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The Institute on Taxation and Economic Policy (ITEP) is one of the leading research and education organizations in the country working on tax policy. Since its founding in 1980, ITEP's work has played a key role in educating the public and informing federal and state tax reform debates.

More information on ITEP can be found on the attached *About ITEP* description of our organization. Most of our recent studies and analyses can be found on our web site at www.itepnet.org.

Before I say anything about the Virginia tax system, I would like to offer two disclaimers. First, there are a lot of people in Virginia who know a lot more about the Virginia tax system than I. Second, I'm not here to tell Virginia what it ought to do with its tax system. There's more to tax policy than economics, equity and lists of principles of taxation. These are, of course, important. But it is also important that a tax system be one that, as much as possible, the taxpayers of a state respect and can live with. And the features of such a tax system can vary by state. Jean Baptiste Colbert, Controller General of Finances for Louis XIV of France, is reputed to have said "The art of taxation consists in so plucking the goose as to get the most feathers with the least hissing." There's something to that.

My understanding is that this commission is charged with developing revenue-neutral recommendations for changing Virginia's tax systems. I've been at this for 11 years and have testified before many tax commissions. They are usually composed of distinguished people, knowledgeable about taxes and committed to doing what's right for their state. Also, state tax commission recommendations usually get a couple of headlines when they're released and are pretty much ignored after that.

In addition, revenue-neutral tax reform is extremely difficult to accomplish. Revenue-neutral means some see their taxes go up and some see their taxes go down. In my experience, those whose taxes are raised get a lot more angry than those whose taxes go down are grateful. This dynamic makes it very hard, in the legislative environment, to enact large-scale tax reforms.

Most tax policy is not made in single sweeping reform packages. Tax systems most frequently evolve incrementally through tax-cuts and tax-increases. Each coinciding with political or economic circumstances that push the tax system one way or the other.

Whether the accumulation of these changes moves the state towards a better tax system or a worse one depends on whether there's any consideration, as each piece of legislation is adopted, as to what it does in the context of the state's overall tax objectives.

This Commission may prove more successful than those in other states in seeing its specific recommendations adopted. Even then, however, those reforms will not stop the year-in, year-out changes that legislatures make in the tax code. Thus, I would suggest that as important as any specific recommendations for changes in the tax code, is the guidance the Commission offers future Governors and Legislatures on the criteria those institutions should apply when considering tax legislation. States should have a guiding vision for where they want to proceed in tax policy and all tax legislation should be measured against that vision. Providing a vision, and emphasizing the need to judge each piece of tax legislation by it, can be important contributions of this Commission.

Virginia Tax System

Virginia is a low tax state. The best measure of overall tax level, in my view, is taxes as a share of personal income. By that measure Virginia ranked 48th in state and local taxes in 1996. As a share of Gross State Product, Virginia ranks 41st. In per-capita terms, probably the least generally informative of the commonly used measures, Virginia ranks 28th.

Virginia is a low tax state, but is it a fair tax state? Fairness is, of course, in the eyes of the beholder.

Virginia has a regressive tax structure—middle- and low-income families pay a greater share of their income in Virginia state and local taxes than do the wealthy. The following table shows the distribution, by income level of Virginia taxes in 2000 but with recently enacted legislation fully phased-in. This assumes that the first $20,000 of automobile value is not subject to car tax. It also assumes that the grocery tax reduction is fully phased in. This analysis was produced using the ITEP Microsimulation Tax Model.

The table shows that low-income families will pay 10.4 percent of their income in Virginia state and local taxes. Middle-income families will pay 8.6 percent and the best-off one-percent will pay 6.9 percent. This puts Virginia in the wide middle band of state tax structures in regressivity. The fact that Virginia has a lot of company in having regressive taxes, doesn't, of course, make it an attractive feature.

Virginia Taxes at 2000 Levels *
As Shares of Family Income for All Taxpayers

Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
					Next 15%	Next 4%	Top 1%
Average Income in Group	$8,500	$19,300	$33,300	$55,100	$94,200	$191,600	$997,000
Income Range	Less than $15,000	$15,000 – $26,000	$26,000 – $43,000	$43,000 – $71,000	$71,000 – $142,000	$142,000 – $295,000	$295,000 – or more
Sales, excise & gross receipts taxes	**6.2%**	**4.7%**	**3.8%**	**3.0%**	**2.2%**	**1.4%**	**0.6%**
General sales tax, individuals	2.4%	1.9%	1.5%	1.3%	0.9%	0.6%	0.3%
Excise & gross receipts taxes, individuals	2.7%	2.0%	1.5%	1.2%	0.9%	0.5%	0.2%
Sales, excise & gross receipts taxes, busine	1.1%	0.9%	0.7%	0.5%	0.4%	0.2%	0.1%
Property taxes	**3.4%**	**2.3%**	**2.1%**	**2.1%**	**2.3%**	**2.5%**	**1.4%**
Property taxes on families	3.3%	2.2%	1.9%	1.9%	2.1%	2.2%	0.6%
Business property taxes	0.1%	0.2%	0.2%	0.2%	0.3%	0.4%	0.8%
Income taxes	**0.8%**	**2.2%**	**2.8%**	**3.1%**	**3.6%**	**4.1%**	**4.8%**
Personal income tax	0.8%	2.2%	2.8%	3.0%	3.5%	4.0%	4.7%
Corporate income tax	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%
Total before Federal Itemized Offset	**10.4%**	**9.2%**	**8.6%**	**8.2%**	**8.1%**	**8.0%**	**6.9%**
Federal Itemized Deduction Offset	**0.0%**	**0.0%**	**–0.1%**	**–0.4%**	**–1.1%**	**–1.7%**	**–2.0%**
Net Taxes after Federal Offset	**10.4%**	**9.2%**	**8.5%**	**7.8%**	**7.0%**	**6.3%**	**4.9%**

Source: Institute on Taxation and Economic Policy Microsimulation Tax Model, July 5, 2000.

* Assumes fully phased-in car tax relief and grocery tax reduction

In general, tax systems are regressive or progressive because of two factors. The relative reliance on different taxes and the regressivity or progressivity of the component taxes. Consumption taxes, such as the general sales tax, gas tax and tobacco tax, are typically the most regressive taxes. Income taxes are usually progressive. Property taxes are in between and usually somewhat regressive.

Virginia relies more heavily on income taxes than most states—ranking 12th in 1996 in the percentage of state and local tax revenue coming from income taxes. This doesn't mean that Virginia has a high personal income tax. Virginia's taxes overall are low so the Virginia personal income tax is merely a big piece of a small pie. Heavy reliance on a personal income tax is typically a feature of a progressive tax system. But Virginia's personal income tax isn't very progressive.

Reliance on regressive consumption taxes is relatively low in Virginia—ranking 35th in 1996. But the taxation of groceries makes the tax somewhat more regressive than many other states.

Virginia has about an average reliance on property taxes relative to other states.

These components: a heavy reliance on a not very progressive income tax, regressive consumption taxes and moderate property taxes, add up to form Virginia's somewhat regressive tax system.

Tax Reform Thoughts

There are obviously many issues one can discuss regarding Virginia tax reform. Time is limited, however, and I would like to highlight just a few quick points.

Taxes on the Poor. Virginia has taken several measures in recent years that have reduced taxes on the poor. Nevertheless, low-income families in Virginia still pay a higher percentage of their income in state and local taxes than do other groups. A good further step would be adoption of a refundable state Earned Income Tax Credit.

Taxes on the Rich. The well-off have the lowest overall tax burden in Virginia. Adding a higher top marginal tax rate in the personal income tax to pay for tax relief at lower income levels would make the tax system less regressive. Claims of negative economic impacts of personal income taxes are vastly overstated. Also, because the state personal income tax is deductable on the federal tax return, much of the burden of this tax increase would be offset by reduced federal taxes. For those in the top federal tax bracket, every dollar of additional state tax would lower their federal tax by 40 cents. In other words, for every additional dollar received by the state, it would cost Virginians only 60 cents and the rest would come from the federal government.

Simplicity. Simplicity in a personal income tax is a virtue that almost everyone agrees on. So why is it so hard to accomplish? There's a saying that may explain it: "No simplification makes a tax simple enough if it raises your taxes and no complication is too complicated if it lowers your taxes." In other words, people want simplification, but not so much that they're personally willing to pay for it.

Nevertheless, simplicity is a worthy objective. The best way for a state to achieve greater simplicity is to make the state income tax form conform closely to the federal form. Requiring Virginia married couples to file under the same status as on their federal returns and creating a Virginia rate schedule for married couples that would ensure that there was no marriage penalty would be a big step in that direction.

Recent changes in Virginia tax law have clearly been taking the state towards greater complication, not simplicity. This is a prime example where some guidelines for tax reform could, over the long-run, produce a better tax system.

Interaction with Federal Taxes. An often underappreciated consideration in the making of state and local tax policy is the interaction with federal taxes. Personal income and property taxes are deductible from the federal personal income tax. Consumption taxes are not. This is an important difference. Every dollar of consumption tax paid by Virginians comes directly from their pockets with no offsetting reduction in federal income tax. For those who itemize on their federal tax returns, however, between 15 and 40 percent of their state and local income and property tax is, in effect, paid for by reduced federal income tax payments. This not only has a taxpayer-by-taxpayer impact, but an impact on Virginia's economy as a whole. The less money leaving Virginia in federal tax payments, relative to other states, the better it is for the state's economy.

Conclusion

The Commission on Virginia's State and Local Tax Structure for the 21st Century has an opportunity to offer a vision for equitable and sensible reform. Equity, simplicity and the interaction of the state's tax system with the federal tax system should be critical components of this vision.

About ITEP

The Institute on Taxation and Economic Policy (ITEP) is one of the leading research and education organizations in the country working on government taxation and spending policies. Since its founding in 1980, ITEP's work has played a key role in educating the public and informing federal and state tax reform debates.

For the first 15 years of its existence, ITEP worked extensively with Citizens for Tax Justice (CTJ), providing much of the research for important studies released by that organization. CTJ's studies of federal corporate income taxation in the early 1980s are widely credited with fomenting an intense public debate over the wisdom of tax-based corporate subsidies. This debate eventually helped lead to a bipartisan consensus that many of these tax provisions were unwise public policy, and to their demise in the Tax Reform Act of 1986.

ITEP and CTJ reports, such as *Inequality & the Federal Budget Deficit* (1991), helped inspire new thinking about tax policy that informed the debate that eventually led to the federal tax reforms of 1993.

The development of the ITEP Microsimulation Tax Model, completed in 1996, marked the beginning of a new era for ITEP. This model is capable of calculating the impact of current tax law and tax change proposals on taxpayers by income level. The model can also project potential revenue yields of tax law changes. The ITEP model is unique in its ability to produce analysis at the federal *and* state levels and to analyze income, consumption and property based taxes.

ITEP has continued to work with CTJ, primarily on federal tax issues. In particular, in May of 1996, CTJ and ITEP published *The Hidden Entitlements*, a detailed analysis and critique of the hundreds of billions of dollars in hidden spending programs buried in the federal tax code. ITEP tax model analyses have also been used by CTJ to show the likely impacts of various flat tax and national sales tax proposals on the federal budget and the direct tax consequences for families at different income levels. ITEP is also frequently called upon to analyze many federal tax proposals and to look at the impact of current tax policies on issues of public concern.

Over the years, ITEP has also played a key role in tax reform debates in the states. In June 1996, ITEP published *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*. This report analyzed the distributional effects of all major state and local taxes, on a state-by-state, tax-by-tax basis. The report found that all but a handful of states have regressive tax systems that impose higher effective tax rates on lower- and middle-income families than on the well off. It also outlined possible reforms that state and local government could adopt to make their tax laws more equitable.

Who Pays? received extensive media coverage and is currently being used by public and private sector analysts. Recently, ITEP has completed detailed studies of the Iowa, Minnesota and Arkansas tax systems. CTJ, using ITEP research, has done major tax studies in Rhode Island, Massachusetts, Indiana, Florida and several other states.

In addition to studies, ITEP is frequently called on to do analyses of state tax proposals and to testify before state legislatures.

In 1998, ITEP began a new project called *Good Jobs First* (GJF). The GJF project is already a national leader on the issue of state and local government subsidies for corporations. GJF analyzes corporate subsidies and is working to catalog corporate accountability "best practices" for state and local governments. GJF's first major study was released in January 1999. This report, *Economic Development in Minnesota: High Subsidies, Low Wages, Absent Standards,* found that many companies receiving substantial government subsidies in Minnesota pay extremely low wages.

ITEP works with a broad spectrum of local organizations on tax, corporate subsidy, and other issues relating to government taxation and spending policy. Tax and budget advocates, unions, community organizations, religious groups, living wage campaigns, environmentalists, and economic development networks consult with ITEP regularly.

ITEP's work is relied upon by officials at all levels of government and their professional staffs as a source of high quality, accurate analysis of issues directly affecting economic well-being. ITEP's studies and reports are also used by economists, professors in classrooms, and research institutions around the country.

ITEP efforts to educate the public are augmented by the widespread media coverage that ITEP receives. In addition to the flurry of attention that occurs when a major study is issued, ITEP receives many calls daily from media outlets needing information and comment on a variety of issues. ITEP's staff members are frequently quoted in newspapers, write articles and op-ed pieces in numerous papers and magazines, and have appeared on hundreds of radio and television shows (including all of the national network news shows) to explain to the public the effects of current and proposed tax and corporate subsidy laws.