Joint Meeting: Small Business Commission and Manufacturing Development Commission

October 18, 2013
Meeting Summary

Introduction

The Small Business Commission and the Manufacturing Development Commission met jointly for the fourth time this year on October 18th in Charlottesville. A primary focus of the meeting was the Thomas Jefferson Institute for Public Policy's State Tax Analysis Modeling Program (STAMP) and its projected outcomes. The Commission members also heard presentations relaying Fairfax County's experiences with the local license (BPOL) tax and explaining the mission of, and services provided by, the Commonwealth Center for Advanced Manufacturing.

Dr. Barry W. Johnson, Senior Associate Dean, L. A. Lacy Distinguished Professor, University of Virginia School of Engineering and Applied Science
Commonwealth Center for Advanced Manufacturing (CCAM)

Dr. Barry W. Johnson explained that CCAM is a separate nonprofit corporation with a mission of bridging the gap between research and commercialization of technology, fostering collaboration among diverse industries, lowering research and development costs of CCAM member companies, and training the next generation of technology leaders. He mentioned that one of CCAM's goals is to help foster the establishment of an advanced manufacturing innovation zone in Southern Virginia. Sixteen private companies have partnered to form CCAM. Public members of CCAM include the University of Virginia, Virginia Polytechnic Institute and State University, Virginia State University and NASA. CCAM is a 62,000 square-foot facility located in Prince George County adjacent to Rolls-Royce's new manufacturing plant. CCAM employs a chief technology officer, a manager of administration, six full-time research specialists, and twenty to twenty-five full time students.

Dr. Johnson indicted that there are three levels of CCAM membership. Member companies can be founding or organizing members, each of whom have made a $3 million commitment to CCAM. Tier 2 members participate in generic research and are granted a non-royalty non-exclusive right to use any intellectual property produced by the research. Tier 3 members do not contribute funds to CCAM but may contribute machinery and equipment for use by CCAM.

Dr. Johnson stated that CCAM is committed to accelerating technology into markets and demonstrating on real problems. He indicated that the sharing of CCAM facilities, CCAM personnel, and research by member companies lowers the research and development costs incurred by each member. CCAM will be involved in training the next generation of technology leaders by providing market ready experiences for students and connecting students with industries.

Dr. Johnson mentioned that CCAM performs both directed research and generic research for its member companies. Directed research is research conducted exclusively for a member company who becomes the owner of any intellectual property resulting from the research. When CCAM undertakes generic research, all intellectual property related to the research is owned by CCAM but each member company retains a non-royalty non-exclusive right to use the property. Next year CCAM will perform $9 million in funded research paid by member companies.

CCAM operates a workforce development program that has been funded by the Virginia Tobacco Indemnification and Community Revitalization Commission. The focus of the program is to develop the skills needed by machinists, welders, and industrial machinery mechanics and for such persons to acquire industry-recognized credentials. Dr. Johnson related that three regional centers of excellence for training are being created to each produce credentialed machinists, welders, and industrial machinery mechanics. The objective is for each regional center to produce 75 certified graduates annually beginning in 2017.

Michael Cassidy, President and Chief Executive Officer, The Commonwealth Institute for Fiscal Analysis

Mr. Cassidy commented on the STAMP model used by the Thomas Jefferson Institute. The STAMP model is a dynamic model that can forecast changes in Virginia in private employment, capital investment, real disposable income, and real gross domestic product as a result of changes to Virginia's state and local taxes. The Thomas Jefferson Institute has used the STAMP model to forecast changes in these economic measures under a proposal to eliminate the local BPOL, machinery and tools, and merchants' capital taxes and to apply the retail sales tax to selected services to offset the loss in local revenues. Mr. Cassidy indicated that his top concerns with the STAMP model used to evaluate the Institute's proposal are that additional revenue and job growth projections are too positive and localities are heavily reliant on the BPOL, machinery and tools, and merchants' capital taxes.

The Beacon Hill Institute at Suffolk University maintains a STAMP model. Mr. Cassidy stated that the model's conclusions are driven by its assumptions with regard to how workers will respond to a cut in their income taxes, how investors will respond to lower taxes on investments, how consumers will respond to higher sales taxes, and the value of government services to a state's economy. He noted that the STAMP model assumes high-income individuals are roughly three times more sensitive to changes in their after-tax incomes than was assumed by the Congressional Budget Office. Mr. Cassidy concluded that the STAMP model assumes that Texas investors are twice as responsive to lower taxes on investments as compared to Pennsylvania and North Dakota investors. He suggested that the STAMP model has no data on how consumers will respond to higher sales taxes, so it simply assumes that consumption will not change. Mr. Cassidy also stated that the STAMP model underestimates the value of government services to a state's economy because it does not acknowledge that government hires people directly and can spend money in a way that directly creates jobs in the private sector.

Specifically with regard to the STAMP model maintained for Virginia, Mr. Cassidy noted that the responsiveness of Virginia investors to lower taxes is based upon estimates for Texas investors. Mr. Cassidy related that because the Virginia STAMP model has no data on how consumers will respond to a sales tax increase, it simply assumes consumption in Virginia would not change. Mr. Cassidy pointed out that this is particularly important in light of any proposal to apply the retail sales tax to services to generate revenue to replace local revenues from the elimination of the BPOL, machinery tools, and merchants' capital taxes.

Mr. Cassidy also spoke on the Thomas Jefferson Institute's proposal to eliminate the local BPOL, machinery and tools, and merchants' capital taxes and to replace the loss in local revenues from a retail sales tax on services. One requirement of the Institute's proposal is to exempt business-to-business services from sales tax. Mr. Cassidy suggested that this would be highly unlikely because some of the services to be taxed under the proposal are purchased frequently and even overwhelmingly by businesses. He concluded that business purchases are an enormous part of Virginia's tax base. Mr. Cassidy also suggested that middle class and low-income households would bear a greater financial burden from the extension of the sales tax to services because these households pay a larger percentage of their disposable income on rent, public transportation, personal services, etc. Mr. Cassidy stated it would not be politically viable to expand the sales tax to certain services. For instance, only three states impose a sales tax on services provided by attorneys and different scenarios under the Institute's proposal would call for extending Virginia's retail sales tax to legal services under different scenarios.

Mr. Cassidy ended by suggesting that reform of the local BPOL tax would address many of the concerns of stakeholders on this issue.

Kevin C. Greenlief, Director, Department of Tax Administration, Fairfax County

Mr. Greenlief presented the experiences of localities with the local BPOL tax with special emphasis on Fairfax County's experiences.

The BPOL tax was paid by 40,814 businesses in Fairfax County in 2012 and generated $152 million. The tax accounted for approximately 4.5 percent of the County's general fund revenue. If the BPOL tax were eliminated, the County could replace the revenue by increasing its real estate tax rate by $.08 per $100 of value. According to Mr. Greenlief, residential homeowners would pay 80 percent of the real estate tax increase. Of the 40,814 businesses paying a BPOL tax to Fairfax County, 16,375 or 40 percent paid a flat tax averaging $38 and 11,418 or 28 percent paid an average tax of $552. Conversely, businesses with gross receipts in the top 1 percent realized on average $72 million in gross receipts and paid 43.2 percent of the total BPOL taxes collected by Fairfax County in 2012.

Fairfax issues 16 different classes of business licenses. Its average BPOL tax rates in 2012 were approximately 58 percent of the maximum BPOL tax rates allowed under state law. Mr. Greenlief stated that commercial real estate values and growth in BPOL revenues in Fairfax County each averaged 4 percent per year since 2006 with commercial real estate values exhibiting much more volatility.

Mr. Greenlief also reviewed a survey of Virginia's localities with regard to the BPOL tax compiled by Fiscal Analytics, Ltd. in September of this year. The survey captured 85 percent of the total BPOL revenue paid in Virginia in Fiscal Year 2012. The survey revealed that 60.6 percent of businesses in the Commonwealth either paid a flat BPOL fee or collected under $100,000 in gross receipts for the year meaning that these businesses paid less than $100 for a BPOL license. Financial, real estate, and professional services businesses generated 31 percent of the survey revenue, repair, personal, and business services businesses generated 26 percent, retail businesses generated 25 percent, contracting businesses generated 7 percent, wholesale businesses generated 5 percent, and 6 percent of the survey revenue was generated by other businesses.

Mr. Greenlief concluded by reviewing for the Commission members a Joint Legislative Audit and Review Commission (JLARC) briefing on changing the BPOL tax from a tax on a business' gross receipts to a tax on a business' net income. JLARC forecasted that BPOL revenues collected by all localities in Virginia would be reduced by 95 percent if the BPOL tax were modified to be imposed on net income. Retailers and wholesalers would see the largest reduction in BPOL taxes followed by unprofitable or low-profitable businesses and then C corporations.

If the BPOL tax was imposed on net income and the General Assembly wanted to maintain the same level of local revenue, this would result in profitable businesses seeing their BPOL tax increase on average 40 percent through increases in BPOL tax rates. Sole proprietorships, high profitability businesses, and repair, personal, and business service providers would see a disproportionate increase in their BPOL taxes while retailers, C corporations, and unprofitable or low-profitable business would still pay lower BPOL taxes. JLARC suggested that making BPOL a net income tax would make it far more difficult for businesses to understand and local governments to administer.

BPOL generated $683 million in local revenues in Fiscal Year 2012. JLARC indicated that the tax accounted for 4.2 percent of local revenues on average but 9.5 percent of the revenues for towns. Ninety percent of the BPOL revenues in Virginia in Fiscal Year 2012 were generated by businesses with gross receipts in excess of $1 million.

Michael W. Thompson, Chairman and President, The Thomas Jefferson Institute for Public Policy

Mr. Thompson explained the tax restructuring proposal of the Thomas Jefferson Institute for Public Policy and briefed the Commission members on STAMP model projected results under different scenarios. The Institute's tax restructuring proposal requires several constants: elimination of the local BPOL, machinery and tools, and merchants' capital taxes; extending the retail sales tax to services and using a portion of the additional revenues to fully reimburse local governments for the loss in revenue from the elimination of these local taxes; keeping in place the sales tax exemption for health care; providing that business-to-business sales of services are exempt from any retail sales tax; revenue neutrality; and the creation of thousands of new jobs, hundreds of millions of dollars in new investment, and billions of dollars in disposable income and gross domestic product.

In addition to the constants noted above, one scenario studied by the Institute would also eliminate Virginia's 2 percent and 3 percent individual income tax brackets, reduce the tax rate on individual income between $5,000 and $17,000 from 5 percent to 4.55 percent and reduce the tax rate on individual income in excess of $17,000 from 5.75 percent to 5 percent. For this scenario the STAMP model forecasts the creation of 79,000 jobs, $287 million in new capital investment, and an increase of $2.85 billion in real disposable income and $8.4 billion in real gross domestic product. Under a different scenario in which the sales and use tax is imposed on food at a rate of 1 percent, the 2 percent and 3 percent individual income tax brackets are eliminated, and the 5 percent and 5.75 percent individual income tax brackets are both reduced by 4.5 percent, the STAMP model forecasts the creation of 78,400 jobs, $447 million in new capital investment, and an increase of $3.43 billion in real disposable income and $6.35 billion in real gross domestic product. Under a third scenario in which the sales and use tax on food is eliminated, the 2 percent and 3 percent individual income tax brackets are eliminated, and the 5 percent and 5.75 percent individual income tax brackets are both reduced by 3 percent, the STAMP model forecasts the creation of 68,500 jobs, $439 million in new capital investment, and an increase of $3.07 billion in real disposable income and $5.52 billion in real gross domestic product.

Mr. Thomas concluded that under all of the scenarios studied by the Institute there would be a significant number of new jobs created and a significant increase in capital investment, real disposable income, and real gross domestic product in Virginia.