The Commonwealth Institute
Building a Prosperous Virginia for All

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Meeting Budget Challenges

New report shows Virginia's revenue hasn't kept up with changes in the economy

Richmond, VA -- Downgrades from a Wall Street rating firm on Virginia's economic outlook because the state keeps drawing from the rainy day fund even during periods of economic growth. A tough upcoming budget year with the state being on the edge of not having enough money to maintain current obligations, despite the growing economy. New estimates showing Virginia is losing over $200 million a year because the state sales tax hasn't kept pace with the explosion of e-commerce. These are just a few of the latest signs of how Virginia's current revenue system isn't keeping up relative to the overall economy, and that puts important public investments at risk, according to a new report from The Commonwealth Institute for Fiscal Analysis, an economic and policy research organization in Richmond.

Despite economic growth in recent years, Virginia's tax system is generating less revenue relative to incomes than before the recession. Before the recession, general fund revenue when measured as a share of personal income averaged around 4.5 percent. Since the recession, that has dropped to 4.1 percent, a difference of about $1.8 billion in 2017.

"That's money that could be used to invest in K-12 education, health care, and other state priorities," says Chris Wodicka, co-author of the report.

That drop is due to a number of changes in the overall economy that the state's revenue system hasn't kept up with. For example, corporations have found new ways to reduce the taxes they pay, and consumers have changed their buying habits from goods to services.

The new report documents key challenges with each of the state's major revenue sources, identifies root causes, and offers solutions to address lagging revenues.

Among the report's key findings:

- Many corporations have lowered or even eliminated the amount of state corporate income tax they pay through aggressive tax planning. As a result Virginia's corporate

income tax is generating only about 6 percent of the state's income tax revenue, down from 15 percent in 1980. In fiscal year 2017, corporate income tax revenues remained down over $200 million since fiscal year 2006, after adjusting for inflation.

- Sales tax revenue is down as a share of income. Virginia's sales tax was designed for an economy that predates the rise of services and e-commerce. State sales tax revenues represented, on average, 0.92 percent of personal income from FY 2003 through FY 2008, while the share from FY 2009 through FY 2017 was 0.79 percent.

The report includes recommendations for decoupling from federal tax loopholes, enacting policies to limit corporate tax avoidance, and extending the sales tax to digital purchases. In the longer term, lawmakers need to expand Virginia's sales tax to more types of services.

"Until our tax system catches up to the 21st century, it's that much harder to seriously boost funding in areas like education and transportation and sustain priorities families and businesses care about," says Wodicka.

The full report, *A Tax System for Yesterday: Slow Revenue Growth amid Economic Change*, is available online at www.thecommonwealthinstitute.org.

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The Commonwealth Institute for Fiscal Analysis provides credible, independent, and accessible information and analyses of fiscal and economic issues with particular attention to the impacts on low- and moderate-income persons. Our products inform fiscal and budget policy debates and contribute to sound decisions that improve the well-being of individuals, communities and Virginia as a whole. Visit www.thecommonwealthinstitute.org for more information.