How Important are Local Taxes to Localities?

The Commonwealth Institute

Business Professional Occupational License, Machinery & Tools, and Merchant's Capital taxes support core local services

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Eliminating or reducing key local business taxes in Virginia without providing cities, towns, and counties with ways to make up the revenue losses undermines their ability to invest in local priorities like keeping streets clean, neighborhoods safe, and kids educated.

Efforts to weaken or completely dismantle local business taxes are not new in Virginia. Over the last 10 years, numerous legislative proposals have been introduced in the General Assembly to undermine three local business taxes: business professional occupational license tax (BPOL), machinery & tools tax (M&T), and merchant's capital tax (MC).

Legislative proposals have included freezing tax rates, prohibiting local governments from enacting a BPOL tax, and reclassifying M&T by certain industries to make them exempt from state and local taxation. And Virginia's Joint Legislative Audit and Review Commission is now conducting a study on making net income the basis of the BPOL tax, rather than gross receipts.

The latest proposals come from both gubernatorial candidates in Virginia. But these new proposals face the same challenge: if Virginia were to eliminate these local sources of revenue, how would the state also provide local governments with the tools to make up for the lost revenue needed to support core local services like education, health care, and public safety?

This issue brief discusses problems related to legislative proposals to eliminate these local taxes.

Communities Rely on Local Taxes

Local governments in Virginia currently rely on these three local taxes. In 2012, localities collected $899 million from BPOL, M&T and MC taxes, which is 6.2 percent of total local tax revenue statewide. To put this in perspective, it is roughly equivalent to all local government sanitation and waste removal spending for the entire year.

All but two of Virginia's 171 cities, towns, and counties collect at least one of these local taxes, according to a survey by the state's auditor: 130 collect BPOL, 153 collect M&T, and 47 collect MC taxes.

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While dependence on these resources ranges widely, on average Virginia's counties get 5.1 percent of their total local tax revenue from these local business taxes, independent cities get 8.3 percent, and towns get 14.5 percent. Generally, lower-income and less property-rich communities depend more heavily on local business taxes than wealthier communities.

Options to Offset Elimination of Local Taxes

If the state were to eliminate these local taxes, ways to make up for lost revenue are limited.

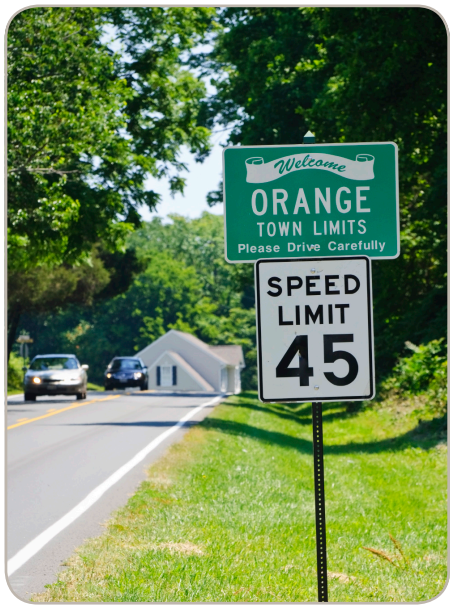
Virginia places strict limits on the ability of local governments to tax income, a key source of revenue that is available to the state. Only a handful of localities are authorized to tax income, and any attempt to enact a local income tax, must be approved by voters in the location through a referendum. Even if a local government institutes an income tax, it can only be in place for five years.

Instituting a new local tax, such as taxing meals and lodging, is another option. But the ability to do this is also limited by Virginia law. Without permission from the General Assembly, counties cannot impose meal or lodging taxes except by referendum. And if a county is authorized to levy lodging taxes, the state has set maximum tax rates. Moreover, nearly 75 percent of all localities already collect taxes on meals and/or hotel rooms, which are two of the most likely areas for local revenue collection, so this tax holds little ability to make up for lost revenue from current proposals to limit local business taxes.

The state could reimburse local governments for lost revenue with state general fund money, but this has not worked well in the past. The "Personal Property Tax Relief Act" of 1998 sought to eliminate the locally imposed car tax, but the cost of reimbursing the local car tax was such a drain on state revenues that the General Assembly was never able to give 100 percent reimbursement and had to cap it at just 70 percent in 2002. Then, beginning in 2006, reimbursements were frozen at $950 million and distributed based on each locality's 2005 reimbursement. There's no reason to think that reimbursement of local business taxes would go much better.

Conclusion

Virginia's local governments understand the needs of their own community best. While there may be better ways to raise revenue at the local level, eliminating local business taxes without the right replacement mechanisms threatens the ability of cities, towns, and counties to raise enough resources to pay for local priorities. In the absence of real alternatives from Richmond, simply eliminating these locally-controlled revenue sources just passes the buck.



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