Presentation to the Joint Meeting of Small Business Commission and Manufacturing Development Commission

October 18, 2013

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Overview

The Thomas Jefferson Institute for Public Policy proposal includes two key components:

1. Estimates of the impact of cutting certain taxes and increasing others using a Virginia version of the "State Tax Analysis Modeling Program" (STAMP) model prepared by the Beacon Hill Institute in Boston.
2. Estimates of the new revenue to be gained by extending the sales tax to more services using estimates from Chmura Economics and Analytics in Richmond.

This presentation provides information on:

1. Issues of concern with the overall STAMP model
2. Particular issues of concern with the Virginia STAMP model
3. Issues of concern with the Thomas Jefferson Institute proposal
4. Alternative approaches for consideration

Section 1: Issues of concern with the overall STAMP model

The model's conclusions are largely driven by its assumptions regarding:

1. How workers will react to a cut of income taxes.
2. How investors will react to lower taxes on investments.
3. How consumers will react to higher sales taxes.
4. The value of government services to state economies.

The STAMP model's assumptions for each of these are troublesome

How workers will react to a cut of income taxes.

- STAMP assumes that upper-income workers are roughly three times more sensitive to changes in their after-tax income than was indicated in a literature review by the Congressional Budget Office (CBO).

- Also in sharp contrast to the CBO analysis, STAMP assumes that upper-income workers are more likely than their poorer neighbors to seek out a job, increase their hours worked, or increase their productivity if their after-tax wage rate is increased.

How investors will react to lower taxes on investments.

STAMP assumes that investors will substantially increase their investments if their taxes are lowered. But this core assumption leads to wildly different conclusions in different states. Texas investors, for example, are assumed to be twice as responsive to changes in the rate of return on investment compared to their counterparts in Pennsylvania and North Dakota.

How consumers will react to higher sales taxes.

- The STAMP model has no specific data on how consumers will respond to higher sales taxes, so it simply assumes the total level of after-tax consumption in the state will remain unchanged.
- The use of this generic assumption is reason for concern given that the model is being used to analyze proposals that include expansion of the state sales tax to services—applying it to a host of services currently untaxed in the vast majority of states.
- Having a better handle on how consumers will respond to those tax policy changes, therefore, is critical.

The value of government services to state economies.

- STAMP systematically underestimates the value of government services to state economies.
- It does so by assigning government only an indirect role, rather than acknowledging that governments provide services, hire people directly, and spends money in a way that produces direct jobs in the private sector.

Section 2: Particular issues of concern with the Virginia STAMP model

1. It's unclear what the Virginia STAMP model is assuming about the responsiveness of investors to lower taxes since both the 2004 and 2012 model consistently base findings in Virginia off estimates in Texas (or the model has a typo in its inputs).

From the Virginia STAMP report (page 24):

"Based on the econometric results from STAMP models estimated for Texas and elsewhere, we estimated the investment demand elasticity to be about 0.6."

2. For some unexplained reason, it appears that the Beacon Hill Institute in designing STAMP believe Virginia investors react very differently than those based out of Pennsylvania or North Dakota.

The model assumes investment demand elasticity is TWICE the level in VA and TX as it is in PA and ND

Texas (2004)

http://www.texaspolicy.com/sites/default/files/documents/2004-03-10-stamp.pdf

Based on the econometric results from STAMP models estimated for Texas and elsewhere, we estimated the investment demand elasticity to be about 0.6.

Virginia (2004)

http://heartland.org/sites/all/modules/custom/heartland_migration/files/pdfs/15667.pdf

Based on the econometric results from STAMP models estimated for Texas and elsewhere, we estimated the investment demand elasticity to be about 0.6.

Pennsylvania (2009)

http://www.beaconhill.org/BHIStudies/PA-STAMP2009/PA-STAMP2009.pdf

Based on the econometric results from STAMP models estimated for Pennsylvania and elsewhere, we estimated the investment demand elasticity to be about 0.3.

Virginia (2012)

http://www.thomasjeffersoninst.org/files/3/TaxRestructure_appendix3_STAMP.pdf

Based on the econometric results from STAMP models estimated for Texas and elsewhere, we estimated the investment demand elasticity to be about 0.6.

North Dakota (2012)

http://www.policynd.org/images/uploads/ND_STAMP_Metho_2012.pdf

Based on the econometric results from STAMP models estimated for North Dakota and elsewhere, we estimated the investment demand elasticity to be about 0.3.

3. Like other STAMP models, the Virginia STAMP model has no specific data on how consumers will respond to higher sales taxes, so it simply assumes the total level of after-tax consumption in the state will remain unchanged.

The use of this generic assumption is a major reason for concern in the Virginia model.

That's because the Thomas Jefferson Institute proposal being modeled includes expansion of the state sales tax to a wide range of services. Consumers will react; and react differently. So reflecting that reality in the estimates is critical. But it's not being done in this Virginia model.

Section 3: Issues of concern with the Thomas Jefferson Institute proposal

1. The assertion that in their proposal "there are no new business-to-business taxes involved" is not accurate.
2. Middle class and low-income Virginians will likely pay more in taxes as a result of this proposal, despite the cuts to personal income taxes or the sales tax on groceries that is included in some of the scenarios.
3. The proposal's goal of having all these changes be revenue neutral is highly unlikely to be achieved
4. The political viability of many of the sales tax increases proposed is limited.

Business-to-business taxes

- Even though the various scenarios set about exempting certain businesses, like health care, private colleges, etc, the Appendix 3 list of services to which the sales tax would be extended in the Thomas Jefferson Institute proposal includes lots of items that are purchased frequently (or even overwhelmingly) by businesses.
- Business purchases are an enormous part of state sales tax bases.
- It's inaccurate to suggest that a fundamental sales tax overhaul such as the one contemplated by this proposal could be enacted without affecting business-to-business taxes.

Middle-class and low-income Virginians would likely pay more

- Despite the changes to personal income taxes and even the sales tax on groceries, the scenarios in the Thomas Jefferson proposal are likely to increase the taxes paid by middle class and low-income Virginians.
- This is because middle class and low-income Virginia households have relatively low state income tax burdens to begin with.
- Therefore, they would see little benefit from the state income tax rate cuts that are included in many of the proposal’s scenarios.
- But, by expanding the state sales tax to services to include such areas as rent, public transportation, and personal services, middle class and low-income households would be paying significantly more in taxes.

Revenue neutrality is unlikely

- The proposal's goal of revenue neutrality is likely out of reach.
- That's because once you adjust the estimates of new revenues to be gained through sales tax expansion to more completely exclude business-to-business transactions, you see that they do not make up for the lost revenue of the elimination of BPOL, M&T, and MC and the other tax cuts included in the proposal.

Political viability is limited

- The political viability of many of the sales tax increases proposed is limited
- The scenarios in the proposal include expansion of the state sales tax to services that are rarely taxed in other states or already taxed in Virginia.
- For example, based upon the Federation of Tax Administrators' 2007 Services Taxation Survey, just 3 states apply their sales tax to attorneys. Yet, the scenarios in the Thomas Jefferson Institute proposal include expansion to this sector.
- In addition, Virginia already taxes things like insurance premiums, meaning that subjecting these transactions to additional taxation through the state sales tax expansion is especially unlikely.

Section 4: Alternative Approaches

- Given the significant concerns over the economic impacts of proposals to eliminate BPOL, M&T, and Merchant's Capital – with or without offsetting new taxes – effective reform of the current system could address many of the concerns of stakeholders on this issue.
- For example, Brian Strahle, owner and managing member of LEVERAGE SALT LLC (which provides state and local tax research, writing, and help-desk services to accounting firms and other organizations) recently proposed in a "State Tax Notes" column "In Search of a Win-Win for the Virginia BPOL Tax":
  - *"The main areas of contention come from a few areas: determining whether a taxpayer has a definite place of business, the application of the out-of-state deduction, situsing of gross receipts, and apportioning gross receipts among more than one definite place of business…"*
  - *Therefore, perhaps a more plausible option would be to improve and simplify the BPOL tax in the areas causing taxpayers the most pain. Wouldn't that approach help localities maintain revenue while also decreasing the compliance burden of businesses — making the BPOL tax less of a deterrent?"*

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