AMERICANS FOR PROSPERITY

Principles for **Tax Reform in West Virginia**

For too long, West Virginia has faced a demographic winter in which more people leave our state than move here every year. We're one of the only states in the country to have continually lost population since the 1950's. This trend is unsustainable from both a fiscal and economic opportunity perspective. Without transformational changes that will rapidly make West Virginia a more attractive place to live, work, and raise a family, we will unfortunately continue to see reductions in our population and an overall lack of economic opportunity that will continue to hold West Virginians back from reaching their full potential. Swiftly pursuing policy solutions to reverse this harmful trend must be of utmost concern for lawmakers.

Fortunately, West Virginia has the opportunity to make meaningful, comprehensive tax reforms that will address many of the shortcomings in our current tax code that keep our state's individuals, families and businesses from truly thriving.

Americans for Prosperity supports efforts to thoughtfully eliminate the state's personal income tax. Removal of the state's personal income tax provides individuals with a significant financial incentive to call the Mountain State home and bring more opportunity to the citizens of our state in the form of economic growth—which will help diversify our economy and shore up the solvency of our state's financial obligations and fundamental programs.

This crucial reform will make our state more competitive, put more money back in the pockets of West Virginia families, and bring the kind of economic diversification our state has sought after for so long. We applaud policymakers who are prioritizing this much needed policy change.

In crafting this comprehensive tax reform, lawmakers should focus on the following basic principles to guide their efforts:

Simple

West Virginians make the best decisions for their lives and their households, not the state government. That's why lawmakers should work to eliminate the personal income tax. The current top marginal personal income tax rate is 6.50 percent, which is higher than every other boarder state, including the otherwise high tax state of Maryland, which is 5.75 percent. Individuals making the median income of $44,921 pay the second-highest bracket rate of 6.00 percent. That is nearly double that of individuals in Pennsylvania who pay a flat rate of 3.07 percent on their income.

According to research published by the CATO Institute, taxation does impact where businesses locate and where individuals move. In 2016, 24 of the 25 highest taxed states saw net out-migration. Likewise, the lowest taxed states, particularly those without income taxes such as Florida, saw the largest net in-migration.[1] This trend was also occurring in 2018[2], and is increasing today. In fact, not only are high tax states repelling businesses, but also high income earners. From CATO's report, "Florida, for example, has 1.23 households arriving for each one leaving but has 2.36 high-earning households arriving for each one leaving. By contrast, New York has 0.67 households arriving for each one leaving, and it

1. https://www.cato.org/publications/tax-budget-bulletin/tax-reform-interstate-migration
2. https://www.cato.org/blog/migration-low-tax-states-continues

has just 0.48 high-earning households arriving for each one leaving. In other words, low-tax states such as Florida attract people overall but particularly high earners, whereas high-tax states such as New York repel people overall but particularly high earners."[3]

One of the simplest taxes are sales taxes that are levied on goods and services and paid for by the end consumer. Sales taxes are simple and straightforward and do not need any accounting knowledge or business experience to calculate. Anyone with the calculator app on their cell phone can determine what the sales tax will be on an item or service they purchase. They are also transparent as the amount of the tax shows on all receipts.

Fair

West Virginia has given away millions of taxpayer dollars in corporate welfare[4] much of that coming through tax subsidies, exemptions, carve outs, and loopholes. The government shouldn't be picking winners and losers, including in the tax code. Lawmakers should seek to expand the tax base by eliminating existing tax exemptions in favor of lowering the overall tax rate, which would create a more level playing field for West Virginians when it comes to their tax burden.

No Net Increase in Tax Burden

Lawmakers should offset any base broadening with corresponding rate reductions to offset revenue gains. Legislators should learn from poorly structured tax rate reductions, like what occurred in Kansas, which reduced tax rates but did not reduce spending. Reductions in revenues must have a corresponding reduction on the expenditure side so that the state does not have an immediate deficit. Policymakers must go through the budget to look for any unnecessary spending to eliminate. Ideally, lawmakers would make bold budgetary decisions such as eliminating the Individual Income Tax by broadening and increasing the sales tax while overall reducing the amount spent by the general fund. However, it is important that tax reform does not result in an increase in spending nor in a net tax increase on West Virginians. The plan should be revenue negative.

Tax Reform Will Help Jumpstart the Economy

High tax rates and other factors have lessened the attractiveness of West Virginia as a state to live and do business. The Rich States, Poor States: ALEC-Laffer Economic Competitiveness Index ranks West Virginia's economic outlook at 28, in the bottom half of states. Like many states, West Virginia climbs the indices not because of proactive action taken by legislators, but because of the poor decisions made by legislators in other states. States such as Utah, North Carolina, and Indiana have vastly improved their economies due to tax and spending reform and should be used as models for action taken in West Virginia.

Many who oppose tax cuts or elimination say that it will hurt budget revenues, but the opposite is actually true in the years following the initial cut. While tax cuts in Kansas led to budget deficits because legislators did not reconcile both sides of the balance sheet, tax reforms in North Carolina let to general fund growth as the economy rebounded after years of high taxes and high spending. Opponents of that tax cut said that the general fund would take a hit, which in the first year it must align spending with new revenues. However, the following biennial budget in North Carolina saw a $440 million surplus[5], followed by a $897 million surplus[6] due to the economic growth directly related to the tax and spending reforms.

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3. https://www.cato.org/blog/tax-driven-interstate-migration-increasing
4. https://subsidytracker.goodjobsfirst.org/prog.php?statesum=WV
5. https://www.ncleg.gov/FiscalResearch/generalfund_outlook/18-19/August%202018%20General%20Fund%20Revenue%20Update.pdf
6. https://www.ncleg.gov/FiscalResearch/generalfund_outlook/19-20/Revised%20Consensus%20Memo%20September%202019.pdf

Legislator should not seek to reduce or eliminate certain taxes only to see increased revenues into the general fund. It must be accompanied with further reductions in unnecessary or wasteful spending and use future surpluses to maintain rainy day funds. When rainy day funds are sufficiently full, any surplus should be returned to taxpayers in the form of further tax reductions, or used to pay down government pensions and other debt.

Key Elements of PIT Elimination:

Revenue generated by the state's personal income tax (PIT) represents roughly 43% of the general revenue budget, or around $2 billion dollars. To create a tax reform plan that phases out the PIT, lawmakers will need to:

1. Use spending reductions to realign spending with initial reductions in revenue. Lawmakers should make significant spending reductions in areas that either do not represent a genuine funding priority or are not within the proper role of government. The more nonessential spending that can be reduced, the more rapidly lawmakers can provide meaningful tax relief to West Virginia families.

2. Eliminate exemptions and carveouts on consumer sales taxes to further realign spending with any initial reductions in revenue. Lawmakers should move government spending away from reliance on the PIT and towards a more consumer-based tax system. Consumer based taxes give citizens more choices and freedom when it comes to how and when they are taxed. The larger a consumer tax base, the less consumer taxes will need to be increased in order to realign revenues to properly reduce the elimination of the PIT. This means that lawmakers should focus on eliminating carveouts and loopholes that exempt various industries from sales tax. They should also consider reinstating the food tax, as this is one of the least distortive means by which to greatly increase the sales tax base.

3. Lawmakers should create a series of reality-based triggers that will phase out the PIT while phasing in the increases in consumer sales taxes. The timeframe for this phase out should be reasonably short. But, at no time should lawmakers allow the phase out to be a net tax increase on West Virginians. This plan should be revenue negative throughout implementation.