Destination Unknown

Navigating Virginia's New Transportation Funding Package – and Potential Potholes

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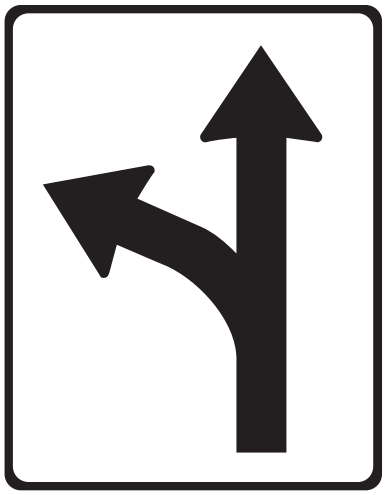


The final transportation package passed by the General Assembly raises a lot of money for our roads, bridges and mass transit-- but it creates some problems, too.

The final legislation (HB2313) makes far-reaching changes to the way transportation is funded in Virginia. Among the key concerns it raises:

- The tax increases in the package would require low- and moderate-income Virginians to pay a bigger share of their earnings for transportation than wealthier households.
- The legislation includes no measures to make the funding responsibility more equitable.
- It shifts the cost of paying for highway improvements and routine maintenance away from drivers, who benefit the most from better roads. Less than 10 percent of the package resources come from driving-related revenues.
- One major component of the package requires federal action, and it's possible that the local pieces will face legal challenges. Either of these could cost the package millions of dollars if things don't fall the state's way.

A Rocky Road for Low-Income Virginians

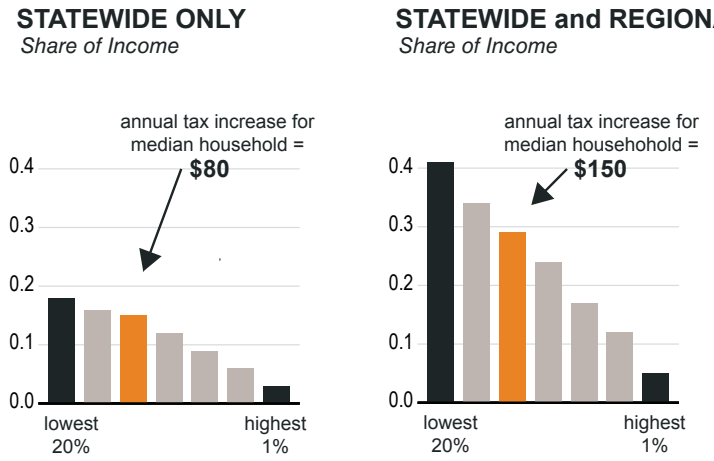
Regardless of how the transportation package plays out politically and legally, under every scenario laid out in the legislation, low-income families across the state will be paying a larger share of their income to fund transportation than high-income families. That's because the sales tax increases included in the package will fall more heavily on lower-income families. Sales taxes are not based on anyone's ability to pay, unlike income taxes whose rates can rise along with income. Low-income families also spend most or all of their earnings on goods subject to the higher taxes.

On average, a median-income household in Virginia, earning about $51,000 annually, will pay roughly $80 more a year – around 0.2 percent of its income – in the new taxes included in the transportation package (see Figure 1).

FIGURE 1

Transportation Taxes Hit the Poor Harder

Share of Income to be Paid in New Taxes by Income Group



Source: Institute on Taxation and Economic Policy, 2013.

NOTE: These estimates assume no remote seller legislation passed at the federal level.

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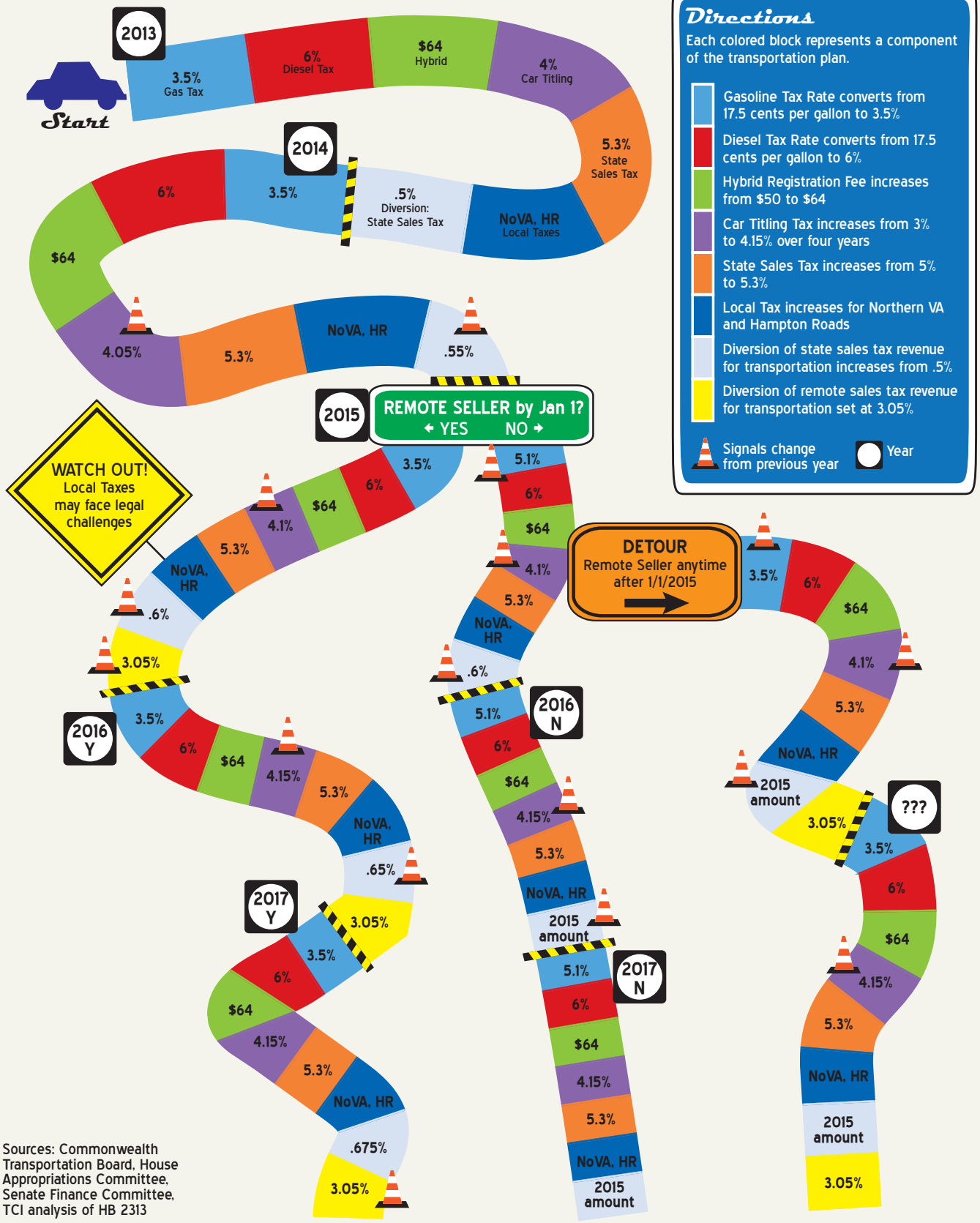
Confused about the transportation legislation? Follow along this path to trace the different tax increases and changes and how they could adjust over time.



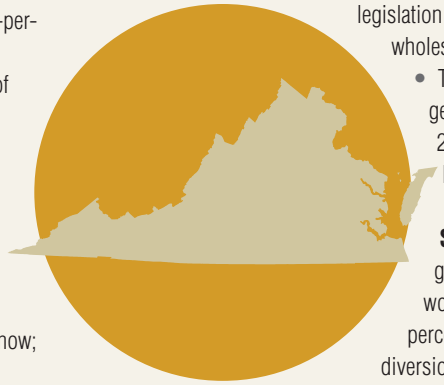
Sources: Commonwealth Transportation Board, House Appropriations Committee, Senate Finance Committee, TCI analysis of HB 2313

A Closer Look at the Transportation Funding Package (HB2313): Major Landmarks

The transportation legislation relies on a series of tax increases and other changes to generate resources for transportation in Virginia on both a statewide and regional level.

Statewide

Gas Tax Conversion: Virginia's current 17.5-cents-per-gallon gas tax, paid by drivers at the pump, would be replaced by a 3.5 percent tax on the wholesale price of gasoline and a 6 percent tax on the wholesale price of diesel fuel. The average wholesale price will be determined twice a year, and cannot drop below the current price as of February 20, 2013.



Given the current wholesale price of around $3.50 a gallon, this tax translates to about 12.25 cents per gallon, making it a slight cut in motor fuels taxes for now; but as prices rise, the tax will rise as well.

Sales Tax Increase: The statewide sales and use tax is increased by three-tenths of a cent, to 5.3 percent. Purchases in Northern Virginia and Hampton Roads will be taxed an additional 0.7 percent, bringing the total sales tax in those regions to 6 percent.

Remote Seller Legislation: The package assumes passage of federal legislation allowing Virginia to require online merchants and other "remote sellers" to collect and remit sales taxes on purchases by Virginia residents. A share of that new money would be diverted from the general fund to the transportation fund. But because passage of the federal legislation is so uncertain, contingency plans were included in the package. If Congress fails to pass remote seller legislation by January 1, 2015, then:

- The wholesale tax on gasoline will increase to 5.1 percent from 3.5 percent. (The tax on diesel would not change.) If remote seller legislation is enacted after January 1, 2015, the tax rate on the wholesale price of gasoline would revert to 3.5 percent.
- The percentage of the sales tax that is diverted from the general fund to the transportation fund is capped at the 2015 level. The cap stays in place even if remote seller legislation is enacted later.

Sales Tax Diversion: The share of the existing general sales and use tax dedicated to transportation would be gradually increased to 0.675 percent from 0.5 percent by 2018. Over the first three years, the amount of diversion increases in .05 percent increments, with a smaller .025 percent increase in the fourth year.

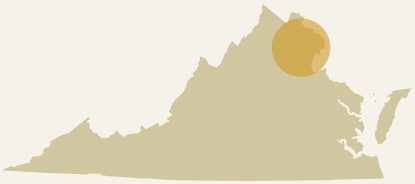
If by January 1, 2015, remote seller legislation has not yet been enacted by Congress, however, the share of the sales tax that is diverted to transportation is capped at the 2015 amount.

Hybrid Registration Fee: The annual registration fee on hybrid, alternative fuel, and electric motor vehicles would increase to $64 from $50.

Car Titling Tax Increase: The tax paid on the sale of motor vehicles (known as the "titling tax") will increase to 4.15 percent from 3 percent over four years.

Regional Provisions

Northern Virginia



- ***Additional Sales Tax Increase:*** The sales tax in Northern Virginia would increase an additional 0.7 percent on top of the 0.3 percent statewide increase, bringing the total sales tax on purchases made in Northern Virginia to 6 percent.
- ***Real Estate Recording Tax:*** A "regional congestion fee" of 15 cents per $100 of property value would be added to the real estate recording fee for real property for which a deed, instrument or writing is recorded in Northern Virginia.
- ***Transient Occupancy Tax:*** The hotel tax in Northern Virginia would be increased by 2 percent.

Hampton Roads

- ***Additional Sales Tax Increase:*** The sales tax in Hampton Roads would increase an additional 0.7 percent on top of the 0.3 percent statewide increase, bringing the total sales tax on purchases made in Hampton Roads to 6 percent.
- ***Additional Fuels Tax:*** The wholesale tax on motor fuels would be boosted by an additional 2.1 percent beyond the statewide level for Hampton Roads.

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Households in the bottom 20 percent of the income distribution (earning less than $21,000) will pay between three and six times more of their income than the top one percent of households (earning at least $509,000), depending upon whether the remote seller legislation is enacted or the sales tax on gas increases.

For low-income families in Northern Virginia and Hampton Roads, the impact will be even more severe because the package includes bigger tax hikes for those densely populated regions. While the median household in those regions will pay at least $150 more a year, households in the bottom 20 percent of the income distribution will pay a share of their income that is between five and eight time larger than that paid by the regions' top one percent of households.

The way to deal with this problem would be for policymakers to offset the impact of the tax increase on Virginia's low- and middle-income families by expanding a key tax credit or creating a sales tax rebate.

Refundable Earned Income Credit

Making Virginia's Earned Income Credit (EIC) refundable would be one way to offset part of the sales tax increase's disproportionate impact on lower-income Virginians.

Workers who qualify for the credit, generally those in low-wage jobs, would get a tax refund if their credit is greater than the income tax they pay. This would help offset a portion of the other taxes they pay, including the higher sales tax in the transportation package.

Numerous studies have found that the refundable federal version of this credit makes low-wage work more viable, boosting the number of single mothers who work, reducing cash welfare, and lifting families out of poverty by helping them make ends meet. Making Virginia's credit refundable is critical to ensuring it reaches its full potential, especially with sales taxes going up.

Tax Rebate

Another option for offsetting the impact of new transportation taxes is providing a direct rebate to low-income households. Five states (Arizona, Hawaii, Idaho, New Mexico, and Oklahoma) have some form of rebate designed to offset sales and excise taxes. Most are a flat dollar amount per family member and are only available to families below a certain income threshold. All of these rebates are refundable in order to help the lowest income, hardest-hit families. While the particular details of such a rebate would need careful attention, it would be a simple way to give targeted tax relief to low-income Virginians.

Spotlight

Remote Seller Legislation

A point often overlooked in the discussion of federal "remote seller" legislation is that the new revenue flowing to Virginia would not be the result of a new tax, but instead would come from better enforcement of an existing tax.

Federal law prohibits states from requiring out-of-state sellers to collect state sales and use taxes on sales if the seller has no physical presence in the state. State sales taxes are still legally due on purchases made over the Internet, but states must rely on customers to pay these taxes directly to the state. Income tax forms include a line for these payments. But because few taxpayers remit the required tax and it is difficult and costly to enforce, states lose millions of dollars a year in revenue from online and other remote sales.

Federal action will simply allow Virginia to impose a new collection requirement that will shift the responsibility from buyers to sellers, treating online and catalog sales the same as sales made in bricks-and-mortar stores across the state. Yet the transportation legislation treats this sales tax revenue differently than other sales tax revenue: Rather than diverting the same share of it to transportation as other sales tax revenues, 3.05 cents of every 5.3 cents collected (or about 58 percent) will go to funding transportation, a much higher share than from other sales and use tax revenue.

Even if federal remote seller legislation is enacted, given the strong opposition to any tax increase by many members of Congress it is likely that it would include an offsetting tax cut, which could significantly reduce other tax collections in Virginia. For example, the legislation could be amended to include a change in other aspects of state taxes that would lead to revenue losses.

A Free Ride? Package Shifts Costs Away from Drivers

The vast majority of the new resources in the transportation package come from revenues that are not related to transportation, breaking a long tradition of having the heaviest users of our roads pay for most of their upkeep. In fact, less than 10 percent of the statewide resources included in the transportation funding package come from driving-related revenues (see Figure 2).

Part of the reason is a change the package would make in the gas tax. By switching from a 17.5 cents-per-gallon retail tax to a 3.5 percent sales tax on the wholesale price of gas, Virginia is expected to lose roughly $847 million over the next five years. While the tax change will allow revenue to grow over time, the tax rate set by the General Assembly is not high enough to raise the same level of revenue as the current system. In fact, the wholesale price of gas would need to hit $5 a gallon before Virginia would break even on the amount of gas taxes raised.

Roughly half of the total statewide transportation resources in the legislation will come from new[1] revenues unrelated to driving, like the statewide 0.3 percent increase in the general sales and use tax and – if Congress agrees – requiring online merchants like Overstock.com and other "remote sellers" to collect state sales tax on purchases by Virginia consumers.

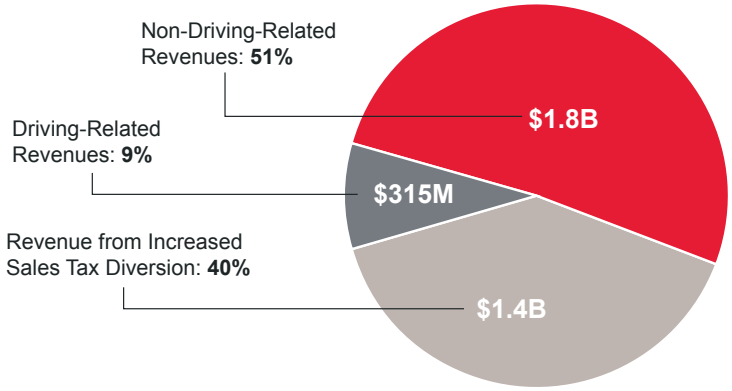
The remaining 40 or so percent of statewide transportation resources in the package come from gradually increasing the share of sales tax dollars diverted from Virginia's general fund to transportation – to 0.675 cents of every five cents collected in the existing sales tax per dollar and then to 3.05 cents from 0.675 for collections from remote sellers. Over the next five years, this means that more than $1.4 billion that otherwise would be used to pay for education, health care, public safety, and other services will instead be spent on transportation.

When it comes to the regional components of the legislation, the amount of revenue derived from sources unrelated to driving will differ. As shown in Figure 3, Northern Virginia's supplemental funding relies entirely on revenues unrelated to driving, and Hampton Roads relies on an additional sales tax on gas to raise slightly over a third of all new regional transportation resources.

FIGURE 2

Slipping Out of Gear

Statewide Transportation Resources, FY2014-FY2018

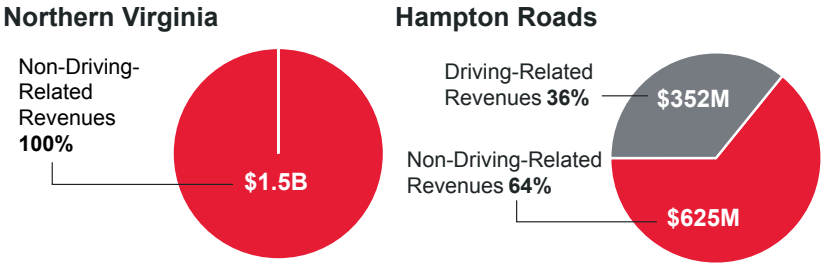


Source: Senate Finance Committee and TCI analysis of HB2313.

FIGURE 3

Regional Sources of Revenue

Regional Transportation Resources for Northern Virginia and Hampton Roads, FY2014-FY2018



Source: Senate Finance Committee and TCI analysis of HB2313.

1 "New non-driving-related revenues" refers to the .3 percent increase in the sales tax and the new online sales tax collection requirement that would come from federal passage of remote seller legislation. While the tax due on remote sales is not a "new" tax, as it is already legally due, it is treated as new because of low compliance without proper enforcement mechanisms under current law.

Mapping the Course: Where the Money Comes From

The transportation package passed by the General Assembly relies on a slew of tax changes to generate resources for transportation. But challenges to implementing those changes make it difficult to predict exactly how much the package will raise, how it will be raised, and from whom.

If carried out completely as intended, the package would result in over $6 billion in new funds for transportation: $3.5 billion in new statewide resources for transportation over the next five years and another $2.5 billion for Northern Virginia and Hampton Roads (See Figure 4).

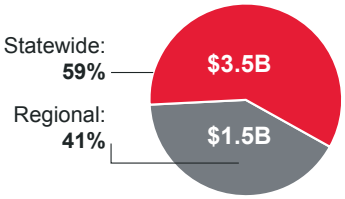
Of the statewide revenue sources, the 0.3 percent increase in the sales tax generates the most over the next five years ($1.5 billion), followed by the car titling tax increase ($1.1 billion), and the assumption that remote seller legislation will be approved by Congress ($980 million). The diversion of a larger amount of existing sales and use tax revenue from the general fund provides an additional $700 million over the next five years to transportation, and the increased hybrid registration fee brings in an extra $43 million.

The conversion of the gas tax from the current cents-per-gallon basis to a percentage basis assessed at the wholesale level is a net revenue loser, costing the state nearly $850 million over the next five years (see Figure 5).

FIGURE 4

Resource Blend

Transportation Funding Package Total Expected Revenues, Statewide and Regional, FY2014-FY2018

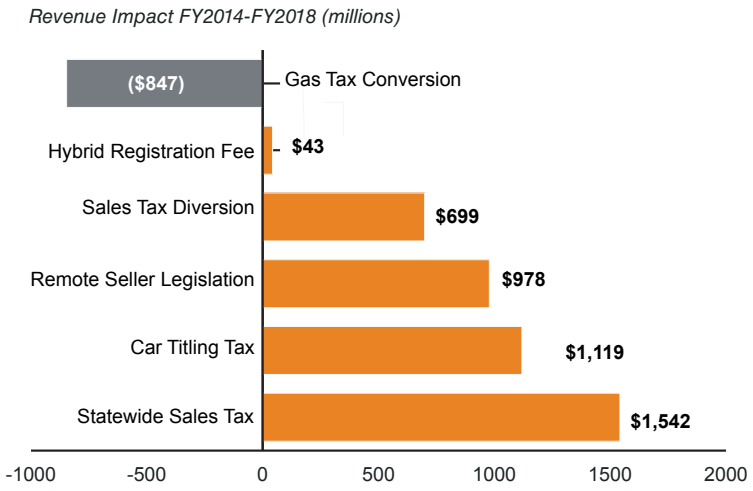


Source: Senate Finance Committee and TCI analysis of HB2313.

FIGURE 5

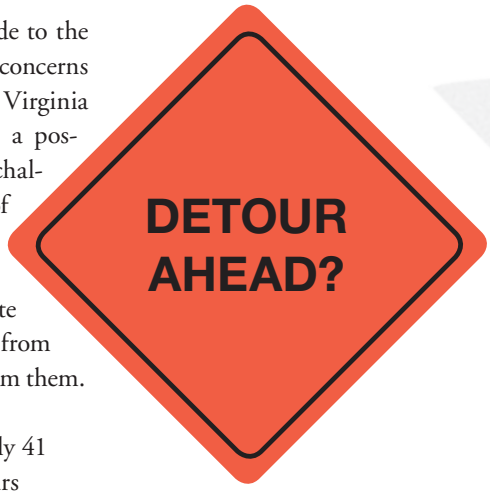
Statewide Sources of Revenue

Sources of Statewide Transportation Revenues, FY2014-FY2018



Source: Senate Finance Committee and TCI analysis of HB2313.

Other Potential Issues with the Transportation Plan



Even though the amendments made to the package address the constitutional concerns over the local taxes for Northern Virginia and Hampton Roads, there's still a possibility that they will face legal challenge. Furthermore, a key piece of the package relies on Congress to pass legislation by 2015 that will allow Virginia to require remote sellers to collect the state's sales tax from Virginians who make purchases from them.

Without the regional taxes, roughly 41 percent of the transportation dollars included in the plan disappears. Total transportation resources between 2014 and 2018 would drop to $3.5 billion from $6 billion.

Relying on Congress to pass the remote seller requirement is another major gamble. To help cushion the potential blow if Congress doesn't act, the legislation would increase the sales tax on the wholesale price of gasoline to 5.1 percent from 3.5 percent in 2015. While this would bring in about $783 million over five years, it would not fully replace the $978 million the remote sales tax was estimated to raise from FY 2014-2018.

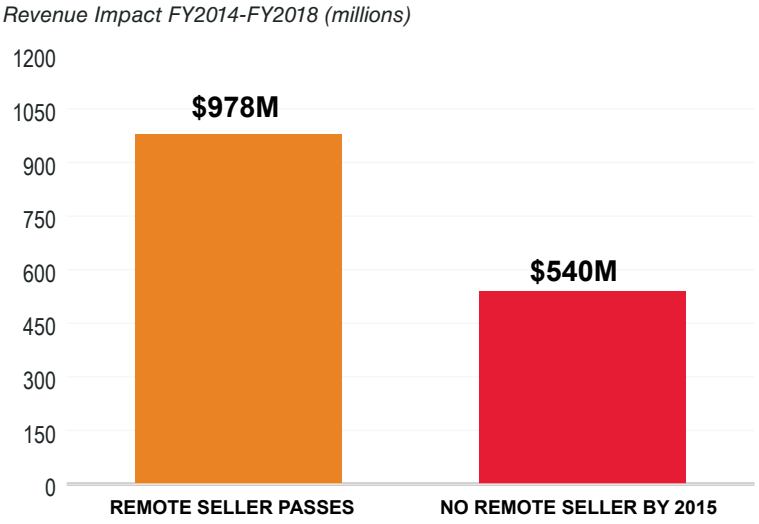
In addition, if Congress does not enact remote seller legislation by 2015, the diversion of sales tax revenues from the general fund to the transportation fund would be capped at the 2015 amount instead – of rising to 0.675 as planned. This would reduce transportation resources an additional $220 million by 2018.

All told, a failed bet on federal remote seller legislation could reduce the package's transportation investment by over $400 million by 2018 (see Figure 6).

FIGURE 6

No Hedge for This Bet

Revenue Impact from Remote Seller Legislation vs Additional Gas Tax Increase and Capped Sales Tax Diversion, FY2014-FY2018



Source: Senate Finance Committee and TCI analysis of HB2313.

Spotlight

Does the transportation funding package mean more money for education?

The transportation funding package dedicates an additional 1/8th of a penny of the existing state sales and use tax to public education, bringing the total amount to 1.25 cents.

But does this mean that education will see any real increase in resources?

The answer is not clear. The increase amounts to about $578 million over the next five years – or around $120 million a year – but this is from current sales and use tax revenues, not any new money generated by the increase in those taxes.

The forecast for Virginia's schools looks particularly grim given how much more general fund revenue would be diverted to transportation under the package. As shown in Figure X, over the next five years, roughly $121 million more in sales tax dollars will go to transportation than to education.

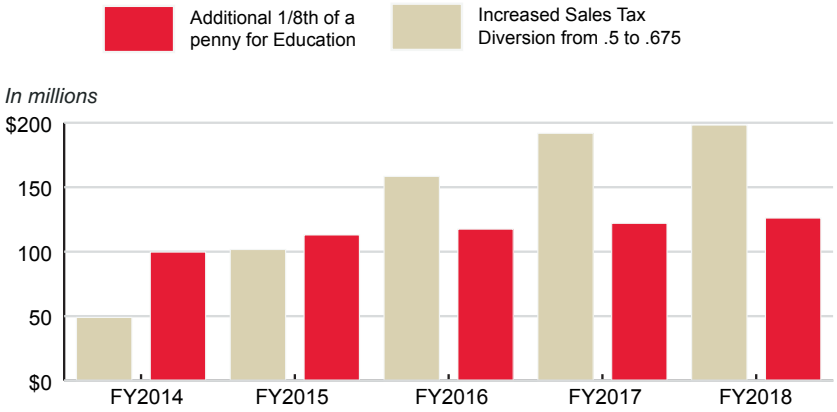
Perhaps more importantly, over the next five years the pool of general fund resources that can be used at legislators' discretion to fund key public priorities like education will be reduced by nearly $1.3 billion under these new provisions in the transportation package. Over the last 10 years, state support for K-12 education has accounted for between 30 and 35 percent of general fund spending.

Whether dedicating more sales and use tax dollars to K-12 will enhance funding for education or simply replace other general fund appropriations that would have otherwise gone to education is an important question in determining whether this transportation funding package does anything meaningful for Virginia's students.

FIGURE 7

Uneducated Tradeoff

Increase in Existing Sales Tax Diversion to Transportation Compared to Increase in Existing Sales Tax Dedicated to Education, FY2014-FY2018



Source: Senate Finance Committee and TCI analysis of HB2313.

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