Hit and Run

Governor's Transportation Tax Hike Hits Low-Income Virginians Hardest

The Commonwealth Institute

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The tax and fee hikes proposed by Governor McDonnell to fund transportation will take a far larger share of income from Virginians at the low end of the income spectrum than those with higher incomes who are better able to pay.

The governor proposes to increase the state sales tax to 5.8 percent, eliminate the gas tax (except for diesel), increase vehicle registration fees by $15, add a $100 fee for hybrids, and divert more funds from the general fund from both the state sales taxes of current collections and future collections of internet sales.

Instead of approving the plan as proposed, lawmakers should modify it to make it more fair.

This analysis looked at the entire proposal and shows the impacts by income group. [1]

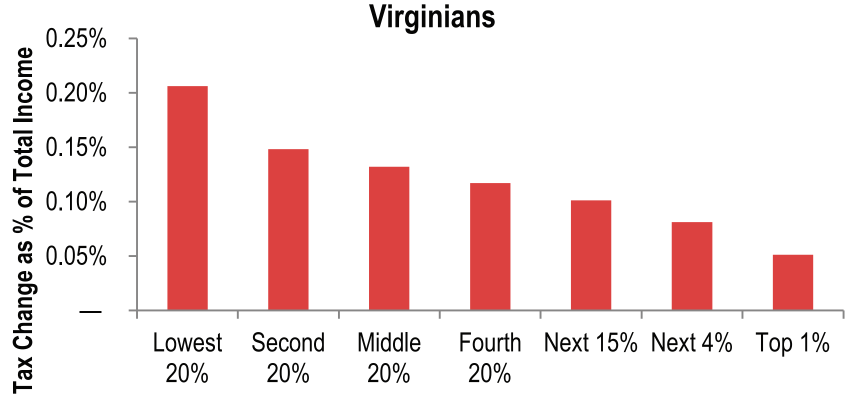
Even with the proposed elimination of the tax on gas, the governor's plan would result in higher taxes for Virginians across the board. However, the proposed tax changes will fall most heavily on lower-income families.

That's because as a share of their income, low- and moderate- income households spend more than high-income households buying the basic necessities of life like clothing, toiletries, and school supplies, which are subject to the state's sales and use tax.

For example, a family making less than $21,000 a year, among the lowest 20 percent of the income distribution, would see its taxes rise by about .21 percent under the governor's plan. But at the other end of the spectrum, households making over $509,000 a year, in the top 1 percent of the income distribution, would see an increase of just .05 percent.

Wrong Way

Proposed Net Tax Increases Greatest for Lower-Income Virginians



Source: Institute on Taxation and Economic Policy, January 2013.

While the Commonwealth needs new revenue, especially for investment in such a fundamental building block of our economy as transportation, sticking low-income Virginians with a bigger bill is the wrong approach.

Fortunately, lawmakers can improve the governor's proposal to offset the effect of the tax and fee hikes on low-income families across the state. The two best approaches are improving a key tax credit or creating a new tax rebate.

Refundable Earned Income Credit

Strengthening Virginia's Earned Income Credit (EIC), which provides a crucial income tax break to low-earning working families, would offset part of the impact of the higher sales tax and registration fees on lower-income Virginians. By making the earned income credit refundable, workers whose credit is greater than the income taxes they pay would receive the remaining credit in the form of a refund, offsetting a portion of the sales and use taxes they pay. Refundability is critical to bringing the state's earned income credit to its full potential.

Tax Rebate

Another option is a simple rebate. Five states (Arizona, Hawaii, Idaho, New Mexico, and Oklahoma) have some form of rebate designed to offset sales and excise taxes that gobble up a larger share of the resources of low-income households. Most of the rebates are a flat dollar amount per family member and are only available below a certain income threshold. All of these rebates are refundable in order to help the lowest income, hardest-hit families.

Endnote

1 The governor's plan includes raising the sales tax from 5 percent to 5.8 percent, collecting sales taxes owed on remote purchases, raising vehicle registration fees by $15, and repealing the gasoline tax. His proposal to impose a $100 fee on alternative fuel vehicles is not included in the above analysis due to data limitations. However, we do not believe it significantly impacts these results since less than 1 percent of the gross revenue raised by the governor's plan comes from this fee.

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