2	x	The income classes reported are for individuals and heads of households. For joint returns the rates shown apply to income classes twice as large. A credit for property taxes is allowed for senior citizen homestead relief. Cash refunds granted if tax credit exceeds income tax due. (Method of claiming relief revised eff. 1/1/74.)		
	\$2,001-\$3,000	3.5				
	\$3,001-\$5,000	4				
	\$5,001-\$7,000	5				
	Over \$7,000	6.5				
Kentucky	First \$3,000	2	x ⁵			
	\$3,001-\$4,000	3				
	\$4,001-\$5,000	4				
	\$5,001-\$8,000	5				
	Over \$8,000	6				
Louisiana ¹	First \$10,000	2		
	\$10,000-\$50,000	4				
	Over \$50,000	6				
Maine	First \$2,000	1	The income classes reported are for individuals and heads of households. For joint returns the rates shown apply to income classes twice as large.		
	\$2,001-\$5,000	2				
	\$5,001-\$10,000	3				
	\$10,001-\$25,000	4				
	\$25,001-\$50,000	5				
	Over \$50,000	6				
Maryland	First \$1,000	2	A credit is allowed for State personal property taxes payable.		
	\$1,001-\$2,000	3				
	\$2,001-\$3,000	4				
	Over \$3,000	5				
Massachusetts	Earned income	5	No tax is imposed on, and the tax may not reduce, total income below \$5,000 for a husband and wife or \$3,000 for a single individual. A consumer tax credit is allowed: \$4 each for the taxpayer and his spouse and \$8 for each qualified dependent. If there is no income tax liability the taxpayer can apply for a refund.		
	Interest and dividends, capital gains on intangibles	9				
Michigan	All taxable income	3.9	The following credits are allowed:		
					City income tax	Credit
					Not over \$100	20% of city tax
					\$101-\$150	\$20 + 10% of excess over \$100
					\$151-\$200	\$25 + 5% of excess over \$150
					Over \$200	\$27.50 + 5% of excess over \$200
						Maximum credit \$10,000
					The sum of this credit and the credit allowed for charitable contributions may not exceed tax liability.	
					A credit is allowed for property taxes based on type and/or age of claimant and household income. If the allowable claim exceeds the income tax due, or if no income tax is due, the unused claim shall be paid to the claimant.	

TABLE A.2. -- STATE INDIVIDUAL INCOME TAXES; RATES, JULY 1, 1973 (continued)

State	Net income after personal exemption	Rate (percent)	Federal tax deductible	Special rates or features
Minnesota	First \$500	1.6	x	A credit for property taxes is allowed for senior citizen homestead relief and for renters. Cash refund granted if tax credit exceeds income tax due.
	\$501-\$1,000	2.2		
	\$1,001-\$2,000	3.5		
	\$2,001-\$3,000	5.8		
	\$3,001-\$4,000	7.3		
	\$4,001-\$5,000	8.8		
	\$5,001-\$7,000	10.2		
	\$7,001-\$9,000	11.5		
	\$9,001-\$12,500	12.8		
\$12,501-\$20,000	14.0			
Over \$20,000	15.0			
Mississippi	First \$5,000	3
	Over \$5,000	4		
Missouri	First \$1,000	1.5	x
	\$1,001-\$2,000	2		
	\$2,001-\$3,000	2.5		
	\$3,001-\$4,000	3		
	\$4,001-\$5,000	3.5		
	\$5,001-\$6,000	4		
	\$6,001-\$7,000	4.5		
	\$7,001-\$8,000	5		
	\$8,001-\$9,000	5.5		
Over \$9,000	6			
Montana	First \$1,000	2	x ⁶	After computing the tax liability pursuant to these rates, there shall be added as a surcharge, 10% of the tax liability. The minimum tax is \$1 on all individuals having taxable income.
	\$1,001-\$2,000	3		
	\$2,001-\$4,000	4		
	\$4,001-\$6,000	5		
	\$6,001-\$8,000	6		
	\$8,001-\$10,000	7		
	\$10,001-\$14,000	8		
	\$14,001-\$20,000	9		
	\$20,001-\$35,000	10		
Over \$35,000	11			
Nebraska ²	The tax is imposed on the taxpayer's Federal income tax liability before credits, with limited adjustments. The rate is set as a flat percentage by the State Board of Equalization and Assessment on or before November 15 annually for the taxable year beginning during the subsequent calendar year. The rate for 1973 was 13%.			A \$10 tax credit is allowed each taxpayer and each dependent for sales tax paid on food. If there is no income tax liability the taxpayer can apply for a refund.
New Hampshire	Interest and dividends (excluding interest on savings deposits)	4.25
	Commuter's income tax.	4		
New Jersey	First \$1,000	2	Tax applies to commuters only, New Jersey-New York area. In addition there is a 6% tax on minimum taxable income. A surcharge of 2½% of the regular income tax and the minimum income tax, before the deduction of any allowable credits, is imposed effective 1/1/74. No tax is due from individuals with A.G.I. of \$2,500 or less; married, head of a household, or a surviving spouse of \$5,000 or less.
	\$1,001-\$3,000	3		
	\$3,001-\$5,000	4		
	\$5,001-\$7,000	5		
	\$7,001-\$9,000	6		
	\$9,001-\$11,000	7		
	\$11,001-\$13,000	8		
	\$13,001-\$15,000	9		
	\$15,001-\$17,000	10		
	\$17,001-\$19,000	11		
	\$19,001-\$21,000	12		
\$21,001-\$23,000	13			

TABLE A.2. -- STATE INDIVIDUAL INCOME TAXES: RATES, JULY 1, 1973 (continued)

State	Net income after personal exemption	Rate (percent)	Federal tax deductible	Special rates or features
New Jersey (Continued) . . .	\$23,001- \$25,000	14		
	Over \$25,000	15		
	All taxable income*	2.3		*Tax applies to commuters only, New Jersey-Pennsylvania area.
New Mexico ^{1,2}	First \$500	1	The income classes reported are for single individuals and married individuals filing separate returns. For heads of households and married individuals filing joint returns the rates shown apply to income classes twice as large. A credit is allowed for State-local taxes paid during the tax year by taxpayers with modified gross income of \$6,000 or less. The credit ranges from 0 to \$133 based on income and number of exemptions. If the credit exceeds tax liability, the excess will be refunded.
	\$501- \$1,000	1.5		
	\$1,001- \$1,500	1.5		
	\$1,501- \$2,000	2.0		
	\$2,001- \$3,000	2.5		
	\$3,001- \$4,000	3.0		
	\$4,001- \$5,000	3.5		
	\$5,001- \$6,000	4.0		
	\$6,001- \$7,000	4.5		
	\$7,001- \$8,000	5.0		
	\$8,001- \$10,000	6.0		
	\$10,001- \$12,000	7.0		
	\$12,001- \$20,000	7.5		
	\$20,001- \$50,000	8.0		
\$50,001- \$100,000	8.5			
Over \$100,000	9			
New York	First \$1,000	2	No tax is due from individuals with a N.Y. A.G.I. of \$2,500 or less; married, head of a household or a surviving spouse of \$5,000 or less. Capital gains treatment is similar to that provided under Federal law. Income from unincorporated business is taxed at 5½ percent. The following credit is allowed: If tax is— credit is— \$100 or less . . . full amount of tax. \$100- \$200 . . . difference between \$200 and amount of tax. \$200 or more . . . no credit. In addition to the personal income tax, a 6% tax is imposed on the N.Y. minimum taxable income (tax preference items) of individuals, estates, or trusts. A surcharge of 2½% of the regular income tax and the minimum income tax, before the deduction of any allowable credits, is imposed effective 1/1/74.
	\$1,001- \$3,000	3		
	\$3,001- \$5,000	4		
	\$5,001- \$7,000	5		
	\$7,001- \$9,000	6		
	\$9,001- \$11,000	7		
	\$11,001- \$13,000	8		
	\$13,001- \$15,000	9		
	\$15,001- \$17,000	10		
	\$17,001- \$19,000	11		
	\$19,001- \$21,000	12		
	\$21,001- \$23,000	13		
	\$23,001- \$25,000	14		
	Over \$25,000	15		
	North Carolina	First \$2,000	3	
\$2,001- \$4,000		4		
\$4,001- \$6,000		5		
\$6,001- \$10,000		6		
Over \$10,000		7		
North Dakota	First \$1,000	1	x	An additional 1% tax is imposed on net incomes derived from a business, trade, or profession, other than as an employee. Effective for taxable years beginning on or after 1/1/72, a 2nd. additional tax of 1% of taxable income is imposed, with a minimum tax \$2.50 and a maximum of \$12.50.
	\$1,001- \$3,000	2		
	\$3,001- \$5,000	3		
	\$5,001- \$6,000	5		
	\$6,001- \$8,000	7.5		
Over \$8,000	10			

TABLE A.2. -- STATE INDIVIDUAL INCOME TAXES: RATES, JULY 1, 1973 (continued)

State	Net income after personal exemption	Rate (percent)	Federal tax deductible	Special rates or features
Ohio	First \$5,000	½	The following tax credit is allowed taxpayers filing joint returns, provided the husband and wife each had adjusted gross income of \$500 or more excluding interest, dividends, royalties, rents and capital gains: Adj. gross income (less exemptions) Cdt. equal to following % of tax liability \$10,000 or less 20% \$10,001-\$20,000 12 Over \$20,000 5
	\$5,001-\$10,000	1		
	\$10,001-\$15,000	2		
	\$15,001-\$20,000	2½		
	\$20,001-\$40,000	3		
	Over \$40,000	3½		
Oklahoma ²	First \$1,000	½	The income classes reported are for individuals and married persons filing separately. For joint returns the rates shown apply to income classes twice as large. The rates for heads of households range from 1/2% on the 1st. \$1,500 to 6% on taxable income over \$11,500.
	\$1,001-\$2,500	1		
	\$2,501-\$3,750	2		
	\$3,751-\$5,000	3		
	\$5,001-\$6,250	4		
	\$6,251-\$7,500	5		
	Over \$7,500	6		
Oregon	First \$500	4	x ⁷	The income classes reported are for individuals. For joint returns and heads of households the rates shown apply to income classes twice as large. A credit is provided in an amount equal to 25 percent of the Federal retirement income tax credit to the extent that such credit is based on Oregon taxable income.
	\$501-\$1,000	5		
	\$1,001-\$2,000	6		
	\$2,001-\$3,000	7		
	\$3,001-\$4,000	8		
	\$4,001-\$5,000	9		
	Over \$5,000	10		
Pennsylvania	All taxable income	2.3		
Rhode Island	The tax is imposed on the taxpayer's modified Federal income tax liability. The rate for 1973 is 15%.			
South Carolina	First \$2,000	2	x ⁸	The tax does not apply to persons aged 65 or older who, during the taxable year, receive gross income from all sources of not more than \$2,800 if there are no dependents, or \$4,000 if there is a dependent spouse or other dependent.
	\$2,001-\$4,000	3		
	\$4,001-\$6,000	4		
	\$6,001-\$8,000	5		
	\$8,001-\$10,000	6		
	Over \$10,000	7		
Tennessee	Interest and dividends	6	Dividends from corporations having at least 75 percent of their property subject to the Tennessee ad valorem tax are taxed at 4 percent.
Utah	First \$1,500	2.5	x	Rates shown in table apply to married persons filing jointly. The following rates apply to single persons: First \$750 2% \$751-\$1,500 3 \$1,501-\$2,250 4 \$2,251-\$3,000 5 \$3,001-\$3,750 6 Over \$3,750 7.25
	\$1,501-\$3,000	3.5		
	\$3,001-\$4,500	4.5		
	\$4,501-\$6,000	5.5		
	\$6,001-\$7,500	6.5		
	Over \$7,500	7.25		
	Vermont ²	The tax imposed at a rate of 25% of the Federal income tax liability of the taxpayer for the taxable year (after the allowance of retirement income credit, investment credit, foreign tax credit and tax-free covenant bonds credit, but before			If a taxpayer's liability exceeds, by any amount, what that liability would have been had it been determined in accordance with the Federal Internal Revenue Code in effect on January 1, 1967, instead of the federal statute in effect for

TABLE A.2. -- STATE INDIVIDUAL INCOME TAXES: RATES, JULY 1, 1973 (continued)

State	Net income after personal exemption	Rate (percent)	Federal tax deductible	Special rates or features
Vermont ² (Continued)	the allowance of any other credit against that liability or the addition of any surtax upon that liability granted or imposed under Federal law), reduced by a percentage equal to the percentage of the taxpayer's adjusted gross income for the taxable year which is not Vermont income. For taxable years beginning after December 31, 1972, and before January 1, 1974 a 12% surcharge is imposed (9% for taxable years beginning after December 31, 1973). ⁹			the year for which the return is filed a credit is allowed equal to 106% of the amount of the excess, applicable to the taxpayer's tax liability for the succeeding year. Resident taxpayers who are full-time students for at least five months in the year are allowed a \$10 credit. Effective June 1, 1969 a sales tax credit based on modified adjusted gross income brackets and number of exemptions is provided, ranging from \$0 to \$81. If a taxpayer's credits exceed his tax, a refund will be made. Resident taxpayers are provided a credit for property taxes or rent constituting property taxes. For taxpayers 65 or older if income tax liability is less than the credit the difference between the liability and the credit will be refunded ¹⁰ .
Virginia	First \$3,000	2	.....	.....
	\$3,001-\$5,000	3		
	\$5,001-\$12,000	5		
	Over \$12,000	5.75		
West Virginia	First \$2,000	2.1	.....	The income classes reported are for individuals and heads of households. For joint returns the rates shown apply to income classes twice as large.
	\$2,001-\$4,000	2.3		
	\$4,001-\$6,000	2.8		
	\$6,001-\$8,000	3.2		
	\$8,001-\$10,000	3.5		
	\$10,001-\$12,000	4.0		
	\$12,001-\$14,000	4.6		
	\$14,001-\$16,000	4.9		
	\$16,001-\$18,000	5.3		
	\$18,001-\$20,000	5.4		
	\$20,001-\$22,000	6.0		
	\$22,001-\$26,000	6.1		
	\$26,001-\$32,000	6.5		
	\$32,001-\$38,000	6.8		
	\$38,001-\$44,000	7.2		
	\$44,001-\$50,000	7.5		
	\$50,001-\$60,000	7.9		
	\$60,001-\$70,000	8.2		
	\$70,001-\$80,000	8.6		
	\$80,001-\$90,000	8.8		
	\$90,001-\$100,000	9.1		
	\$100,001-\$150,000	9.3		
	\$150,001-\$200,000	9.5		
	Over \$200,000	9.6		
Wisconsin ²	First \$1,000	3.1	.....	A property tax credit is allowed for home- stead relief. Cash refund granted if property tax credit exceeds income tax due.
	\$1,001-\$2,000	3.4		
	\$2,001-\$3,000	3.6		
	\$3,001-\$4,000	4.8		
	\$4,001-\$5,000	5.4		
	\$5,001-\$6,000	5.9		
	\$6,001-\$7,000	6.5		
	\$7,001-\$8,000	7.6		
	\$8,001-\$9,000	8.2		
	\$9,001-\$10,000	8.8		
	\$10,001-\$11,000	9.3		
	\$11,001-\$12,000	9.9		
	\$12,001-\$13,000	10.5		
	\$13,001-\$14,000	11.1		
	Over \$14,000	11.4		

TABLE A.2. -- STATE INDIVIDUAL INCOME TAXES; RATES, JULY 1, 1973 (continued)

State	Net income after personal exemption	Rate (percent)	Federal tax deductible	Special rates or features
Washington, D.C.	First \$1,000	2	Income from unincorporated business is taxed at 7 percent (8% eff. 1/1/74), minimum tax, \$25. A tax credit is provided for low income taxpayers (AGI not over \$6,000) for increased sales tax on food (\$2 to \$6 credit per exemption). A refund is allowed if the credit exceeds tax liability.
	\$1,001-\$2,000	3		
	\$2,001-\$3,000	4		
	\$3,001-\$5,000	5		
	\$5,001-\$8,000	6		
	\$8,001-\$12,000	7		
	\$12,001-\$17,000	8		
\$17,001-\$25,000	9			
	Over \$25,000	10		

¹ Community property State in which, in general, 1/2 the community income is taxable to each spouse.
² Allows deduction of State individual income tax itself in computing State tax liability.
³ Effective for taxable years beginning on or after July 1, 1969, taxpayers whose only activities in the State consist of making sales, who do not own or rent real estate in the State and whose annual gross sales in or into Colorado amount to not more than \$100,000, may elect to pay a tax of 1/2 of 1% of annual gross receipts derived from sales in or into Colorado in lieu of paying an income tax.
⁴ Limited to \$300 for single persons and \$600 for married persons filing joint returns.
⁵ Limited to the lesser of (a) the Federal income tax actually paid or accrued for the taxable year, or (b) the Federal tax that would result from applying the Federal rates in effect on December 31, 1967 to Federal taxable income for the taxable year.
⁶ Limited to itemized returns.
⁷ For tax years beginning on and after January 1, 1974, and before January 1, 1975, the deduction is limited to \$3,000.
⁸ Limited to \$500 per taxpayer.
⁹ The tax liability for any taxable year shall not in any case equal an amount such that the combined Vermont and Federal income tax liability of the taxpayer for the taxable year, less the Federal income tax liability (without consideration of the deduction for Vermont income taxes paid or accrued) exceeds 4% percent of the total income of the taxpayer for that taxable year.
¹⁰ Claimants under age 65 shall file for a credit on forms provided by the commissioner. Such claims shall be processed separately from the Vermont income tax returns and no amount of claim shall be allowed as a credit against income tax liability.

SOURCE: Commerce Clearing House, State Tax Reporter as shown in Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism, 1973-74 Edition (Washington: U. S. Government Printing Office, 1974), pp. 261-268.

TABLE A.3--STATE SALES TAXES: TYPES AND RATES, JULY 1, 1973
(Percent)

Rates on selected services subject to tax										
State	Type of tax ¹	Rate on tangible personal property at retail	Admissions	Restaurant meals	Transient lodging	Telephone and telegraph	Gas and electricity	Water	Transportation of persons and property	Rates on other services and businesses subject to tax (including retail sales subject to special rates)
Alabama	Retail sales	4 ²	4	4	4	3	3	3	. . . .	Lease or rental of tangible property, 4% except, motor vehicles and trailers, 1½% and, linens and garments, 2%; agricultural machinery and equipment, and mining and manufacturing machinery, 1½%; gross receipts of amusement operators, 4%.
Arizona	do	3	3	3	3	3	3	3	3 ⁴	Lease or rental of real and tangible personal property, advertising, printing, publishing, contracting, storage, and amusement operators, 3%; extracting and processing minerals, 2%; timbering, 1½%; meat-packing and wholesale sales of feed to poultrymen and stockmen, 3/8%.
Arkansas	do	3	3	3	3	3	3	3	. . . .	Repair services, including automobile, electrical and other repairs, printing, photography, and receipts from coin-operated devices (except car washes), 3%. Use tax on personal property of carriers and utilities, including motor carriers, railroads (except fuel consumed in the operation of railroad rolling stock), public pipe line carriers, airlines, telephone and telegraph companies, gas companies, water companies and electric companies, 1% through 6/30/72; 1½%, 7/1/72-6/30/73; 2% 7/1/73-6/30/74; and 3% 7/1/74 and thereafter.
California	do	4%	. . . .	4%	. . . .	. . . .	. . . .	. . . .	. . . .	Renting, leasing, producing, fabrication, processing, printing or imprinting of tangible personal property, 4%.
Colorado	do	3	. . . .	3	3	3	3 ⁶	. . . .	. . . .	Selling, leasing or delivering in Colorado of tangible personal property by a retail sale for use, storage, distribution or consumption within the State, 3%.

See footnotes at the end of table.

TABLE A.3--STATE SALES TAXES: TYPES AND RATES, JULY 1, 1973 (continued)
(Percent)

Rates on selected services subject to tax										
State	Type of tax ¹	Rate on tangible personal property at retail	Admissions	Restaurant meals	Transient lodging	Telephone and telegraph	Gas and electricity	Water	Transportation of persons and property	Rates on other services and businesses subject to tax (including retail sales subject to special rates)
Connecticut ⁵	Retail sales	6½	....	6½ ⁷	6½	6½ ⁶	6½ ⁶	6½ ⁶	....	Storing for use or consumption of any article or item of tangible personal property, 6½%.
Florida	do	4	4	4	4	4 ⁶	4 ⁶	....	....	Fishing, hunting, camping, swimming and diving equipment, 5% of wholesale price or cost. Rental, storage or furnishing of taxable things or services, altering, remodeling or repairing tangible personal property, lease or rental of commercial offices or buildings, the rental of privately owned parking and docking facilities, wired television service, coin operated vending machines, 4%.
Georgia	do	3	3	3	3	3	3	....	3 ⁴	Lease or rental of tangible personal property, and charges on amusements and amusement devices, 3%.
Hawaii	Multiple stage sales	4	4	4	4	....	....	....	....	Manufacturers, producers, wholesalers, and selected service businesses, 1/2%; sugar processors and pineapple canners, 1/2%; insurance solicitors, 2%; contractors, sales representatives, professions, radio broadcasting stations, service businesses and other businesses (not otherwise specified), including amusement business, 4%.
Idaho	Retail sales	3	3	3	3	....	....	....	....	Renting, leasing, producing, fabricating, processing, printing or imprinting of tangible personal property, and gross receipts of amusement operators, 3%. (5% of the gross receipts from sales of tickets to closed circuit telecasts of boxing, sparring and wrestling matches).
Illinois	do	4	....	4	....	....	....	....	....	Property sold in connection with a sale of service, 4%; remodeling, repairing and

See footnotes at the end of table.

TABLE A.3--STATE SALES TAXES: TYPES AND RATES, JULY 1, 1973 (continued)
(Percent)

Rates on selected services subject to tax										
State	Type of tax ¹	Rate on tangible personal property at retail	Admissions	Restaurant meals	Transient lodging	Telephone and telegraph	Gas and electricity	Water	Transportation of persons and property	Rates on other services and businesses subject to tax (including retail sales subject to special rates)
Illinois (cont'd)										reconditioning of tangible personal property, 4%. Hotel operators are subject to a hotel occupancy tax of 5% of 95% of the gross receipts from the rental of rooms to transients.
Indiana	Retail sales	4	....	4	4	4 ⁶	4 ⁶	4 ⁶	....	Lease or rental of tangible personal property, sales at auction, cable television service, 4%.
Iowa	do	3	3	3	3	3	3	3	....	Laundry, drycleaning, automobile and cold storage, printing, repair service to tangible personal property, and gross receipts derived from operation of amusement devices and commercial amusement enterprises, 3%.
Kansas	do	3	3	3	3	3	3 ⁶	3 ⁶	3 ⁴	Drycleaning, pressing, dyeing and laundry service (other than through coin-operated devices); washing and waxing vehicles; sales to contractors, subcontractors or repairmen of materials and supplies for use in building, improving, altering or repairing property for others; service or maintenance agreements; gross receipts from the operation of any coin-operated device (other than laundry services); and lease or rental of tangible personal property, 3%.
Kentucky	do	5	5 ⁸	5	5	5	5 ⁶	5	....	Storage, use or other consumption of tangible personal property, sewer services, photography and photo finishing, 5%.
Louisiana	do	3	3	3	3	....	....	....	....	Laundry, drycleaning, automobile and cold storage, printing, repairing, renting, or leasing of tangible personal property, 3%.
Maine	do	5	....	5	5	5	5	5	....	Renting, storing, fabricating or printing of tangible personal property, 5%.

See footnotes at the end of table.

TABLE A.3--STATE SALES TAXES: TYPES AND RATES, JULY 1, 1973 (continued)
(Percent)

Rates on selected services subject to tax										
State	Type of tax ¹	Rate on tangible personal property at retail	Admissions	Restaurant meals	Transient lodging	Telephone and telegraph	Gas and electricity	Water	Transportation of persons and property	Rates on other services and businesses subject to tax (including retail sales subject to special rates)
Maryland	Retail sales	4 ²	. . . .	4 ⁷	4	. . . .	4 ⁶	. . . .	. . . .	Lease or rental of tangible personal property, production, fabrication, or printing on special order, 4%; farm equipment, manufacturing machinery and equipment, 2%; watercraft, 3%.
Massachusetts	do	3	. . . .	7	. . . .	. . . .	. . . .	. . . .	. . . .	Renting, leasing, producing, fabricating, processing, printing or imprinting of tangible personal property, 3%. Transient lodging is subject to a 5.7% (5% plus 14% surtax) room occupancy excise tax.
Michigan	do	4	. . . .	4	4	4	4	. . . .	. . . .	Sales of property to persons engaged in constructing, altering, repairing or improving realty for others; and lease or rental of tangible personal property, 4%.
Minnesota	do	4 ²	4	4	4	4	4	4	. . . .	Renting, leasing, processing, producing, fabricating or printing tangible personal property, 4%; coin-operated vending machines, 3%.
Mississippi ⁹	Multiple stage sales	5 ²	. . . .	5	5	5	5 ⁶	5	5 ⁴	Wholesaling, 1/8% (with following exceptions: sales of meat for human consumption, 1/2%; alcoholic beverages, motor fuel, soft drinks and syrups, 5%); extracting or mining of minerals, 5%; specified miscellaneous businesses (including bowling alleys, pool parlors, laundry and dry cleaning, photo finishing, storage, certain repair services), 5%, except cotton ginning, 15¢ per bale; sales of railroad track material (to a railroad whose rates are fixed) 3%; contracting (contracts exceeding \$10,000), 2 1/2%; farm tractors, 1%; other farm equipment, brooders, feeders, waterers, self-propelled equipment used in logging, pulpwood operations or tree farming, 3%; electric power associations; renting or leasing manufacturing or processing machinery, and sales of manufacturing machinery and manufacturing machine parts over \$500, 1%.

See footnotes at the end of table.

TABLE A.3--STATE SALES TAXES: TYPES AND RATES, JULY 1, 1973 (continued)
(Percent)

Rates on selected services subject to tax										
State	Type of tax ¹	Rate on tangible personal property at retail	Admissions	Restaurant meals	Transient lodging	Telephone and telegraph	Gas and electricity	Water	Transportation of persons and property	Rates on other services and businesses subject to tax (including retail sales subject to special rates)
Missouri	Retail sales	3	3	3	3	3	3 ⁶	3	3 ⁴	Trailer camp rentals, and lease or rental of tangible personal property, 3%.
Nebraska (Next year's rate determined annually by the State Board of Equalization, by Nov. 15)	do	2½	2½	2½	2½	2½	2½	2½	. . . .	Renting, leasing, producing, fabricating, processing, printing, or imprinting of tangible personal property, 2½%.
Nevada (includes 1% mandatory county tax)	do	3	. . . .	3	. . . .	. . . .	. . . .	. . . .	. . . .	Renting, leasing, producing, fabrication, processing, and printing, or imprinting of tangible personal property, 3%.
New Jersey	do	5	5 ¹⁰	5	5	. . . .	. . . .	. . . .	. . . .	Advertising, renting, leasing, producing, fabricating, processing, printing, or imprinting, and installation or maintenance of tangible personal property, 5%.
New Mexico	do	4 ²	4	4	4	4	4	4	4	Leasing or storing tangible personal property, and sales of services, 4%. Sales of farm implements, 2%.
New York	do	4	4 ¹⁰	4	4	4	4	. . . .	. . . .	Renting, leasing, producing, fabricating, processing, printing, or imprinting, and installation or maintenance of tangible personal property, 4%.
North Carolina	do	3 ²	. . . .	3	3	. . . .	. . . .	. . . .	. . . .	Leasing or renting of tangible personal property, laundry and drycleaning, 3%; airplanes, boats, railway locomotives and cars, 2% (with a maximum tax of \$120 per item); sales of horses or mules, sales of fuel to farmers, manufacturing industries and plants other than for residential heating purposes, and to commercial laundries or to pressing and drycleaning establishments, sales of machinery to farmers, manufacturing industries, laundry and drycleaning establishments, and other selected items, 1% (maximum tax is \$80 per article for several items).

See footnotes at the end of table.

TABLE A.3--STATE SALES TAXES: TYPES AND RATES, JULY 1, 1973 (continued)
(Percent)

Rates on selected services subject to tax										
State	Type of tax ¹	Rate on tangible personal property at retail	Admissions	Restaurant meals	Transient lodging	Telephone and telegraph	Gas and electricity	Water	Transportation of persons and property	Rates on other services and businesses subject to tax (including retail sales subject to special rates)
North Dakota	Retail sales	4 ²	4	4	4	4	4	4	...	Leasing, renting, fabricating, and storing of tangible personal property, proceeds from coin-operated amusement or entertainment machinery, and the severance of sand or gravel from the soil, 4%.
Ohio	do	4	...	4	4	...	...	...	...	Printing, processing, and reproducing, 4%.
Oklahoma	do	2 ²	2	2	2	2	2	...	2 ⁴	Advertising (limited), gross proceeds from amusement devices, printing, automobile storage, 2%.
Pennsylvania	do	6	...	6	6	6 ⁶	6 ⁶	...	...	Lease or rental of tangible personal property, repairing, altering, or cleaning of tangible personal property (other than wearing apparel or shoes), printing, or imprinting of tangible personal property for persons who furnish materials, cleaning, polishing, lubricating, and inspecting of motor vehicles, and rental income of coin-operated amusement machines, 6%.
Rhode Island	do	5	...	5	5	5	5 ⁶	5	...	Renting, leasing, producing, fabricating, processing, and printing, or imprinting of tangible personal property, 5%.
South Carolina	do	4	...	4	4	4	4 ⁶	...	...	Renting or leasing of tangible personal property, and laundry and drycleaning, 4%.
South Dakota	do	4 ²	3	4	3	3	3	3	...	Farm machinery, and agricultural irrigation equipment sold by licensed retailers, 2%; contractors, gross receipts from engaging in the practice of any professional or business in which the service rendered is of a professional, technical, or scientific nature, but not including persons engaged in the healing arts or veterinarians, 4%. Gross receipts from amusement devices, 3%.

See footnotes at the end of table.

TABLE A.3--STATE SALES TAXES: TYPES AND RATES, JULY 1, 1973 (continued)
(Percent)

Rates on selected services subject to tax										
State	Type of tax ¹	Rate on tangible personal property at retail	Admissions	Restaurant meals	Transient lodging	Telephone and telegraph	Gas and electricity	Water	Transportation of persons and property	Rates on other services and businesses subject to tax (including retail sales subject to special rates)
Tennessee	Retail sales	3%	. . . .	3%	3%	3%	3% ⁶	3% ⁶	. . . .	Vending machine operators may pay a \$2 registration fee plus \$1 per machine, and 1% of gross receipts from such machines in lieu of privilege and sales taxes, except that the tax on gross receipts from machines dispensing tobacco items is 2½%; parking lots and storage of motor vehicles, repair services, installation, lease or rental of tangible personal property, laundry and drycleaning, 3%; machinery for "new and expanded" industry, air & water pollution control equipment used in fabricating or producing tangible personal property, & farm machinery and equipment, 1%.
Texas	do	4 ²	. . . .	4	. . . .	. . . .	4 ⁶	. . . .	. . . .	Producing, processing, and lease or rental of tangible personal property, 4%.
Utah	do	4	4	4	4	4	4	. . . .	4 ⁴	Laundry, and drycleaning, repairing, renovating, installing, fabricating, and lease or rental of tangible personal property, 4%.
Vermont	do	3	3	11	11	. . . .	3	. . . .	. . . .	Renting, leasing, producing, fabricating, processing, printing or imprinting of tangible personal property, 3%.
Virginia	do	3 ²	. . . .	3	3	. . . .	. . . .	. . . .	. . . .	Fabricating, storage, lease or rental of tangible personal property, 3%.
Washington	do	4½	4½	4½	4½	. . . .	. . . .	. . . .	. . . .	Charges for certain specified services, 4½%; selected amusement and recreation activities, 4½% (unless subject to county or city admission taxes, in which case they remain taxable under the State business and occupation tax, 1%).
West Virginia	do	3 ²	3	3	3	. . . .	. . . .	. . . .	. . . .	All services (including services rendered in amusement places), except public utilities and personal and professional services; and renting or leasing tangible personal property, 3%.

See footnotes on the following page.

TABLE A.3--STATE SALES TAXES: TYPES AND RATES, JULY 1, 1973 (continued)
(Percent)

Rates on selected services subject to tax										
State	Type of tax ¹	Rate on tangible personal property at retail	Admissions	Restaurant meals	Transient lodging	Telephone and telegraph	Gas and electricity	Water	Transportation of persons and property	Rates on other services and businesses subject to tax (including retail sales subject to special rates)
Wisconsin	Retail sales	4	4 ¹⁰	4	4	4	4 ⁶	. . . . .	. . . . .	Laundry, drycleaning, photographic services, the repair, service, maintenance, lease or rental of all items of taxable tangible personal property, 4%.
Wyoming	do	3	3	3	3	3	3 ⁶	. . . . .	3 ⁴	Laundry, drycleaning, producing, fabricating, repairing, altering, printing, lease or rental (with exceptions) of tangible personal property, plus numerous other service businesses, 3%.
District of Columbia	do	5 ²	5	6	6	5	5 ⁶	5	. . . . .	Laundry, drycleaning and pressing services (except self-service coin operated services), textile rental (with exceptions), and nonprescription medicines, 2%. Producing, fabricating, printing, lease or rental (with exceptions), and repair of tangible personal property, 5%.

¹ All but a few States levy sales taxes of the single-stage retail type. Hawaii and Mississippi levy multiple-stage sales taxes (although the Arizona and New Mexico taxes are applicable to some nonretail businesses, they are essentially retail sales taxes). Washington and West Virginia levy a gross receipts tax on all businesses, distinct from their sales taxes. Alaska also levies a gross receipts tax on businesses, New Jersey levies a retail gross receipts tax plus an unincorporated business tax (which includes, unincorporated retail stores); Delaware levies a merchants license tax based on gross receipts; and Indiana levies a tax on the gross income of all persons or corporations doing business in Indiana. The rates applicable to retailers (with exceptions) under these gross receipts taxes are as follows: Alaska 1/2% on gross receipts of \$20,000-\$100,000, and 1/4% on gross receipts in excess of \$100,000; Delaware, retailers generally, 4/5 of 1% less \$20,000 each quarter; Indiana 475/1000 of 1%; New Jersey, retail gross receipts - 1/20 of 1% on gross receipts in excess of \$150,000, unincorporated business tax - 1/4 of 1% if gross receipts exceed \$5,000; Washington, 44/100% and West Virginia, 55/100%.

² Motor vehicles are taxable at the general rates with certain exceptions. The following States apply different rates to motor vehicles under their general sales and use tax laws: Alabama, 1 1/2%; Mississippi, 3%; and North Carolina, 2% (maximum \$120). The following exempt motor vehicles from their general sales and use taxes but impose special sales or gross receipts taxes on them under their motor vehicle tax laws: District of Columbia 5% titling tax; Maryland, 4% titling tax; Minnesota, 4% excise tax; New Mexico, 2% excise tax; North Dakota, 4% excise tax; Oklahoma, 2% excise tax; South Dakota, 3% excise tax; Texas 3% sales and use tax; Virginia, 2% sales and use tax; and West Virginia, 3% titling tax. See also table 00 for sales tax treatment of motor vehicles.

³ Gross sales or gross receipts taxable under separate "Utility Tax Act."

⁴ Arizona and Mississippi also tax the transportation of oil and gas by pipeline. Georgia exempts transportation of property, and charges by municipalities, counties, and public transit authorities for transporting passengers upon their conveyances. Kansas exempts transportation of persons. Missouri exempts contract transportation of employees to and from work, and transportation of property. Oklahoma, and Utah do not tax transportation of property. Mississippi taxes taxicab transportation at the rate of 2%. Local transit buses are exempt. Oklahoma does not tax local transportation, school transportation, and fares of 15 cents or less. Utah does not tax street railway fares. In Arizona, bus, taxi cab, and trucking services registered as "common carriers" pay the carrier tax (2 1/2%) and are exempt from the sales tax.

⁵ Sales under \$4 taxed at 3 1/2% if the vendor keeps adequate records.

⁶ Colorado exempts gas and electricity for use in construction and other industrial uses. Connecticut exempts telephone and telegraph, gas, electricity, and water services provided to consumers through mains, lines or pipes to the extent of \$10 per month. Gas and electricity used for domestic heating are exempt. Florida exempts fuels used by a public or private utility in the generation of electric power or energy for sale. Sales of fuel and utilities to residential households are exempt. Indiana exempts gas, electricity, and water used in manufacturing, mining, refining, oil or mineral extraction, and irrigation; also exempts sale of utility services to other utilities. Kansas exempts gas, electricity, and water used in farming, processing, manufacturing, mining, drilling, refining, irrigation, telephone and telegraph and other taxable services or for use in movement in interstate commerce by railroads or public utilities. Kentucky exempts energy or energy producing fuels used in manufacturing, processing, mining, or refining to the extent that costs exceed 3% of the cost of production. Maryland exempts sales of gas and electricity when made for purposes of resale or use in manufacturing, assembling, processing, refining, or the generation of electricity.

TABLE A.3--STATE SALES TAXES: TYPES AND RATES, JULY 1, 1973 (continued)
(Percent)

Mississippi exempts wholesale sales of electricity between power companies and taxes industrial sales of gas and electricity at the rate of 1%. Missouri exempts electrical energy used in manufacturing, processing, etc., of a product, if the total cost of electrical energy used exceeds 10% of the total cost of production, excluding the cost of electrical energy so used. Pennsylvania exempts gas and electricity, and intrastate telephone or telegraph service when purchased by the user solely for his own residential use. Rhode Island exempts gas and electricity furnished for domestic use by occupants of residential premises. South Carolina's tax is not applicable to sales of gas used in manufacturing or in furnishing laundry service; also exempt are sales of electricity for use in manufacturing tangible personalty and electricity sold to radio and television stations used in producing programs. Tennessee taxes gas, electricity and water sold to or used by manufacturers at the rate of 1% (if used directly in the manufacturing process they are exempt). Texas exempts gas and electricity used in manufacturing, mining, or agriculture. Wisconsin's tax is not applicable to gas or to electricity for space heating charged at a specific rate. Wyoming exempts gas and electricity consumed in manufacturing, processing, and the transportation business. The District of Columbia exempts gas and electricity used in manufacturing, assembling, processing and refining.

⁷ Restaurant meals below a certain price are exempt: Connecticut, less than \$1; Maryland, \$1 or less; the Massachusetts retail sales tax exempts restaurant meals, which (\$1 or more) are taxed at 5%.

⁸ The tax on sale of tickets to prize fighters or wrestling matches on closed circuit television is 5% of the gross receipts. The 5% tax also applies to payments received from broadcasting companies for the right to televise or broadcast any match.

⁹ In Mississippi, effective August 1, 1968, the State sales tax on tangible personal property was increased from 3% to 5%; however, authority for local sales tax was repealed.

¹⁰ In New Jersey, admissions to a place of amusement are taxable if the charge is in excess of 75 cents. Admissions to horse race meetings are taxable at 10% under a separate admissions tax. New York taxes admissions when the charge is over 10 cents: exempt are participating sports (such as bowling and swimming), motion picture theatres, race tracks, boxing, wrestling, and live dramatic or musical performances. Sales of admission: to motion picture theatres costing 75 cents or less are exempt in Wisconsin.

¹¹ Taxed at 5% under separate "Meals and Rooms Tax."

SOURCE: Commerce Clearing House, State Tax Reporter, as shown in Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism, 1973-74, (Washington: Government Printing Office, 1974), pp. 242-250.

Possible Taxable Service	Is the Service Subject to Other Gross Receipts Taxes?	Ease of Administration	Taxpayer Equity	Potential Net Revenue Impact
Amusements - movie theaters; performances; bowling, pool, skating, swimming, riding, and other recreation fees; Turkish baths; massage and reducing salons; health clubs; golf and country clubs; other recreation clubs; itinerant amusement shows.	License taxes are imposed by localities on admissions and on some of the others.	This would require collections from many new dealers, including one night performances and itinerant amusement shows. A question would arise about taxing amusements to raise money for charities, and "charitable" would have to be defined. Relating to clubs where fees are paid in the form of membership dues, it might logically follow that all dues to all clubs are taxable.	This category would have to include most types of amusements to avoid discrimination against the ones taxed.	Very good.
Business Services - advertising; promotion and direct mail; armored cars; janitorial services; mailing services; telephone answering services; testing laboratories; wrapping, packing, and packaging of merchandise; weighing; sign painting; equipment rental; collection agencies; bookkeeping services; secretarial services; employment agencies.	Merchants license taxes are imposed by many localities on all of these.	Most of these are fairly easy to define and would add new dealers to the tax rolls. However, advertising is difficult to define, there is a question about tax interstate commerce, and it would be costly to administer the tax on out-of-state advertisers.	Taxing these services would frequently discriminate against the small nonvertically integrated firm.	Good, (not including advertising.)
Construction Services - all construction services relating to buildings and structures erected for the improvement of realty; real estate construction contracts-primary; carpentry; masonry; plastering; painting, papering, and interior decorating; excavating and grading; pipe fitting and plumbing; house and building moving; well drilling.	Some localities impose license taxes on the fees received on gross amount of contract or order of contractors.	The point can be made that the purchase of real property, including structures, is a capital investment and not a consumer expenditure. Repairs and remodeling may be classified as repairs to tangible property and therefore are taxable. It would be difficult to differentiate between construction of structure and the addition or alteration of a few rooms. It would be difficult to enforce complete compliance among so many small concerns. Many new dealers would be added to the tax rolls.	Taxing construction could be a penalty to potential construction investors and might be detrimental to the construction market. Taxing only a primary contractor would discriminate against general contractors and would be easily avoidable. Taxing minor work done by carpenters, plasterers, etc. would be equitable if all categories were included.	Very good.
Educational Services - private schools; dancing schools; music lessons; flying lessons; vocational schools; modeling schools; art schools.	Private schools are not usually subject to these taxes, but dancing schools and some others frequently are.	Careful definition would be necessary to encompass all types of educational services. Since many lessons are taught by private individuals, evasion would be easy.	This is a very questionable category since it taxes people for learning a vocation.	Good, (not including private schools.)
Financial Services - bank service charges; finance charges; all types of insurance premiums; investment counseling.	There is a state tax on the gross premiums of insurance companies.	The dealers in question would be easily locatable. Finance charges would have to be differentiated from interest. Finance charges apply to bank credit cards and retail store credit cards as well as to financial institutions. It would be necessary to define the types of insurance premiums taxed.	Taxing this category penalizes people with small accounts, people dealing with certain banks, credit users, and people dealing with investment counselors rather than bankers or stock brokers. Taxing insurance premiums imposes a tax on saving since the purchase of insurance is often a form of saving as well as a purchase of the service.	Good, (not including insurance premiums or finance charges.)
Personal Services - barbers and beauty salons; dry cleaning, pressing, dyeing and laundry; coin operated laundry and dry cleaning; shoe repair and shoe shine; alterations; sewing and stitching; fur storage, repair, dyers, and dressers.	These are subject to license taxes on gross receipts by localities.	Since most of these services are provided by retail stores which already collect the tax on some items, it would be fairly easy to extend coverage to these items. It might be beneficial to set some sort of lower limit to exempt shoe-shine boys and other extremely small operators.	Taxpayer equity seems satisfactory although most states do not tax these - perhaps because many are viewed as necessities.	Good.

(Table continued on next page.)

TABLE A.4--EXAMINATION OF POSSIBLE TAXABLE SERVICES AND RELATED ISSUES (Continued)

Possible Taxable Service	Is the Service Subject to Other Gross Receipts Taxes?	Ease of Administration	Taxpayer Equity	Potential Net Revenue Impact
Professional Services - accountants; architects; attorneys; artists; chemists; doctors; dentists; nurses; allied health personnel; veterinarians; engineers; geologists; surveyors; morticians; pharmacists; chiropractors; fortune tellers; pawn brokers; taxidermists; interior decorators.	Many professionals are subject to local license taxes on gross receipts.	This tax may be difficult to collect from so many independent practitioners.	There are questions about taxing health and legal services. Who pays the tax bill on court assigned legal services?	Very good.
Public Utilities - electric power; gas; water; telephone and telegraph.	Most localities levy some type of user or sales tax on public utilities. These may have a nominal tax rate of as high as 25% although upper limits often lessen the effective rate. Many state public service corporation taxes relate to gross receipts.	These services are simple to define and to collect from. A question would arise about the local taxes. If permitted to continue, taxes would be excessive. If disallowed, localities would lose revenue.	Taxing these may discriminate against the users of electricity or natural gas when the alternatives are fuel oil or bottled gas, which are subject only to the regular sales tax.	Very good if all present taxes are maintained.
Repair Services - automobile repair; battery, tire, and allied; oilers and lubricators; washing, waxing, and polishing; wrecker service; vulcanizing and retreading; boat repair; machine repair; motorcycle, scooter, and bicycle repair; motor repair; tin and sheet metal repair; roof, shingle, and glass repair; electrical repair; household appliance, television and radio repair; jewelry and watch repair; furniture, rug, upholstery repair and cleaning; office and business machine repair; swimming pool cleaning; wood preparation; welding; finishers; polishers; exterminators.	Frequently subject to local license taxes.	Repair services are fairly easy to define. Many retail dealers offer repair services so that extending coverage to these would not be extremely difficult. It might lower the compliance costs to the dealer.	Satisfactory.	Very good.
Intrastate Transportation Services - buses; taxis; trucks; trains; airplanes.	Many are taxed by the state on gross receipts.	Intrastate transportation is difficult to define and difficult for both the Department of Taxation and dealer to collect taxes on since it requires the separation of intrastate from interstate transportation.	Penalizes nonvertically integrated firms and individuals not using private transportation. Discourages public transportation which many areas have found desirable enough to subsidize.	Very good.
Miscellaneous - boarding of animals; grooming of animals; stud fees; engraving, photography, and retouching; printing and binding; refuse services; parking lots, storage warehouses and lockers.	These may be subject to license taxes in many localities.	Most of these are fairly easy to define and to administer.	Satisfactory.	Low for any one of these categories.

TABLE A.5. PROJECTED PRICE INDEXES (1975-76 = 100)

Fiscal Year	GNP Implicit Price Deflator	Implicit Price Deflator for State and Local Government Purchases of Goods and Services	Implicit Price Deflator for all Government Purchases of Buildings Except Military	Consumer Price Index	Medical Services Portion of the Consumer Price Index
1975-76	100.0	100.0	100.0	100.0	100.0
1976-77	107.0	107.8	111.4	107.7	107.1
1977-78	113.6	115.2	122.5	114.6	113.8
1978-79	119.7	122.1	133.2	121.1	120.1
1979-80	125.7	128.9	144.0	127.3	126.2
1980-81	131.7	135.9	155.1	133.4	132.4
1981-82	137.8	142.8	166.7	139.8	138.5

SOURCE: Methodology and historical data on file with the staff of the Revenue Resources and Economic Commission

TABLE A.6. ANNUAL RATE OF CHANGE (Percent)

Fiscal Year	GNP Implicit Price Deflator	Implicit Price Deflator for State and Local Government Purchases of Goods and Services	Implicit Price Deflator for all Government Purchases of Buildings Except Military	Consumer Price Index	Medical Services Portion of the Consumer Price Index
1976-77	+7.0	+7.8	+11.4	+7.7	+7.1
1977-78	+6.2	+6.9	+10.0	+6.4	+6.3
1978-79	+5.4	+6.0	+8.7	+5.7	+5.5
1979-80	+5.0	+5.6	+8.1	+5.1	+5.1
1980-81	+4.8	+5.4	+7.7	+4.8	+4.9
1981-82	+4.6	+5.1	+7.5	+4.8	+4.6

SOURCE: Table A.5.

TABLE A.7--AVERAGE NOMINAL AND AVERAGE EFFECTIVE TRUE REAL PROPERTY TAX RATES IN VIRGINIA COUNTIES AND CITIES, 1971 AND 1973

(Exclusive of Town Taxes Imposed by Incorporated Towns for Town Purposes)

COUNTY	Median Assessment Ratio		Average Nominal Tax Rate		Average Effective True Tax Rate	
	1971	1973	1971	1973	1971	1973
Accomack	18.8%	13.6%	\$2.94	\$2.94	\$0.55	\$0.40
Albemarle	12.2	8.5	5.90	5.90	.72	.45
Alleghany	16.7	15.3	4.75	4.75	.79	.73
Amelia	10.7	8.4	3.00	3.75	.32	.32
Amherst	11.9	12.2	3.18	3.35	.38	.41
Appomattox	16.0	16.4	3.00	2.90	.48	.48
Arlington	34.4	29.0	3.83	3.83	1.32	1.11
Augusta	25.6	20.9	2.60	2.60	.67	.54
Bath	22.3	12.2	3.16	3.57	.70	.44
Bedford	11.0	13.2	4.30	3.80	.47	.50
Bland	5.6	5.8	5.54	5.15	.31	.30
Botetourt	12.5	9.8	4.40	4.75	.55	.47
Brunswick	18.1	15.0	3.00	3.50	.54	.53
Buchanan	9.4	6.7	5.50	5.50	.52	.37
Buckingham	10.6	8.2	2.50	3.75	.27	.31
Campbell	15.1	18.5	3.40	3.15	.51	.58
Caroline	12.2	10.7	3.25	3.35	.40	.36
Carroll	11.1	23.3	6.50	2.20	.72	.51
Charles City	11.9	8.8	4.25	5.00	.51	.44
Charlotte	10.9	9.2	3.90	4.70	.43	.43
Chesterfield	27.9	24.8	3.10	3.10	.86	.77
Clarke	17.9	13.4	3.25	3.25	.58	.44
Craig	15.2	9.4	4.00	4.00	.61	.38
Culpeper	16.7	12.3	3.00	3.00	.50	.37
Cumberland	10.8	7.9	3.60	3.60	.39	.28
Dickenson	7.3	8.5	7.00	7.00	.51	.60
Dinwiddie	16.0	15.1	3.70	3.00	.59	.45
Essex	23.4	17.0	1.85	1.85	.43	.31
Fairfax	32.6	30.5	4.31	4.31	1.41	1.31
Fauquier	10.0	10.8	4.20	3.75	.42	.41
Floyd	12.6	6.3	4.00	5.00	.50	.32
Fluvanna	13.2	12.4	2.90	3.10	.38	.38
Franklin	9.8	9.2	4.80	4.50	.47	.41
Frederick	16.7	12.3	3.40	3.70	.57	.46
Giles	11.7	10.5	4.45	4.80	.52	.50

TABLE A.7--AVERAGE NOMINAL AND AVERAGE EFFECTIVE TRUE REAL PROPERTY TAX RATES IN VIRGINIA COUNTIES AND CITIES, 1971 AND 1973 (Cont'd.)

COUNTY	Median Assessment Ratio		Average Nominal Tax Rate		Average Effective True Tax Rate	
	1971	1973	1971	1973	1971	1973
Gloucester	21.4%	24.2%	\$2.23	\$2.07	\$0.48	\$0.50
Goochland	17.3	16.4	3.45	3.05	.60	.50
Grayson	12.2	8.7	2.79	2.79	.34	.24
Greene	13.5	15.0	4.50	4.50	.61	.68
Greensville	18.8	20.0	2.00	2.00	.38	.40
Halifax	15.4	10.0	2.85	2.85	.44	.29
Hanover	20.2	15.2	2.90	2.90	.59	.44
Henrico	33.7	29.5	2.98	3.08	1.00	.91
Henry	13.1	13.8	4.25	4.00	.56	.55
Highland	21.4	10.0	2.50	2.50	.54	.25
Isle of Wight	16.0	13.4	3.00	3.00	.48	.40
James City	23.3	17.6	4.20	4.00	.98	.70
King George	21.1	16.2	3.35	3.35	.71	.54
King & Queen	15.0	9.3	3.50	4.00	.53	.37
King William	18.0	15.3	2.85(1)	3.70(1)	.51(1)	.57(1)
Lancaster	23.2	15.4	1.80	2.70	.42	.42
Lee	7.0	6.8	10.40	10.42	.73	.71
Loudoun	27.6	26.5	2.65	3.20	.73	.85
Louisa	13.8	10.5	3.10	3.10	.43	.33
Lunenburg	15.0	12.0	4.00	4.00	.60	.48
Madison	11.1	9.1	3.90	3.90	.43	.35
Mathews	23.3	16.0	2.50	2.50	.58	.40
Mecklenburg	15.1	14.0	2.96	2.96	.45	.41
Middlesex	17.6	20.0	2.25	1.90	.40	.38
Montgomery	12.1	13.7	4.75	6.90	.57	.95
Nelson	6.8	8.5	5.00	5.00	.34	.43
New Kent	14.4	10.0	4.25	4.80	.61	.48
Northampton	14.5	15.3	4.50(2)	4.50(2)	.65(2)	.69(2)
Northumberland	24.6	14.4	2.20	2.40	.54	.35
Nottoway	19.1	15.9	3.60	3.90	.69	.62
Orange	15.7	14.3	4.45	4.45	.70	.64
Page	7.7	5.1	5.85	5.85	.45	.30
Patrick	12.3	8.9	3.50	3.50	.43	.31
Pittsylvania	26.7	20.9	2.75	2.75	.73	.57
Powhatan	22.6	16.7	3.55	3.50	.80	.58
Prince Edward	11.7	12.6	2.50	2.80	.29	.35
Prince George	24.0	20.1	2.90	2.90	.70	.58
Prince William	29.5	22.7	3.92	4.67	1.16	1.06
Pulaski	10.6	12.2	5.30	5.30	.56	.65
Rappahannock	7.8	6.5	4.10	4.10	.32	.27

TABLE A.7--AVERAGE NOMINAL AND AVERAGE EFFECTIVE TRUE REAL PROPERTY TAX RATES IN VIRGINIA COUNTIES AND CITIES, 1971 AND 1973 (Cont'd.)

COUNTY	Median Assessment Ratio		Average Nominal Tax Rate		Average Effective True Tax Rate	
	1971	1973	1971	1973	1971	1973
Richmond	21.3%	16.4%	\$2.60	\$3.00	\$0.55	\$0.49
Roanoke	30.6	24.9	2.95	2.95	.90	.73
Rockbridge	15.4	11.6	4.35	4.65	.67	.54
Rockingham	17.5	17.7	2.70	2.70	.47	.48
Russell	16.5	14.9	3.72	4.35	.61	.65
Scott	7.4	4.8	8.20	9.00	.61	.43
Shenandoah	16.7	19.0	2.20	2.20	.37	.42
Smyth	8.2	6.3	6.00	7.00	.49	.44
Southampton	14.0	15.7	4.50	4.00	.63	.63
Spotsylvania	23.2	27.7	3.30	2.30	.77	.64
Stafford	29.0	21.1	3.00	3.30	.87	.70
Surry	12.2	9.1	2.00	2.00	.24	.18
Sussex	12.0	11.3	4.00	4.00	.48	.45
Tazewell	15.1	15.5	4.67	3.40	.71	.53
Warren	9.9	8.0	3.90	3.90	.39	.31
Washington	7.7	4.4	8.80	9.20	.68	.40
Westmoreland	24.0	20.0	3.40	3.40	.82	.68
Wise	20.5	15.2	4.25	3.50	.87	.53
Wythe	13.4	10.1	4.50	4.50	.60	.45
York	17.2	16.7	4.37(3)	4.30(3)	.75(3)	.72(3)
<u>CITY</u>						
Alexandria	42.8	40.0	4.05	4.00	1.73	1.60
Bedford	53.3	42.7	1.30	1.30	.69	.56
Bristol	33.3	30.0	4.00	4.00	1.33	1.20
Buena Vista	32.2	25.9	3.60	3.85	1.16	1.00
Charlottesville	22.3	19.3	4.79	4.79	1.07	.92
Chesapeake	47.7	37.5	3.26	3.26	1.56	1.22
Clifton Forge	37.4	34.2	3.40	3.50	1.27	1.20
Colonial Heights	87.1	75.0	1.30	1.30	1.13	.98
Covington	25.4	20.3	4.15	4.15	1.05	.84
Danville	51.3	44.0	1.75	1.75	.90	.77
Emporia	46.6	34.3	1.60	1.60	.75	.55
Fairfax	40.1	34.2	3.98	3.98	1.60	1.36
Falls Church	46.3	32.3	2.85	3.00	1.32	.97
Franklin	46.4	44.0	2.30	2.30	1.07	1.01
Fredericksburg	34.9	26.9	3.20	3.20	1.12	.86

TABLE A.7--AVERAGE NOMINAL AND AVERAGE EFFECTIVE TRUE REAL PROPERTY TAX RATES IN VIRGINIA COUNTIES AND CITIES, 1971 AND 1973 (Cont'd.)

CITY	Median Assessment Ratio		Average Nominal Tax Rate		Average Effective True Tax Rate	
	1971	1973	1971	1973	1971	1973
Galax	14.2%	11.0%	\$5.75	\$5.75	\$0.82	\$0.63
Hampton	39.9	34.5	3.35	3.75	1.34	1.29
Harrisonburg	34.1	26.3	2.50	2.50	.85	.66
Hopewell	34.7	29.8	3.20	3.20	1.11	.95
Lexington	77.7	64.0	1.20	1.20	.93	.77
Lynchburg	41.6	35.8	3.00	3.00	1.25	1.07
Martinsville	52.1	48.3	1.90	1.90	.99	.92
Nansemond	17.0	12.9	5.07(4)	5.20(4)	.86(4)	.67(4)
Newport News	44.3	29.1	3.96	3.96	1.75	1.15
Norfolk	50.7	44.9	2.70	2.70	1.37	1.21
Norton	22.1	16.4	4.50	4.50	.99	.74
Petersburg	85.5	78.0	1.90	1.90	1.62	1.48
Portsmouth	62.3	52.3	2.25	2.25	1.40	1.18
Radford	36.6	30.5	2.80	2.80	1.02	.85
Richmond	87.7	81.9	2.01	2.01	1.76	1.65
Roanoke	40.0	31.4	3.45	3.45	1.38	1.08
Salem	34.7	27.5	3.25	3.25	1.13	.89
South Boston	22.0	19.4	4.80	4.80	1.06	.93
Staunton	26.0	22.8	3.20	3.60	.83	.82
Suffolk	51.1	39.8	3.10	3.10	1.58	1.23
Virginia Beach	41.1	45.5	2.09	1.55	.86	.71
Waynesboro	20.3	16.9	5.00	5.00	1.02	.85
Williamsburg	28.7	30.4	2.60	2.10	.75	.64
Winchester	39.2	30.4	2.70	2.70	1.06	.82
VIRGINIA MEDIAN	33.0%	22.5%	\$3.21	\$3.21	\$1.06	\$0.72

- (1) Applied only to real estate outside the Town of West Point.
- (2) Applies only to real estate outside the Town of Cape Charles.
- (3) Applies only to real estate outside the Town of Poquoson.
- (4) Became a city on July 1, 1972.

TABLE A.8--LOCAL INCOME TAXES, RATES AND COLLECTIONS
(Dollar amounts in thousands)

State and local government	Rate July 1, 1973 (percent)	Municipal tax collections, 1971-72 (Cities with over 50,000 population in 1970)		
		Total tax collections	Income tax collections	
			Amount	As a percent of total collections
Alabama:				
Auburn	1.0	—	—	—
Birmingham	1.0	\$28,043	\$5,527	19.7
Gadsden	2.0	5,165	2,977	57.6
Opelika	1.0	—	—	—
Rainbow City	2.0	—	—	—
Delaware:				
Wilmington	1.25	20,752	7,614	36.7
Indiana (counties):¹				
Bartholomew	1.0	—	—	—
Benton	0.5	—	—	—
Blackford	0.5	—	—	—
Brown	0.5	—	—	—
Carroll	0.5	—	—	—
Cass	0.5	—	—	—
Clinton	1.0	—	—	—
Decatur	1.0	—	—	—
DeKalb	0.5	—	—	—
Elkhart	1.0	—	—	—
Fountain	0.5	—	—	—
Hancock	1.0	—	—	—
Hendricks (eff. 1/1/74)	0.5	—	—	—
Huntington	1.0	—	—	—
Jasper	0.5	—	—	—
Johnson	0.5	—	—	—
Kosciusko	0.5	—	—	—
Lawrence	1.0	—	—	—
Marshall	1.0	—	—	—
Morgan	0.5	—	—	—
Newton (eff. 1/1/74)	0.5	—	—	—
Noble	1.0	—	—	—
Ohio	0.5	—	—	—
Randolph	0.5	—	—	—
Rush	0.75	—	—	—
Starke	0.5	—	—	—
Steuben (eff. 1/1/74)	0.5	—	—	—
Tipton	0.5	—	—	—
Union	1.0	—	—	—
Wabash	1.0	—	—	—
Washington	0.5	—	—	—
Wayne	1.0	—	—	—
Wells	0.5	—	—	—
White	1.0	—	—	—
Kentucky:				
Ashland	1.5	—	—	—
Auburn	1.0	—	—	—
Benton	0.5	—	—	—
Berea	1.5	—	—	—
Bowling Green	1.5	—	—	—
Burkesville	0.5	—	—	—
Catlettsburg	1.0	—	—	—

See footnotes at end of table.

TABLE A.8--LOCAL INCOME TAXES, RATES AND COLLECTIONS (continued)
(Dollar amounts in thousands)

State and local government	Rate July 1, 1973 (percent)	Municipal tax collections, 1971-72 (Cities with over 50,000 population in 1970)		
		Total tax collections	Income tax collections	
			Amount	As a percent of total collections
Kentucky (Continued)				
Covington	2.5	\$4,754	\$2,682	56.4
Cynthiana	1.5	--	--	--
Danville	1.0	--	--	--
Dawson Springs	1.0	--	--	--
Elizabethtown	0.8	--	--	--
Flemingsburg	1.0	--	--	--
Frankfort	1.0	--	--	--
Fulton	1.0	--	--	--
Gamaliel	1.0	--	--	--
Glasgow	1.0	--	--	--
Hazard	1.0	--	--	--
Hickman	1.0	--	--	--
Hopkinsville	1.0	--	--	--
Leitchfield	1.0	--	--	--
Lexington	2.0	13,925	7,778	55.9
Louisville	1.25	38,333	21,312	55.6
Jefferson County ²	2.0	--	--	--
Ludlow	1.0	--	--	--
Marshall County	0.5	--	--	--
Mayfield	1.0	--	--	--
Maysville	1.5	--	--	--
Middlesboro	1.0	--	--	--
Morgantown	1.0	--	--	--
Newport	2.0	--	--	--
Owensboro	1.0	2,885	1,375	47.7
Paducah	1.25	--	--	--
Pikeville	1.5	--	--	--
Prestonsburg	1.0	--	--	--
Princeton	1.0	--	--	--
Richmond	1.0	--	--	--
Russellville	1.0	--	--	--
Springfield	1.0	--	--	--
Versailles	1.0	--	--	--
Wilder	0.25	--	--	--
Woodford County	0.5	--	--	--
Maryland:				
	% of State tax			
Baltimore City	50	\$229,285	\$32,550	14.2
20 Counties	50	--	--	--
Queen Anne's County	40	--	--	--
Talbot County	35	--	--	--
Worcester County	20	--	--	--
Michigan:³				
Albion	1.0	--	--	--
Battle Creek	1.0	--	--	--
Big Rapids	1.0	--	--	--
Detroit	2.0 ⁴	268,924	94,473	35.1
Flint	1.0	18,884	10,778	57.1
Grand Rapids	1.0	16,484	7,727	46.9
Grayling	1.0	--	--	--
Hamtramck	1.0	--	--	--
Highland Park	1.0	--	--	--

See footnotes at end of table.

TABLE A.8--LOCAL INCOME TAXES, RATES AND COLLECTIONS (continued)
(Dollar amounts in thousands)

State and local government	Rate July 1, 1973 (percent)	Municipal tax collections, 1971-72 (Cities with over 50,000 population in 1970)		
		Total tax collections	Income tax collections	
			Amount	As a percent of total collections
Michigan (Continued): ³				
Hudson	1.0	—	—	—
Jackson	1.0	—	—	—
Lansing	1.0	\$14,859	\$6,120	41.2
Lapeer	1.0	—	—	—
Pontiac	1.0	11,991	4,322	36.0
Port Huron	1.0	—	—	—
Saginaw	1.0	10,212	3,501	34.3
Missouri:				
Kansas City	1.0	78,610	29,106	37.0
St. Louis	1.0	125,035	36,784	29.4
New York:				
New York City	0.7-3.5 ⁵	3,830,557	805,578	21.0
Ohio:				
Akron	1.5	26,440	17,478	66.1
Canton	1.5	9,770	7,814	80.0
Cincinnati	2.0	75,528	43,608	57.7
Cleveland	1.0	81,181	38,807	47.8
Cleveland Heights	1.0	5,025	1,299	25.9
Columbus	1.5	45,024	35,195	78.2
Dayton	1.0	27,344	15,662	57.3
Elyria	1.0	3,413	1,808	53.0
Euclid	1.0	8,240	3,278	39.8
Hamilton	1.5	5,002	3,703	74.0
Kettering	1.0	4,437	2,304	51.9
Lakewood	1.0	5,295	1,518	28.7
Lima	1.0	2,872	2,106	73.3
Lorain	1.0	6,712	3,418	50.9
Mansfield	1.0	4,350	3,053	70.2
Parma	1.0	6,126	3,484	56.9
Springfield	1.5	5,886	4,736	80.5
Toledo	1.5	33,363	25,002	74.9
Warren	1.0	3,507	2,693	76.8
Youngstown	1.5	13,925	9,299	66.8
315 cities and villages (with less than 50,000 population)	0.25-1.7	—	—	—
Pennsylvania: ⁶				
Abington Township	1.0 ⁷	3,692	n.a.	n.a.
Allentown	1.0 ⁷	9,082	1,941	21.4
Altoona	1.0 ⁸	3,246	745	23.0
Bethlehem	1.0 ⁷	6,342	1,657	26.1
Chester	1.0 ⁹	4,523	2,116	46.8
Erie	1.0 ⁷	9,597	1,655	17.2
Harrisburg	1.0 ⁷	5,927	978	16.5
Lancaster	1.0 ⁷	4,578	694	15.2
Penn Hills Township	1.0 ⁷	2,943	925	31.4
Philadelphia	3.3125 ¹⁰	410,362	256,738	62.6
Pittsburgh	1.0 ¹¹	77,281	13,028	16.9
Reading	1.0 ⁷	6,312	1,530	24.2
Scranton	1.0 ^{7,12}	7,825	2,128	27.2

See footnotes at end of table.

TABLE A.8--LOCAL INCOME TAXES, RATES AND COLLECTIONS (continued)
(Dollar amounts in thousands)

State and local government	Rate July 1, 1973 (percent)	Municipal tax collections, 1971-72 (Cities with over 50,000 population in 1970)		
		Total tax collections	Income tax collections	
			Amount	As a percent of total collections
Pennsylvania: ⁶ (Continued)				
Wilkes-Barre	0.5 ⁷	\$4,291	\$630	14.7
York	1.0 ⁷	4,157	556	13.4
Approx. 3,750 other local jurisdictions (including over 1,000 school systems)	0.25-1.0	--	--	--

Note: Excludes Washington, D.C. which has a graduated net income tax that is more closely akin to a State tax than to the municipal income taxes (see table 141). Also excludes the Denver Employee Occupational Privilege Tax of \$2 per employee per month, which applies only to employees earning at least \$250 per month; the Newark 1% payroll tax imposed on employees, profit and nonprofit, having a payroll over \$2,500 per calendar quarter; the San Francisco 1% payroll expense tax (eff. 10/1/70); the 1/2 of 1% quarterly payroll tax on employers imposed in the Tri-county Metropolitan Transit District (encompassing all of Washington, Clackamas and Multnomah counties, Oregon); and the 1/4 of 1 percent payroll tax imposed on employers in the Lane County Oregon Mass Transit District.

-- Signifies a county, or a city under 50,000 population.
n.a. "not available."

- ¹ The tax rate on nonresidents for all counties is 1/4 of 1%.
- ² A taxpayer subject to the 1.25 percent tax imposed by the City of Louisville may credit this tax against the 2.0 percent levied by Jefferson County.
- ³ Under the Michigan "Uniform City Income Tax Act," the prescribed rates are 1.0 percent for residents and 0.5 percent for nonresidents. A resident is allowed credit for taxes paid to another city as a nonresident.
- ⁴ The rate for residents in Detroit was increased from 1 percent to 2 percent effective October 1, 1968.
- ⁵ New York City residents' rate ranges from 0.7 percent on taxable income of less than \$1,000 to 3.5 percent on taxable income in excess of \$30,000. An earnings tax of 0.45 percent of wages or 65/100 of 1 percent on net earnings from self-employment, not to exceed that which would be due if taxpayer were a resident, is levied against nonresidents. A 4% tax is imposed on unincorporated businesses carried on in the city.
- ⁶ Except for Philadelphia, Pittsburgh, and Scranton, the total rate payable by any taxpayer is limited to 1 percent. For coterminous jurisdictions, such as borough and borough school district, the maximum is usually divided equally between the jurisdictions unless otherwise agreed. However, school districts may tax only residents. Thus, if a borough and a coterminous school district each have a stated rate of 1 percent, the total effective rate for residents is 1 percent (1/2 of 1 percent each to the borough and school district) and the tax on nonresidents is 1 percent, the stated rate imposed by the borough.
- ⁷ The school district rate is the same as the municipal rate.
- ⁸ The school district rate is 0.5 percent.
- ⁹ There is no school district income tax.
- ¹⁰ The Philadelphia school district imposes a 2% tax on investment income.
- ¹¹ School district rate. The Pittsburgh city income tax was repealed effective January 1, 1973.
- ¹² Combined city and school district rate may not exceed 2.0 percent.

SOURCE: Commerce Clearing House, State Tax Reporter, as shown in Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism, 1973-74, (Washington: Government Printing Office, 1974), pp. 291-294.

TABLE A.9.--CONSUMER UTILITY TAX RATES IN VIRGINIA CITIES, COUNTIES, AND TOWNS
MARCH, 1975

Virginia Cities	Date Tax First Imposed	Rate	Revisions in Original Ordinances		Present Rate
			Date	Changes	
City of Alexandria	October 1, 1954	10% First \$50	July 1, 1962	- Rate on Residential changed to 10% all from 10% First \$50 Rate on Commercial and Industrial changed to 10% First \$100 from 10% First \$50.	16% First \$15 Residential 16% First \$150 Commercial and Industrial
			August 1, 1962	- Rate on Residential Electric changed from 10% All to 10% First \$10	
			July 1, 1968	- Rate increased to 16%	
			July 1, 1971	- Ceiling increased to \$15 Residential Ceiling increased to \$150 Commercial and Industrial	
City of Buena Vista	April 1, 1957	20% First \$5 (Except Manufacturers) 20% First \$25 (Manufacturers holding city license)	None		20% First \$5 (Except Manufacturers) 20% First \$25 (Manufacturers holding city license) Exclude bills submitted for watchlights.
City of Charlottesville	July 1, 1948	5% First \$3,000 2% Excess \$3,000	July 1, 1972	- Rate changed to 10% First \$3,000 and 4% excess from 5% First \$3,000 and 2% excess	10% First \$3,000 4% Excess \$3,000
City of Chesapeake (See Page 12 for South Norfolk ordinances)	January 2, 1963	10% First \$7.50 Gas 10% First \$15 Residential Electric 10% First \$450 Commercial & Industrial Electric Exclude residential electric service for water heating billed under the water heating schedule where a separate meter is used and on bills submitted for residential unmetered electric service.	July 1, 1964	- Rate increased to 15% (Gas and Electric)	25% First \$7.50 Gas 25% First \$15 Residential Electric 25% First \$450 Commercial & Industrial Electric
			July 1, 1971	- Rate increased to 25% (Gas and Electric)	Exclude residential electric service for water heating billed under the water heating schedule where a separate meter is used and on bills submitted for residential unmetered electric service.
City of Clifton Forge	June 1, 1970	10% First \$10 Residential 10% First \$100 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on bills submitted for unmetered electric service. Exclude tax on bills submitted for sales for resale.	August 1, 1971	- Rate on Residential changed to 15% First \$15 from 10% first \$10 - Rate on Commercial and Industrial changed to 15% First \$125 from 10% first \$100	15% First \$15 Residential 15% First \$125 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on bills submitted for unmetered electric service. Exclude tax on bills submitted for sales for resale.
City of Colonial Heights	July 1, 1959	5% First \$10 Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.	July 1, 1972	- Rate changed to 10% First \$10 from 5% first \$10	10% First \$10 Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.
City of Covington	January 1, 1957	5% First \$100	July 1, 1958	- Rate changed to 5% First \$7,000 from 5% First \$100 Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.	10% First \$100 Residential 10% First \$5,000 Commercial and Industrial; 5% on the amount between \$5,000 and \$10,000; 2% on the amount between \$10,000 and \$50,000; 1/2 of 1% on all sums in excess of \$50,000. Exclude electric service for water heating billed on an off-peak water heater schedule where a separate meter is used.
			July 1, 1971	- Rate changed to 10% Residential and Commercial and Industrial Ceilings changed from \$7,000 all to \$100 Residential and \$7,000 Commercial and Industrial	
			January 1, 1975	- Ceiling on Commercial and Industrial decreased from \$7,000 to \$5,000 plus 5% on amount between \$5,000 and \$10,000; 2% on amount between \$10,000 and \$50,000; and 1/2 of 1% on all sums in excess of \$50,000.	

<u>Virginia</u>						
<u>Cities</u>	<u>Date Tax First Imposed</u>	<u>Rate</u>	<u>Date</u>	<u>Revisions in Original Ordinances Changes</u>	<u>Present Rate</u>	
City of Emporia	July 1, 1959	5% First \$10 Residential 5% First \$100 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.	July 1, 1970	- Rate increased to 10%	10% First \$10 Residential 10% First \$100 Commercial & Industrial Exclude electric service for water heating billed on off-peak water heating schedule where a separate meter is used.	
City of Fairfax	July 1, 1963	10% First \$10 Residential 10% First \$25 Commercial & Industrial Exclude bills submitted for unmetered service.	None		10% First \$10 Residential 10% First \$25 Commercial & Industrial Exclude bills submitted for unmetered service.	
City of Falls Church	July 1, 1954	10% First \$50	None		10% First \$50	
City of Franklin	July 1, 1969	10% First \$15 Residential 10% First \$1,000 Commercial & Industrial	None		10% First \$15 Residential 10% First \$1,000 Commercial & Industrial	
City of Fredericksburg	September 1, 1968	5% First \$10 Residential 5% First \$100 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used; on separately metered space heating and on unmetered electric service.	September 1, 1970	- Rate increased to 10%	10% First \$10 Residential 10% First \$100 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used; on separately metered space heating and on unmetered electric service.	
City of Hampton	July 1, 1959	10% First \$6 Gas 10% First \$12 Electric Exclude electric service for water heating billed under the water heating schedule where a separate meter is used	July 1, 1961	- Rate increased to 15% (Gas and Electric)	22% First \$12 Residential Electric 22% First \$100 Commercial & Industrial 22% First \$4 all Gas Customers	
			July 1, 1964	- Rate on Residential Electric changed to 20% First \$15 from 15% First \$12. Rate on Commercial & Industrial Electric changed to 10% First \$500 from 15% First \$12. Rate on Gas changed to 20% First \$5 from 15% First \$6.	Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.	
			July 1, 1965	- Rate on Residential Electric changed to 18% First \$21 from 20% First \$15 Rate on Gas changed to 15% First \$4 from 20% First \$5.		
			July 1, 1971	- Rate increased to 22% (Gas and Electric) Ceiling decreased to \$100 Commercial and Industrial.		

<u>Virginia</u>		<u>Revisions in Original Ordinances</u>			<u>Present Rate</u>
<u>Cities</u>	<u>Date Tax First Imposed</u>	<u>Rate</u>	<u>Date</u>	<u>Changes</u>	
City of Hopewell	May 1, 1962	10% First \$10 Residential 10% First \$25 Commercial 10% First \$2,500 Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on bills submitted for unmetered service.	July 1, 1974	- Rate increased to 20%	20% First \$10 Residential 20% First \$25 Commercial 20% First \$2,500 Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used, and on bills submitted for unmetered service.
City of Lexington	July 1, 1968	20% First \$10 Residential 20% First \$50 Commercial & Industrial Exclude bills submitted for unmetered service.	None		20% First \$10 Residential 20% First \$50 Commercial & Industrial Exclude bills submitted for unmetered service.
City of Newport News	January 1, 1959	4% First \$6 Gas 4% First \$12 Residential Electric 4% First \$100 Commercial & Industrial Electric Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.	January 1, 1963	- Rate increased to 10% (Gas and Electric)	22% First \$6.60 Gas 22% First \$13.20 Residential Electric
			July 1, 1969	- Rate on Residential electric changed to 11% First \$13.20 from 10% First \$12 Rate on Commercial & Industrial electric changed to 11% First \$110 from 10% First \$100 Rate on Gas changed to 11% First \$6.60 from 10% First \$6	22% First \$110 Commercial & Industrial Electric Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.
			July 1, 1970	- Rate increased to 22%	
City of Norfolk	February 1, 1948	8% (Gas and Electric)	February 1, 1951	- Rate increased to 10% (Gas and Electric)	25% First \$15 Residential Electric (Single Meter) 25% First \$50 Commercial & Industrial Electric; 15% excess
			February 1, 1953	- Rate on Gas reduced to 10% on First \$5	25% First \$6 Residential Gas (Single Meter)
			February 1, 1955	- Rate on Residential Electric changed to 10% First \$12 from 10% all and 10% on water heating service imposed Rate on Gas changed to 10% First \$6 from 10% First \$5	25% First \$2,000 Commercial & Industrial Gas (Single Meter)
			November 1, 1956	- Rate on Commercial and Industrial Gas changed to 10% all from 10% First \$6	
			February 1, 1957	- Rate on Commercial and Industrial Gas changed from 10% all to 10% First \$6	
			February 1, 1959	- Rate increased to 15% (Gas and Electric)	
			July 1, 1969	- Rate increased to 20% (Gas and Electric)	
			July 1, 1970	- Rate increased to 25% (Gas and Electric)	
			July 1, 1971	- Ceiling increased to \$15 Residential - Electric Ceiling increased to \$2,000 Commercial & Industrial - Gas	
			February 11, 1975	- Ceiling decreased on Commercial and Industrial Electric to \$50 plus 15% of excess	

Virginia

<u>Cities</u>	<u>First Imposed</u>	<u>Rate</u>	<u>Date</u>	<u>Revisions in Original Ordinances</u> <u>Changes</u>	<u>Present Rate</u>
City of Petersburg	January 15, 1948	5%	February 1, 1952	- Rate increased to 8%	15% First \$12 Residential 15% First \$500 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on bills submitted for watchlights.
			February 1, 1959	- Rate on Residential Electric changed to 10% First \$12 from 8% all Rate on Commercial and Industrial Electric changed to 10% First \$5,000 from 8% all Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.	
			August 1, 1960	- Rate on Residential Electric changed to 15% First \$12 from 10% First \$12 Rate on Commercial and Industrial Electric changed to 15% First \$500 from 10% First \$5,000 Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.	
			April 2, 1963	- Excluded revenues from watchlights	
			June 1, 1959	- Rate on Residential Electric changed to 15% First \$12 Rate on Electric Service other than Residential changed to 15% First \$200 Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.	
City of Portsmouth	May 1, 1949	10% First \$100 5% Next \$200 1% Excess \$300	July 1, 1967	- Rate on Residential Electric changed to 20% First \$12 Rate on Commercial & Industrial changed to 20% First \$200	20% First \$17 Residential 20% First \$1,000 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.
			July 1, 1970	- Ceilings increased to \$17 Residential Ceilings increased to \$1,000 Commercial & Industrial	

Virginia

<u>Cities</u>	<u>Date Tax First Imposed</u>	<u>Rate</u>	<u>Revisions in Original Ordinances</u>		<u>Present Rate</u>
			<u>Date</u>	<u>Changes</u>	
City of Richmond	February 1, 1947	5%	July 1, 1959	- Rate changed from 5% all to 10% First \$12 Residential 10% First \$12 on Water Heating Service Imposed. 10% First \$300 Commercial & Industrial plus 5% Excess \$300 Commercial & Industrial	25% First \$20 Residential 25% First \$625 Commercial and Industrial 5% Excess \$625 Commercial and Industrial
			June 1, 1962	- Rate changed from 10% First \$12 Residential to 13% First \$12 Residential of Metered Electricity Service. Rate changed from 10% First \$300 Commercial & Industrial plus 5% Excess \$300 Commercial and Industrial to 13% First \$500 Commercial and Industrial plus 5% Excess \$500 Commercial and Industrial.	
			June 1, 1968	- Rate increased to 15%	
			June 1, 1969	- Rate changed from 15% First \$12 metered residential to 18% First \$16 metered residential. Rate changed from 15% First \$12 water heating service (separate meter) to 18% First \$16 water heating service (separate meter). Rate changed from 15% First \$500 metered Commercial & Industrial to 18% First \$625 metered Commercial & Industrial. Ceiling on 5% excess metered Commercial & Industrial changed from \$500 to \$625.	
			June 1, 1970	- Rate changed from 18% First \$16 metered residential and 18% First \$16 water heating service (separate meter) to 23% First \$20. Rate changed from 18% First \$625 metered Commercial and Industrial to 23% First \$625.	
			June 1, 1971	- Rate increased to 25%	
City of South Boston	September 1, 1952	5%	September 1, 1967	- Rate changed from 5% all to 10% First \$15 Residential 10% First \$1,000 Commercial and Industrial. Exclude bills submitted for unmetered electric service.	10% First \$15 Residential 10% First \$1,000 Commercial and Industrial Exclude bills submitted for unmetered electric service.

<u>Virginia</u>		<u>Revisions in Original Ordinances</u>			
<u>Cities</u>	<u>Date Tax First Imposed</u>	<u>Rate</u>	<u>Date</u>	<u>Changes</u>	<u>Present Rate</u>
City of Staunton	July 1, 1957	10% First \$10 Residential 10% First \$100 Commercial & Industrial Exclude electric service for water heating billed under water heating schedule where a separate meter is used.	February 1, 1959 January 1, 1963 January 1, 1968 December 1, 1973 July 1, 1974	- Rate increased to 15% - Rate increased to 20%; ordinance expiration date January 30, 1962 extended to December 31, 1967 - Ordinance expiration date extended to December 31, 1973 - Ordinance expiration date extended to December 31, 1974 - Ordinance expiration date extended to December 31, 1975	20% First \$10 Residential 20% First \$100 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.
City of Suffolk	January 1, 1974	10% First \$15 Residential 10% First \$10,000 Commercial & Industrial	NONE		10% First \$15 Residential 10% First \$10,000 Commercial & Industrial Excludes tax on bills submitted for sales for resale.
City of Virginia Beach	February 1, 1957	10% First \$12 Residential 10% Water Heating Service (Separate Meter) 6% Commercial (Applied to city limits of old city)	January 1, 1963 July 1, 1967 June 1, 1969 June 1, 1971	- 10% First \$6 Gas 10% First \$12 Residential Electric 6% Commercial Electric Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on bills submitted for watchlights. - Rate changed from 10% First \$12 Residential Electric to 15% Rate changed from 6% Commercial Electric to 9% First \$400 Commercial & Industrial Rate changed from 10% First \$6 Gas to 15% - Rate increased to 20% Electric Residential Rate increased to 12% Electric Commercial & Industrial. Rate increased to 20% Gas. - Rate decreased to 12% - Gas Commercial and Industrial Ceiling increased to \$400 - Gas Commercial and Industrial	20% First \$12 Residential Electric 12% First \$400 Commercial & Industrial Electric 20% First \$12 Residential Gas 12% First \$400 Commercial and Industrial - Gas Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on bills submitted for watch lights.
City of Waynesboro	July 1, 1954	10% First \$100	January 1, 1957	- Rate increased to 15%	15% First \$100
City of Williamsburg	July 1, 1958	5% First \$10 Residential 5% First \$200 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.	July 1, 1960	- Rate increased to 10%	10% First \$10 Residential Electric 10% First \$200 Commercial & Industrial Electric 10% First \$10 Residential Gas 10% First \$200 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.

<u>Counties</u>	<u>First Imposed</u>	<u>Rate</u>	<u>Date</u>	<u>Changes</u>	<u>Present Rate</u>
County of Alcorn	July 1, 1966	5% First \$20 Residential 5% First \$1,500 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.	July 1, 1967	- Rate on Residential changed from 5% First \$20 to 10% First \$20 Rate on Commercial & Industrial changed from 5% First \$1,500 to 10% First \$2,000	20% First \$20 Residential 10% First \$3,000 Commercial & Industrial 2% Excess \$3,000 Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.
			July 1, 1968	- Rate on Residential changed from 10% First \$20 to 20% First \$20 Ceiling on Commercial & Industrial increased from \$2,000 to \$3,000 plus 2% excess \$3,000.	
County of Arlington	June 1, 1968	14%	December 1, 1968	- Rate changed on residential to 4% First \$5; 10% next \$10; 4% excess \$15 from 14% all	Effective August 31, 1969 the tax was rescinded.
County of Augusta	July 1, 1968	15% First \$10 Residential 15% First \$100 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.	None		15% First \$10 Residential 15% First \$100 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used.
County of Brunswick	July 1, 1972	10% First \$10 Residential 10% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes unmetered services and sales for resale.	None		10% First \$10 Residential 10% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes unmetered services and sales for resale.
County of Caroline	June 15, 1974	20% First \$15 Residential 20% First \$50 Commercial and Industrial Excludes electric service for water heating and space heating where separate meter is used and bills submitted for sale for resale.	None		20% First \$15 Residential 20% First \$50 Commercial and Industrial Excludes electric service for water heating and space heating where separate meter is used and bills submitted for sale for resale.
County of Charles City	August 1, 1970	10% First \$10 Residential 10% First \$100 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on separately metered space heating. Also on unmetered electric service. Exclude bills submitted for sales for resale.	None		10% First \$10 Residential 10% First \$100 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on separately metered space heating. Also on unmetered electric service. Exclude bills submitted for sales for resale.
County of Clarke	June 1, 1968	5% First \$10 Residential 5% First \$100 Commercial & Industrial	July 1, 1970	- Rate increased from 5% to 10% Ceiling decreased from \$100 to \$75 Commercial & Industrial	10% First \$10 Residential 10% First \$75 Commercial & Industrial
County of Dinwiddie	July 1, 1968	10% First \$10 Residential 10% First \$100 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on separately metered space heating. Also on unmetered electric service. Exclude tax on bills submitted for sales for resale.	None		10% First \$10 Residential 10% First \$100 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on separately metered space heating. Also on unmetered electric service. Exclude tax on bills submitted for sales for resale.
County of Fairfax	August 1, 1966	10% First \$10 Residential 10% First \$100 Commercial or Industrial	July 1, 1971	- Ceiling increased to \$50 Residential Ceiling increased to \$600 Commercial and Industrial - Rate increased to 14.6%	8% First \$50 Residential 8% First \$1,600 Commercial and Industrial
			July 1, 1974	- Ceiling on Commercial & Industrial increased to \$900	
			November 5, 1974	- Rate decreased from 14.6% to 8%.	
			December 17, 1974	- Ceiling increased from \$900 to \$1,600 Commercial and Industrial.	
County of Fauquier	August 1, 1973	15% First \$10 Residential 15% First \$100 Commercial & Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes unmetered services and sales for resale.	None		15% First \$10 Residential 15% First \$100 Commercial & Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes unmetered services and sales for resale.
County of Gloucester	August 1, 1970	10% First \$10 Residential 5% First \$100 Commercial & Industrial Exclude tax on bills submitted for sales for resale.	None		10% First \$10 Residential 5% First \$100 Commercial & Industrial Exclude tax on bills submitted for sales for resale.

<u>Virginia</u>	<u>Date Tax</u>	<u>Rate</u>	<u>Revisions in Original Ordinances</u>	<u>Changes</u>	<u>Present Rate</u>
<u>Counties</u>	<u>First Imposed</u>		<u>Date</u>		
County of Goochland	August 1, 1969	6% First \$10 Residential 6% First \$25 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on separately metered space heating. Also on un-metered electric service. Exclude tax on bills submitted for sales for resale.	July 1, 1971	- Rate increased to 10%	10% First \$10 Residential 10% First \$25 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on separately metered space heating. Also on un-metered electric service. Exclude tax on bills submitted for sales for resale.
County of Greene	July 1, 1972	15% First \$15 Residential 15% First \$50 Commercial and Industrial	None		15% First \$15 Residential 15% First \$50 Commercial and Industrial
County of Halifax	July 1, 1970	10% First \$10 Residential 10% First \$100 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on separately metered space heating. Also on un-metered electric service and sales for resale.	July 1, 1972	- Rate on Residential changed from 10% First \$10 to 20% First \$10 Rate on Commercial and Industrial changed from 10% First \$100 to 20% First \$100 plus 1% excess \$100	20% First \$10 Residential 20% First \$100 Commercial & Industrial 1% Excess \$100 Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on separately metered space heating. Also on un-metered electric service and sales for resale.
County of Henrico	May 15, 1971	10% First \$10 Residential 10% First \$100 Commercial & Industrial Exclude sales to public service corporations or municipalities for resale. Also on un-metered services, watchlights and facilities charges.	None		10% First \$10 Residential 10% First \$100 Commercial & Industrial Exclude sales to public service corporations or municipalities for resale. Also on un-metered services, watchlights and facilities charges.
County of King George	September 1, 1970	10% First \$10 Residential 10% First \$100 Commercial & Industrial Exclude electric service for water heating and space heating where a separate meter is used or sales for resale.	None		10% First \$10 Residential 10% First \$100 Commercial & Industrial Exclude electric service for water heating and space heating where a separate meter is used or sales for resale.
County of Loudoun	June 1, 1971	10% First \$30 Residential 10% First \$300 Commercial & Industrial	November 5, 1974	- Rate decreased to 9%	9% First \$30 Residential 9% First \$300 Commercial & Industrial
County of Madison	September 15, 1972	10% First \$10 Residential 10% First \$100 Commercial & Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes un-metered services and sales for resale.	None		10% First \$10 Residential 10% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes un-metered services and sales for resale.
County of Nelson	July 1, 1960	20% First \$10 Exclude tax on bills for sales for resale.	None		20% First \$10 Exclude tax on bills for sales for resale.
County of Powhatan	July 1, 1972	10% First \$10 Residential 10% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes un-metered services and sales for resale.	None		10% First \$10 Residential 10% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes un-metered services and sales for resale.
County of Prince William	September 1, 1966	10% First \$10 Exclude bills submitted for un-metered service	August 1, 1968 July 1, 1969 November 1, 1972 July 1, 1974	- Rate changed to 15% First \$13.35 - Ceiling increased to \$20 Residential Ceiling increased to \$60 Commercial & Industrial - Rate on Commercial and Industrial changed from 15% to 20% with no ceiling - Ceiling on Residential decreased from \$20 to \$15 Rate on Commercial and Industrial decreased from 20% to 15%	15% First \$15 Residential 15% Commercial and Industrial - No ceiling Exclude bills submitted for un-metered service.
County of Rockingham	September 15, 1972	15% First \$10 Residential 15% First \$100 Commercial and Industrial Excludes sales for resale	None		15% First \$10 Residential 15% First \$100 Commercial and Industrial Excludes sales for resale
County of Stafford	August 1, 1972	10% First \$10 Residential 10% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes sales for resale.	None		10% First \$10 Residential 10% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes sales for resale.

Virginia Towns	Date Tax First Imposed	Rate	Revisions in Original Ordinances		Present Rate
			Date	Changes	
Town of Bridgewater	September 1, 1969	10% First \$10 Residential 10% First \$300 Commercial and Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on separately metered space heating and unmetered electric service. Also on sales for resale.	January 1, 1972	- Rate increased from 10% to 15% Commercial and Industrial Ceiling increased from \$10 to \$15 Residential Ceiling increased from \$300 to \$500 Commercial and Industrial	10% First \$15 Residential 15% First \$500 Commercial and Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on separately metered space heating and unmetered electric service. Also on sales for resale.
Town of Broadway	January 1, 1970	10% First \$10 Residential 10% First \$100 Commercial and Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on separately metered space heating and unmetered electric service. Also on sales for resale.	September 1, 1972	- Rate on Residential changed from 10% First \$10 to 15% First \$10 Rate on Commercial and Industrial changed from 10% First \$100 to 15% First \$100	15% First \$10 Residential 15% First \$100 Commercial and Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on separately metered space heating and unmetered electric service. Also on sales for resale.
Town of Clover	September 1, 1973	20% First \$10 Residential 20% First \$100 Commercial & Industrial 1% Excess \$100 Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on separately metered space heating. Also on unmetered electric service and sales for resale.	None		20% First \$10 Residential 20% First \$100 Commercial & Industrial 1% Excess \$100 Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on separately metered space heating. Also on unmetered electric service and sales for resale.
Town of Craigsville	July 1, 1968	15% First \$10 Residential 15% First \$100 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on bills submitted for unmetered electric service.	None		15% First \$10 Residential 15% First \$100 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and on bills submitted for unmetered electric service.
Town of Crewe	November 4, 1974	15% First \$15 Residential 15% First \$200 Commercial and Industrial Exclude electric service for water heating or space heating where a separate meter is used and on unmetered electric service. Also on sales for resale.	None		15% First \$15 Residential 15% First \$200 Commercial and Industrial Exclude electric service for water heating or space heating where a separate meter is used and on unmetered electric service. Also on sales for resale.
Town of Dayton	July 22, 1972	15% First \$10 Residential 15% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes unmetered services and sales for resale.	None		15% First \$10 Residential 15% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes unmetered services and sales for resale.
Town of Dumfries	August 1, 1971	15% First \$20 Residential 15% First \$60 Commercial & Industrial Exclude bills submitted for unmetered electric service.	None		15% First \$20 Residential 15% First \$60 Commercial & Industrial Exclude bills submitted for unmetered electric service.
Town of Farnville	September 1, 1967	10% First \$10 Residential 10% First \$200 Commercial & Industrial Exclude bills submitted for unmetered electric service.	August 1, 1972	- Rate on Residential changed from 10% First \$10 to 15% First \$10 Rate on Commercial and Industrial changed from 10% First \$200 to 15% First \$200	15% First \$10 Residential 15% First \$200 Commercial & Industrial Exclude bills submitted for unmetered electric service.
Town of Grottoes	August 22, 1972	10% First \$10 Residential 10% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes unmetered services and sales for resale.	None		10% First \$10 Residential 10% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes unmetered services and sales for resale.
Town of Halifax	April 1, 1972	10% First \$10 Residential 10% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes unmetered services and sales for resale.	October 1, 1972	- Rate increased to 20%; plus 1% excess \$100 Commercial and Industrial	20% First \$10 Residential 20% First \$100 Commercial and Industrial, Plus 1% Excess \$100 Excludes electric service for water heating and space heating where a separate meter is used. Excludes unmetered services and sales for resale.
Town of Herndon	August 1, 1966	10% First \$10 Residential 10% First \$100 Commercial & Industrial	September 1, 1969	- Ceiling increased to \$15 Residential Ceiling increased to \$150 Commercial & Industrial	10% First \$15 Residential 10% First \$150 Commercial & Industrial
Town of La Crosse	March 1, 1973	10% First \$15 Residential 10% First \$100 Commercial and Industrial	None		10% First \$15 Residential 10% First \$100 Commercial and Industrial

<u>Virginia</u>		<u>Revisions in Original Ordinances</u>				
<u>Towns</u>	<u>Date Tax First Imposed</u>	<u>Rate</u>	<u>Date</u>	<u>Changes</u>	<u>Present Rate</u>	
Town of Manassas	March 1, 1966	2%	October 1, 1970	- Rate increased to 7%	20% First \$15 Residential 20% First \$500 Commercial and Industrial	
			May 1, 1971	- Rate on Residential decreased to 2% Rate on Commercial and Industrial decreased to 5% Established \$1,000 Ceiling on Commercial and Industrial		
			July 1, 1972	- Rate on Residential increased from 2% to 5% Rate on Commercial and Industrial increased from 5% to 10% Ceiling on Commercial and Industrial decreased to \$500		
			July 1, 1974	- Rate on Residential changed from 5% No ceiling to 20% first \$15. Rate on Commercial and Industrial increased from 10% to 20%		
Town of Mt. Crawford	July 22, 1972	15% First \$10 Residential 15% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes unmetered services and sales for resale.	None		15% First \$10 Residential 15% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes unmetered services and sales for resale.	
Town of Orange	October 1, 1970	10% First \$10 Residential 10% First \$100 Commercial and Industrial	July 1, 1972	- Rate on Residential changed from 10% to 20% Rate on Commercial and Industrial changed from 10% to 20%	20% First \$10 Residential 20% First \$100 Commercial and Industrial	
Town of Poquoson	July 1, 1972	10% First \$15 Residential 10% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes unmetered services and sales for resale.	None		10% First \$15 Residential 10% First \$100 Commercial and Industrial Excludes electric service for water heating and space heating where a separate meter is used. Excludes unmetered services and sales for resale.	
Town of Quantico	August 1, 1966	10% First \$10 Residential 10% First \$20 Commercial and Industrial	March 15, 1972	- Rate on Residential changed from 10% to 15% Rate on Commercial and Industrial changed from 10% to 15%	15% First \$10 Residential 15% First \$20 Commercial and Industrial	
Town of South Hill	October 1, 1971	10% First \$15 Residential 10% First \$100 Commercial and Industrial	None		10% First \$15 Residential 10% First \$100 Commercial and Industrial	
Town of Timberville	September 1, 1972	15% First \$10 Residential 15% First \$100 Commercial and Industrial Excludes sales for resale	None		15% First \$10 Residential 15% First \$100 Commercial and Industrial Excludes sales for resale	
Town of Victoria	December 1, 1971	10% First \$15 Residential 10% First \$200 Commercial and Industrial Excludes bills submitted for unmetered service	February 1, 1974	- Rate increased to 15%	15% First \$15 Residential 15% First \$200 Commercial and Industrial Excludes bills submitted for unmetered service	
Town of Vienna	October 1, 1964	5% First \$10 Residential 5% First \$25 Commercial & Industrial Excludes bills submitted for unmetered electric service.	August 1, 1970	- Rate on Residential changed from 5% First \$10 to 10% First \$25 Rate on Commercial & Industrial changed from 5% First \$25 to 10% First \$300	10% First \$25 Residential 10% First \$300 Commercial & Industrial Exclude bills submitted for unmetered electric service.	
Town of Warrenton	March 11, 1966	5% First \$10 Residential 5% First \$100 Commercial & Industrial Exclude bills submitted for unmetered electric service.	July 1, 1968	- Rate increased to 10%	10% First \$10 Residential 10% First \$100 Commercial & Industrial Exclude bills submitted for unmetered electric service.	
Town of Waverly	February 1, 1966	10% First \$10 Residential 10% First \$50 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and for unmetered electric service.	None		10% First \$10 Residential 10% First \$50 Commercial & Industrial Exclude electric service for water heating billed under the water heating schedule where a separate meter is used and for unmetered electric service.	

