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The State of Taxaginia: Taxes Times Four

By Stephen D. Haner

3/11/2019 -- Wealth taxes are all the rage now in national discussions, with Democrats usually getting battered for proposing one. But as final versions of the income tax bill moved around the 2019 General Assembly, Democrats slipped in a provision to cap the amount of deductions wealthiest taxpayers can claim, raising their tax bills. Republicans agreed to it.

It is a wealth tax provision called the Pease Limitation which was long a part of the tax code at the federal level, and thus became part of Virginia's taxes under the doctrine of conformity. The 2017 federal Tax Cuts and Jobs Act got rid of it. Had the legislature simply adopted conformity in its 2019 bill, the cap would have gone away in Virginia, as well.

It will be gone for the Tax Year 2018 returns now being filed, but it slams back into place for Tax Year 2019 and beyond, at the state level only. With that final amendment, the General Assembly guaranteed that less than half of the income tax revenue the state will harvest from federal conformity goes back to taxpayers.

My November 4, 2018 Commentary article identified the coming debate over income tax conformity and policy as one of four potential tax increases moving forward in Virginia, with the hope that at least that one might be headed off by prompt General Assembly action. That hope was not fully realized, not yet, although voters may be distracted from that fact by small one-time refund checks heading their way this summer.

The other three tax increases coming our way mentioned in that article are all on track, as well. The earlier rough estimate that they would cost citizens and businesses $1 billion per year is still reasonable, if not a bit low.

Virginia is now collecting the largest of the three, the hospital provider taxes being used to expand Medicaid coverage and increase Medicaid provider payments. Those alone are expected to collect $763 million in 2020 and $862 million in 2021.

In a matter of months, a far higher proportion of purchases you make through the internet will include the state sales and use tax, with a bill passing to bring Virginia in compliance with the U.S. Supreme Court's *Wayfair v. South Dakota* decision. Most won't notice the change since that net was closing anyway. That accounts for an additional $155 million in 2020 and $175 million in 2021.

And using language buried in the budget, not in a bill, the legislature cemented in place a coming carbon tax imposed by Virginia's membership in the Regional Greenhouse Gas Initiative.

The smart play on RGGI would have been to direct the State Corporation Commission to give the carbon tax revenue back to ratepayers as a credit on their electric bills, probably through the monthly fuel cost rider. Almost every dollar the utilities paid for permission to emit carbon dioxide from their power plants would have returned to us. Wasn't "Give it back!" the operative phrase all session? Couldn't the RGGI carbon tax be given back, too?

Instead the budget conference report, now adopted but not yet signed, directed all the RGGI proceeds into the state general fund, not to be spent "without the express approval of the General Assembly as evidenced by an appropriation." It makes official that the fees the utilities will pay are a carbon tax, ultimately collected from you. Just how much that will be is up to the future auction price on 28 million tons of CO_2 emissions.

The legislature's half-hearted response to the conformity income tax reform opportunity adds at least another half billion dollars or so to the state's revenue flow. In effect, the legislature gave some back, kept some by resurrecting the Pease Limitation, and put the rest into the hopefully-named Taxpayer Relief Fund to accumulate with interest for future disposition.

The best step the General Assembly took was to increase the standard deduction for the taxpayers who use that tax approach, which is most of them. The $3,000 increase in the standard deduction for married taxpayers is at best half what could and should have been done. That change and the one-time rebate of $220 for that same couple represent their entire benefit. The $392.50 tax reduction over two years will be mentioned in the campaign rhetoric, but it drops back to $172.50 after the election.

The long-term impact also matters. The state's own estimate of the revenue harvest from federal conformity is $4.6 billion over six years, 2019-2024. The revenue reduction from the now-signed tax law is $1.3 billion over that same six years, less than 30 percent of the take. Add in the one-time $420 million in cash payouts this summer and the money "returned" is still far less than half the money expected to be collected.

The state comes out ahead by up to $2.8 billion after six years, again using Governor Ralph Northam's Tax Department's figures. It was the late addition of the Pease Limitation wealth tax, $466 million in higher taxes over six years that tipped the balance in the state's favor on the scale.

Yes, the remainder of the tax conformity boost is supposed to be accumulated and held in that Taxpayer Relief Fund. Yes, the bill signed by the Governor states the money "shall" be used "to effectuate permanent or temporary tax reform measures." But there will be an election before that can happen. Seats will change parties. Control may change parties. What one General Assembly gives, the next may taketh away.

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