

W E S T V I R G I N I A



DEPARTMENT OF REVENUE

Joint Select Committee on Tax Reform Income Taxes

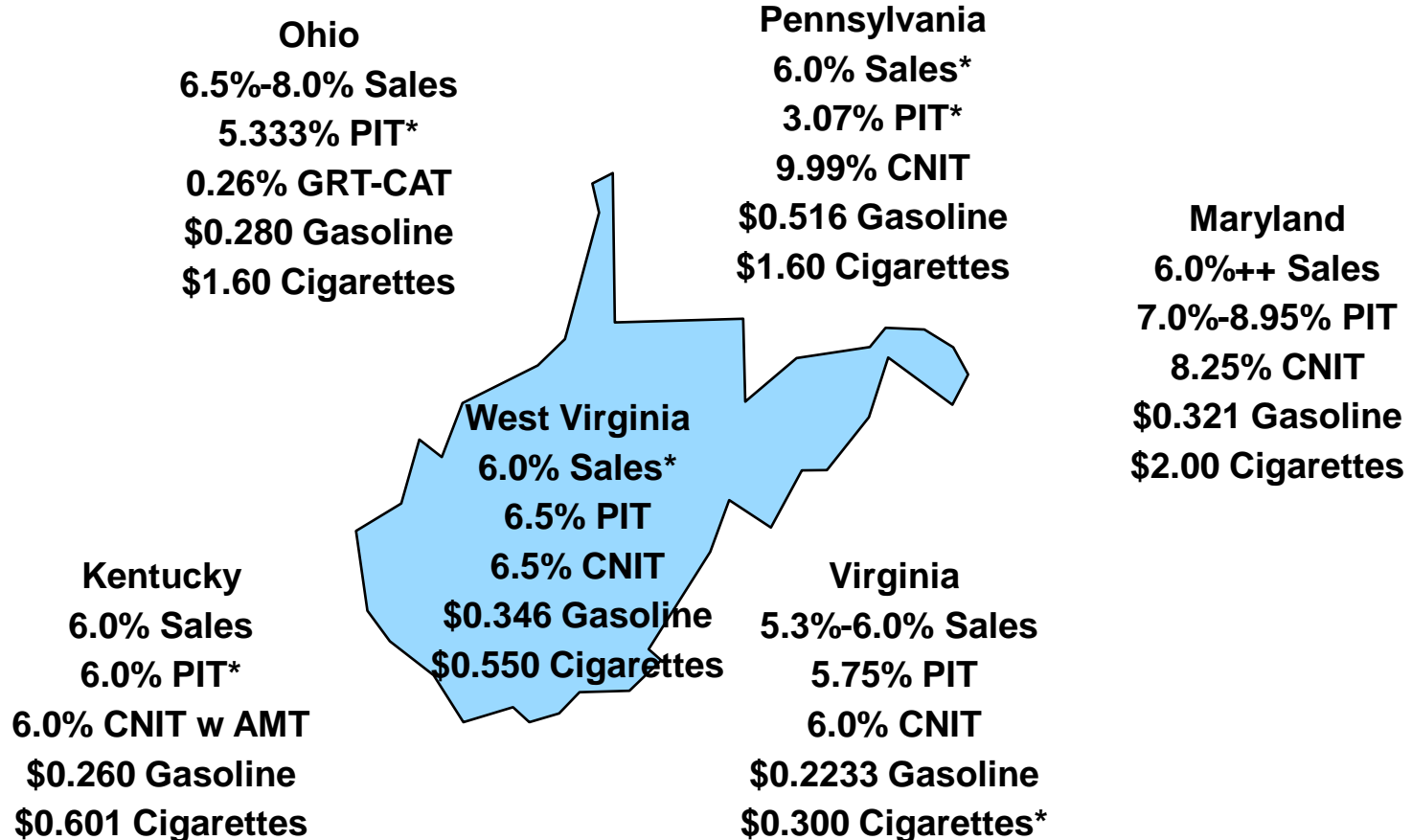
DEPUTY REVENUE SECRETARY MARK B. MUCHOW
GENERAL COUNSEL MARK S. MORTON

West Virginia State Capitol
August 17, 2015

COMPARATIVE TAX RATES

As of July 1, 2015

* Additional local taxes may apply



Personal Income Tax

West Virginia Personal Income Tax Structure

More Than \$1.932 Billion Yield in FY2015

- **Linked to Federal definitions for tax base**
 - **WV link is Federal Adjusted Gross Income (AGI)**
 - More than \$36.6 billion on full-year resident returns in TY2012
 - More than 762,000 full-year resident returns filed
 - Roughly 69,000 part-year or non-resident returns filed
 - 29 states and DC use Federal AGI as starting point
 - 7 states: Federal Taxable Income link (CO, ID, MN, OR, SC, VT)
 - 5 states: Independent (AL, AR, MS, NJ, PA)
 - 0 states start with Federal Income Tax Liability
 - 2 states have limited interest & dividends tax base (NH and TN)
 - 7 states: no personal income tax (AK, FL, NV, SD, TX, WA, WY)

Increasing Modifications

Roughly \$100 million added: Full-Year Resident Returns

- Federal obligation interest/dividends not exempt from state tax
- Interest or dividend income on non-WV state and local bonds
 - Largest source of additions for non-resident returns
- Interest on money borrowed to purchase tax exempt bonds
- Qualifying 402(e) lump-sum distributions
- Section 199 Deduction for U.S. Production Activities
 - Federal return statistics indicate more than \$21.7 million for WV on 1,340 returns
- Withdrawals from a WV Pre-paid Tuition/SMART 529 Savings Plan not used for qualifying expenses
 - Roughly \$0.6 million added

Decreasing Modifications

Roughly \$1.4 Billion subtracted on resident returns

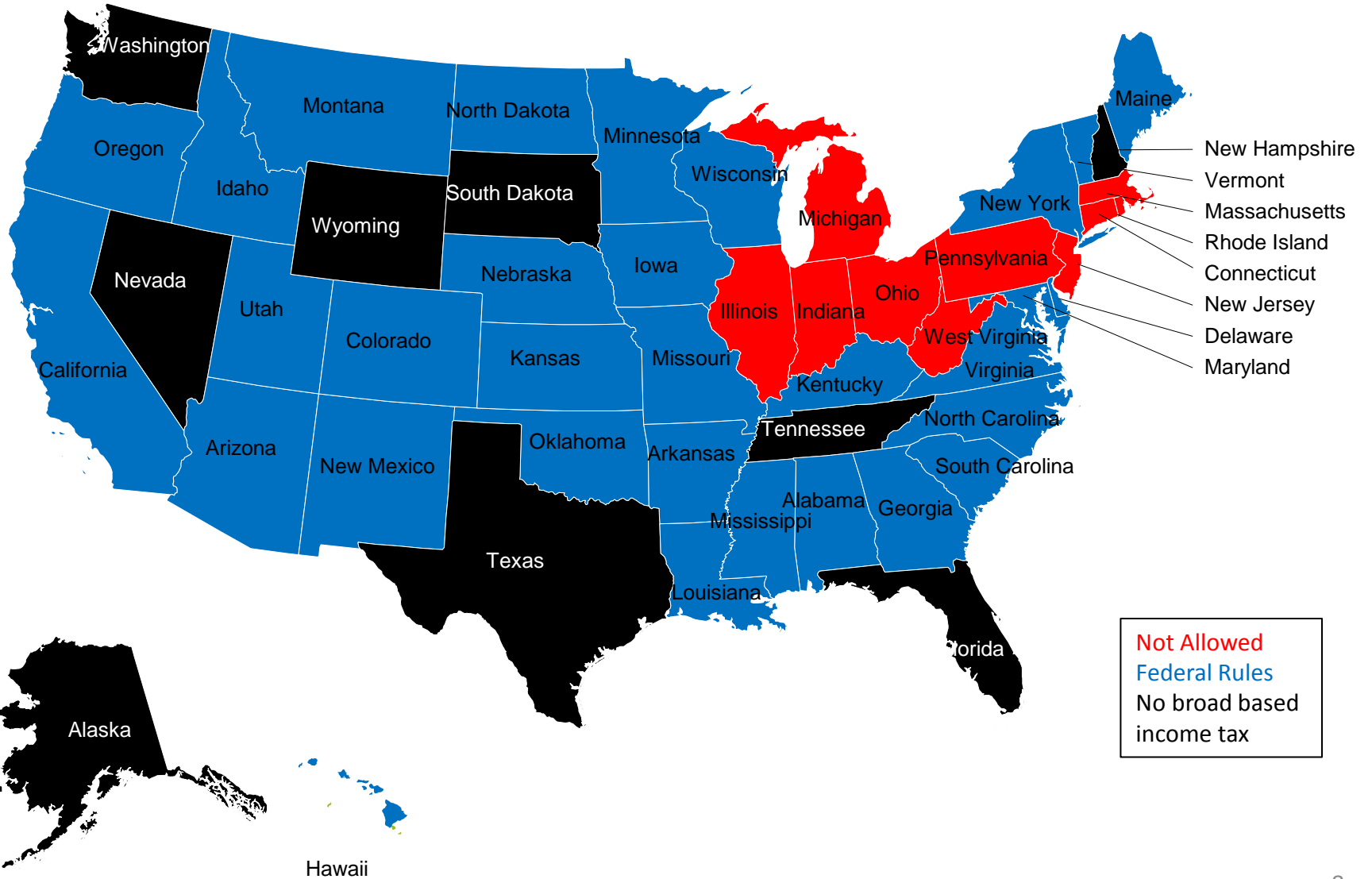
- U.S. obligation interest/dividends & WV Obligations exempt from state tax but not federal tax
- Refunds of State & Local Taxes Reported on Federal Tax Return
- Federally required: Income from Railroad Retirement Board
- Contributions to WV Pre-paid Tuition /SMART529 Savings Plans
- Long-Term Care Insurance Premiums
- Contributions to State Medical Savings Accounts up to \$2,000
- EZ Pass (PAC) Toll Fees of at least \$25 but no more than \$1,200
- Autism Trust Fund contributions up to a maximum of \$1,000 (\$2,000 joint)
- Active duty military pay during year of separation from active service & active duty pay for National Guard or armed forces reserve pursuant to Executive Order of President in Operation Enduring Freedom or for domestic security

Decreasing Modifications Continued

Roughly \$1.4 Billion subtracted on resident returns

- Benefits received from any WV state or local police, deputy sheriff's or firemen's retirement system
- Up to \$2,000 of certain public sector retirement benefits received (federal civil service, military, TRS and PERS)
- Up to \$20,000 in additional military retirement benefits received not elsewhere deducted
- Up to \$8,000 (\$16,000 joint) of income not otherwise deducted for individuals over age 65 or permanently disabled
- Up to \$8,000 of income not otherwise deducted for a surviving spouse of an individual age 65 or older or permanently disabled

Itemized Deductions



Determination of WV Tax

More than \$32.1 Billion in WV Taxable Income & \$1.6 Billion in Pre-Credit Tax Due on Full-Year Resident Returns in TY2012

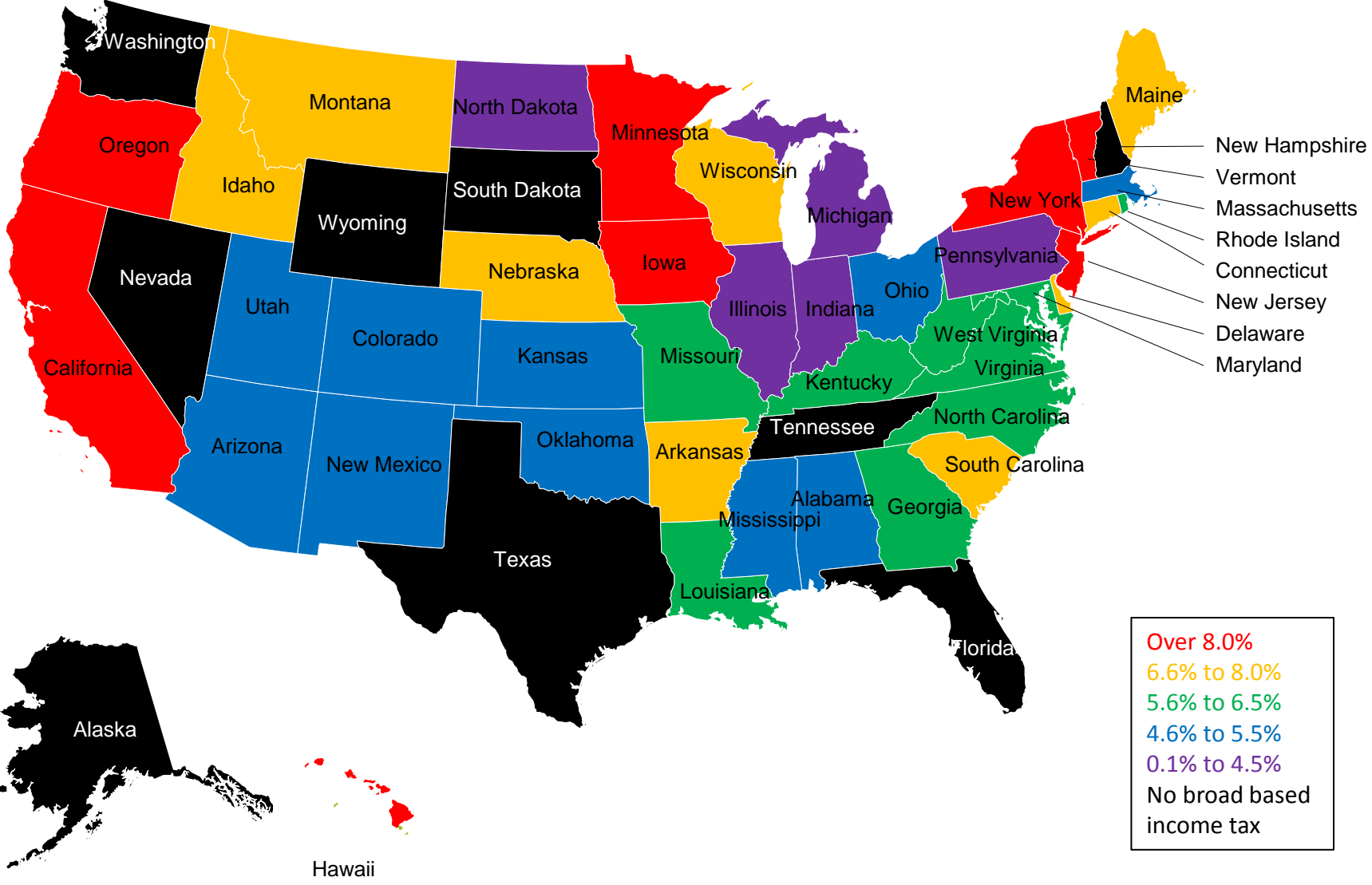
- Federal AGI + (Increasing Modifications – Decreasing Modifications) = WV AGI
- WV Taxable Income = WV AGI – Personal Exemption Allowances
 - Number of exemptions claimed on federal tax return x \$2,000 per allowance
 - Additional \$2,000 for a surviving spouse for 2 years
 - \$500 allowance for a dependent tax return when federal exemption is 0
 - Low-income earned income exclusion for those with AGI ≤ \$10,000 (\$5,000 MFS)
- West Virginia Tax before Credits = WV Taxable Income x graduated tax rates

| <u>Joint Head of Household or Single</u> | <u>Married Filing Separate</u> |
|--|--|
| – \$0 + 3% on first \$10,000 of WVTI | [3% on first \$5,000 of WVTI] |
| – \$300 + 4% on next \$15,000 of WVTI | [\$150 + 4% on next \$7,500 of WVTI] |
| – \$900 + 4.5% on next \$15,000 of WVTI | [\$450 + 4.5% on next \$7,500 of WVTI] |
| – \$1,575 + 6% on next \$20,000 | [\$787.50 + 6% on next \$10,000 of WVTI] |
| – \$2,775 + 6.5% on WVTI > \$60,000 | [\$1,387.50 + 6.5% on WVTI > \$30,000] |

Personal Income Tax Rates

Top Marginal Tax Rate

2015



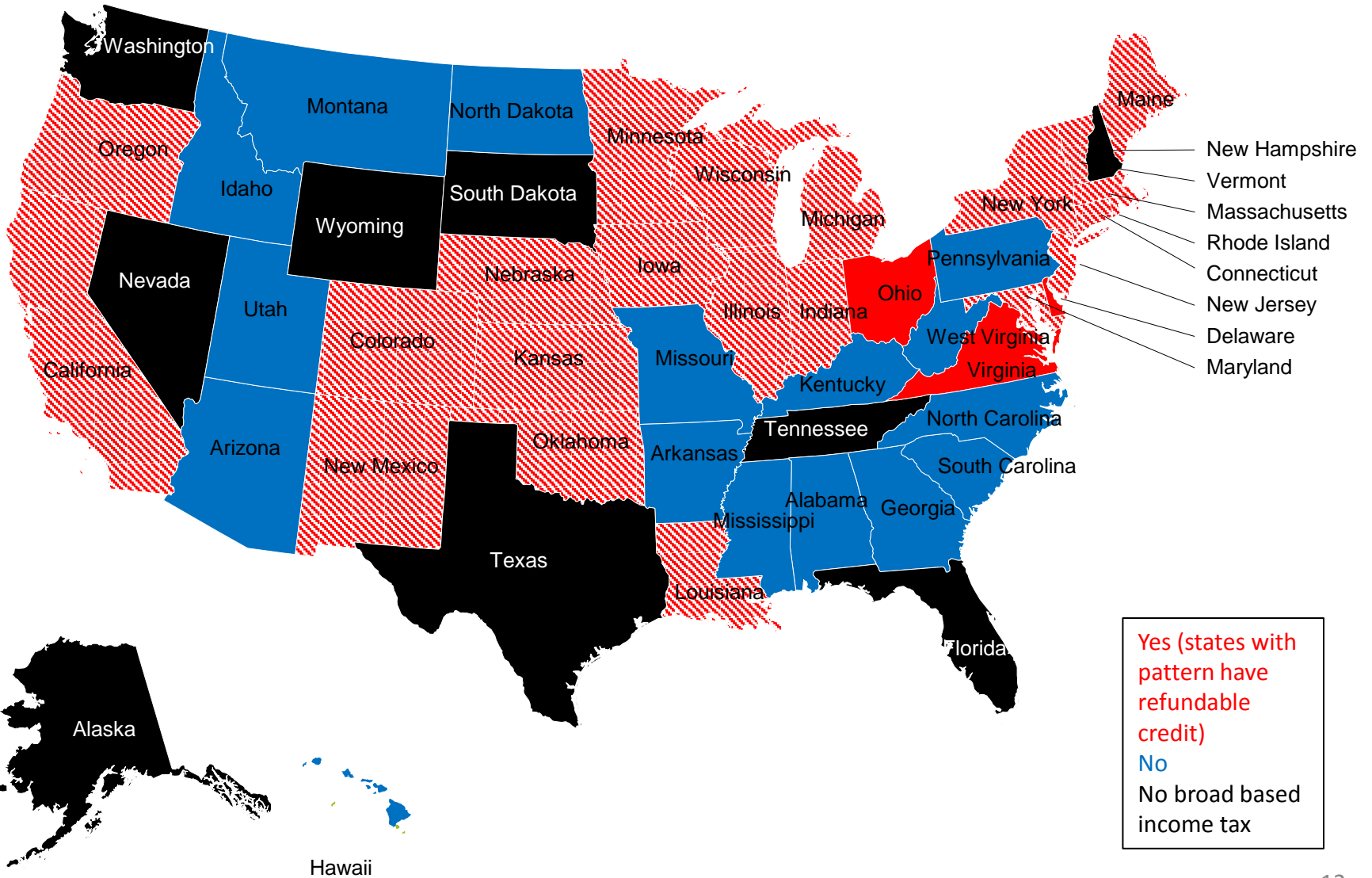
Source: Federation of Tax Administrators Annual Survey

Determination of State Income Tax Liability

\$1.72 Billion in Pre-Credit Tax - \$60.9 million in Tax Credits = \$1.66 billion in Net Tax
Full-Year Residents \$1.54 Billion & Part-Year/Non-Residents \$122 Million

- Credit for Income Tax Paid to Other States \$20.6 million (7,400)
- Low-Income Relief Tax Credits
 - Family Tax Credit: \$17.6 million for (90,500)
 - Senior Citizen Homestead: \$10.8 million (55,000)
 - Homestead Excess Property Tax \$ 2.9 million (7,100)
- Other Tax Credits
 - Adoption \$1.2 million (250)
 - Neighborhood Investment \$2.2 million (1,900)
 - Alternative Fuel Motor Vehicle* \$32.4 million (9,350)
 - Apprenticeship Training \$0.3 million
 - Rehabilitated Buildings (2) \$0.7 million
 - Film \$0.3 million
 - Solar* \$0.2 million
 - All Others < \$0.1 million

Personal Income Tax Earned Income Tax Credit 2015



Federal Earned Income Tax Credit

Originally Intended to Offset Social Security Taxes

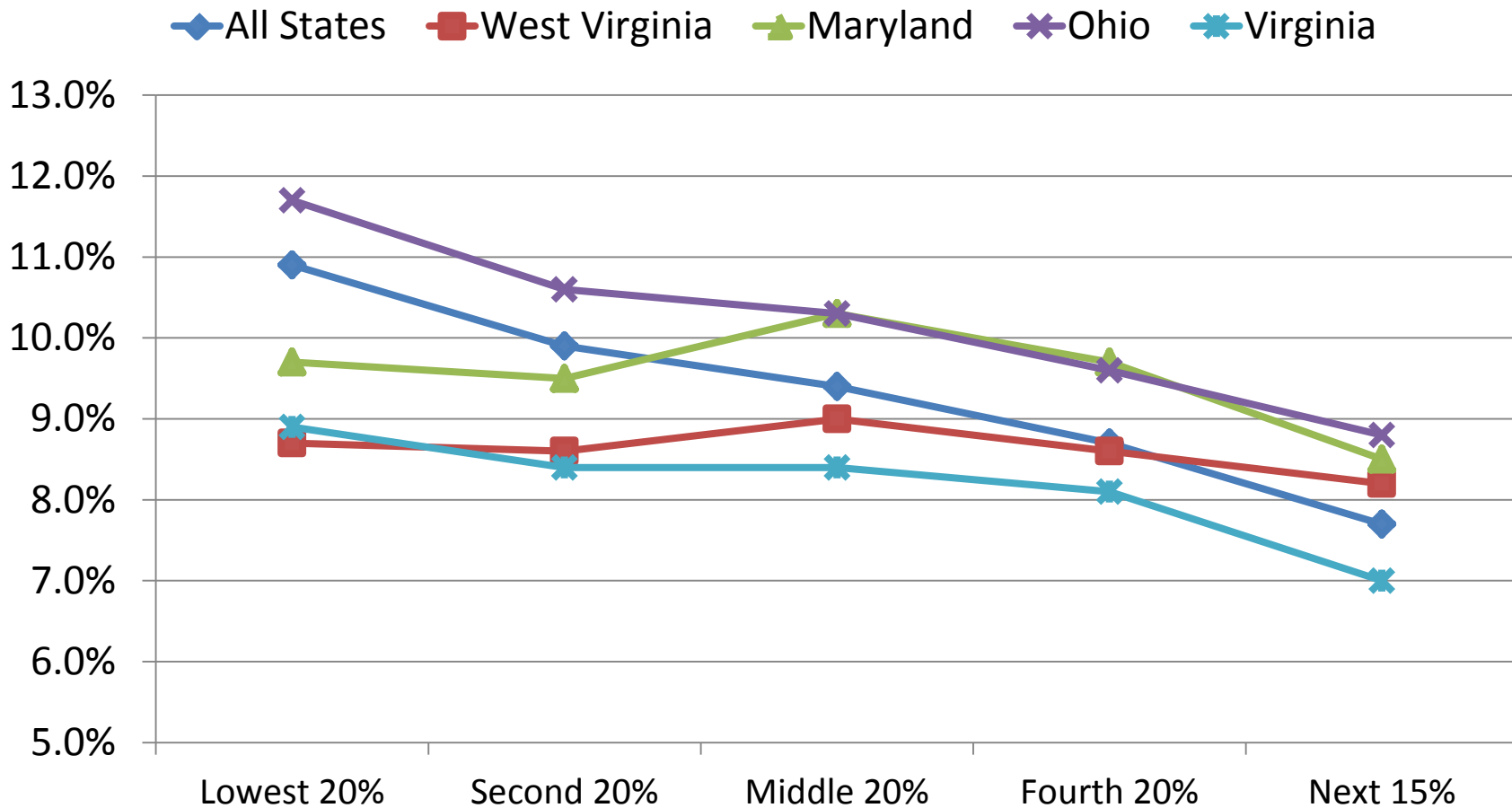
Major Expansion to Alleviate Poverty Began in 1993

- West Virginia Beneficiaries TY2012
 - 159,830 returns [20% of all filers]
 - \$341.1 million in benefits (91.5% refundable)
- Positive Benefits
 - Encourages employment for certain lower income workers
 - Lowers net tax burden for some lower income families
- Costs and Other Concerns
 - High marginal tax rates for those in phase-out range
 - Cost shifted to other taxpayers/other taxes
 - Significant noncompliance See <http://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>

States With Earned Income Tax Credit Tend To Impose Higher Tax Burden On Lower Income Residents Than West Virginia

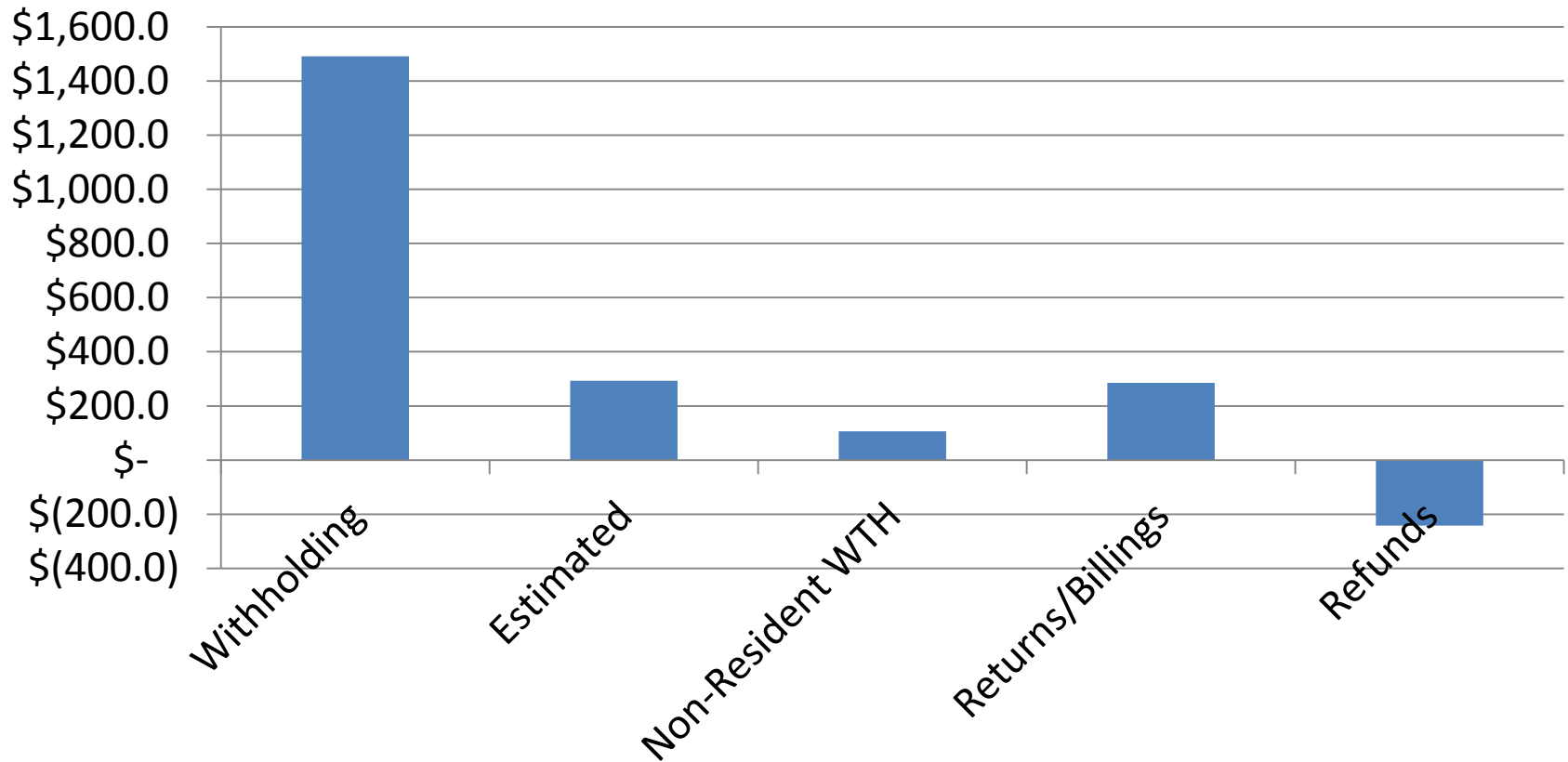
Estimated Tax Burdens By Income Level: Non-Elderly

Source: Institute on Taxation & Economic Policy: *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States* January 2015



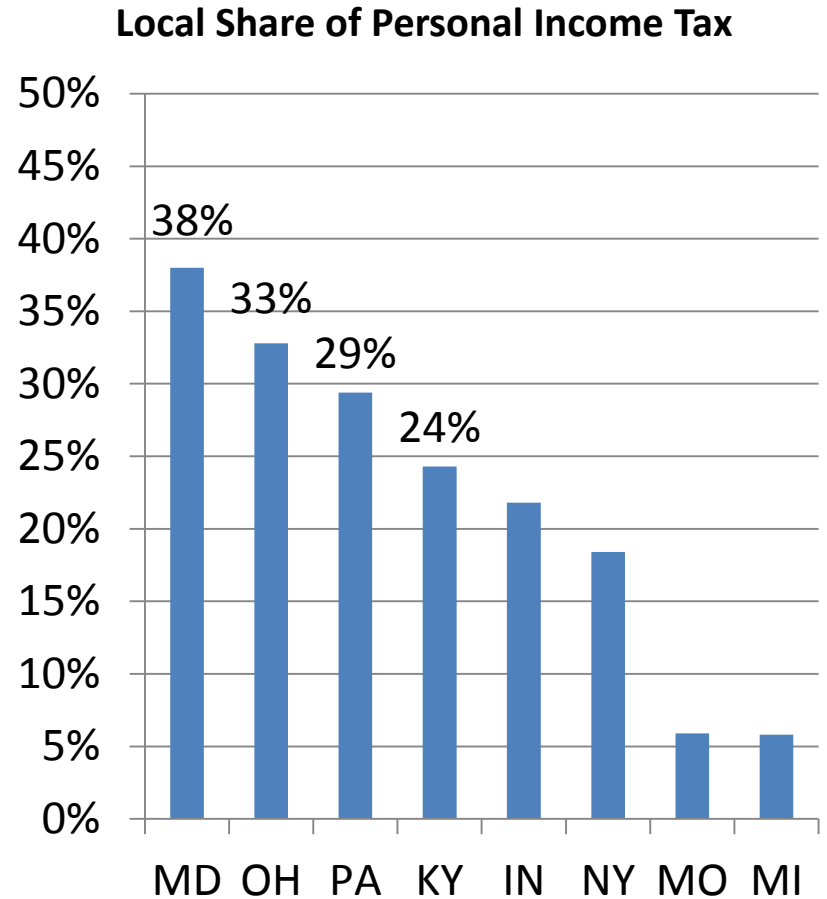
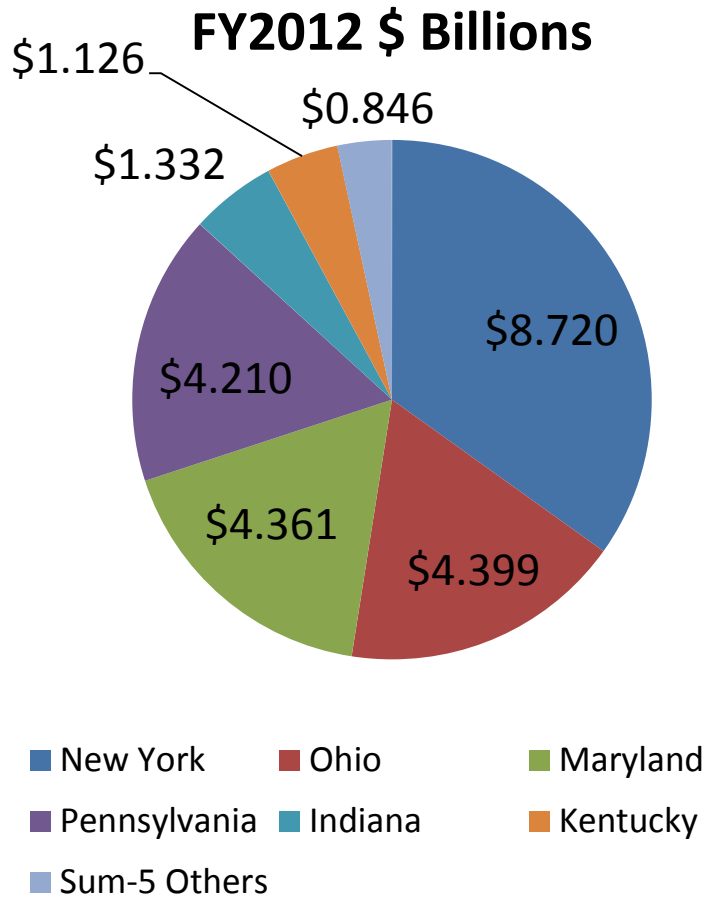
Components of FY2015 Personal Income Tax

\$ Millions



Local Income Taxes: 4.3% of Total Local Taxes

West Virginia's Contiguous Neighbors Account for 53% of \$25.15 Billion



Government Finance Statistics

States Without Broad-Based Personal Income Taxes & WV

| State | Property Tax Rank | Property Tax \$130K | Per Capita Sales Tax Rank | Per Capita Sales Tax | Rank Sales Tax Rate | Hybrid Business Taxes (CNIT*) | K-12 Funding |
|-----------|-------------------|---------------------|---------------------------|----------------------|---------------------|-------------------------------|--------------|
| AK | (19) | \$4,167 | (47) | \$ 288 | (46) | * | 5 |
| FL | (13) | \$4,499 | (17) | \$ 1,111 | (29) | * | 44 |
| NV | (33) | \$2,853 | (9) | \$ 1,383 | (13) | Wage Tax /GRT | 43 |
| NH | (3) | \$7,188 | (48) | \$ 0 | -- | BPT/BET | 13 |
| SD | (21) | \$3,889 | (8) | \$ 1,390 | (40) | | 41 |
| TN | (34) | \$2,781 | (10) | \$ 1,331 | (1) | * | 46 |
| TX | (7) | \$5,491 | (15) | \$ 1,191 | (12) | Gross Margins | 40 |
| WA | (15) | \$4,358 | (3) | \$ 1,917 | (5) | B&O | 30 |
| WY | (45) | \$2,166 | (1) | \$ 2,119 | (43) | | 6 |
| WV | (50) | \$1,560 | (44) | \$ 689 | (35) | * | 23 |

Corporation Net Income Tax

West Virginia Corporation Net Income Tax Structure

More Than \$190 Million Yield in FY2015

- **Federal definitions for tax base Federal Taxable Income (FTI)**
 - 46 states and DC use some definition of Federal Taxable Income
 - 6 states: no corporate net income tax (NV, OH, SD, TX, WA, WY)
 - Ohio & Washington impose business gross receipts tax
 - Nevada imposes an employer wage tax & is implementing an additional business gross receipts tax
 - South Dakota imposes income tax on financial institutions
 - Texas imposes a gross margins tax

Increasing Modifications

- Interest/dividends from any state and local bonds
- U.S. Obligation interest/dividends net of expenses not exempt from State tax
- State & Local Income Taxes deducted on federal return & foreign taxes
- Federal depreciation for qualifying WV water/air pollution control facilities
- Unrelated business income of a corporation exempt from federal tax
- Federal net operating loss deduction & net operating loss from sources outside of U.S.
- Production income deduction under IRC §199
- Neighborhood investment tax credit charitable contributions
- Expenses related to REITS and Regulated Investment Companies & certain interest and intangible expenses

Decreasing Modifications

- West Virginia state income tax refunds included in FTI
- Foreign Dividend Gross-Up, Subpart F Income & taxable income from sources outside of U.S.
- Cost of West Virginia water/air pollution control facilities if not otherwise allocated
- Salary expense not allowed on federal return due to federal jobs credit
- Employer contributions to a WV medical savings account not deductible on federal tax return
- U.S. Obligation, West Virginia Obligation and Residential Property Obligation allowance [share of total assets multiplied by adjusted taxable income]

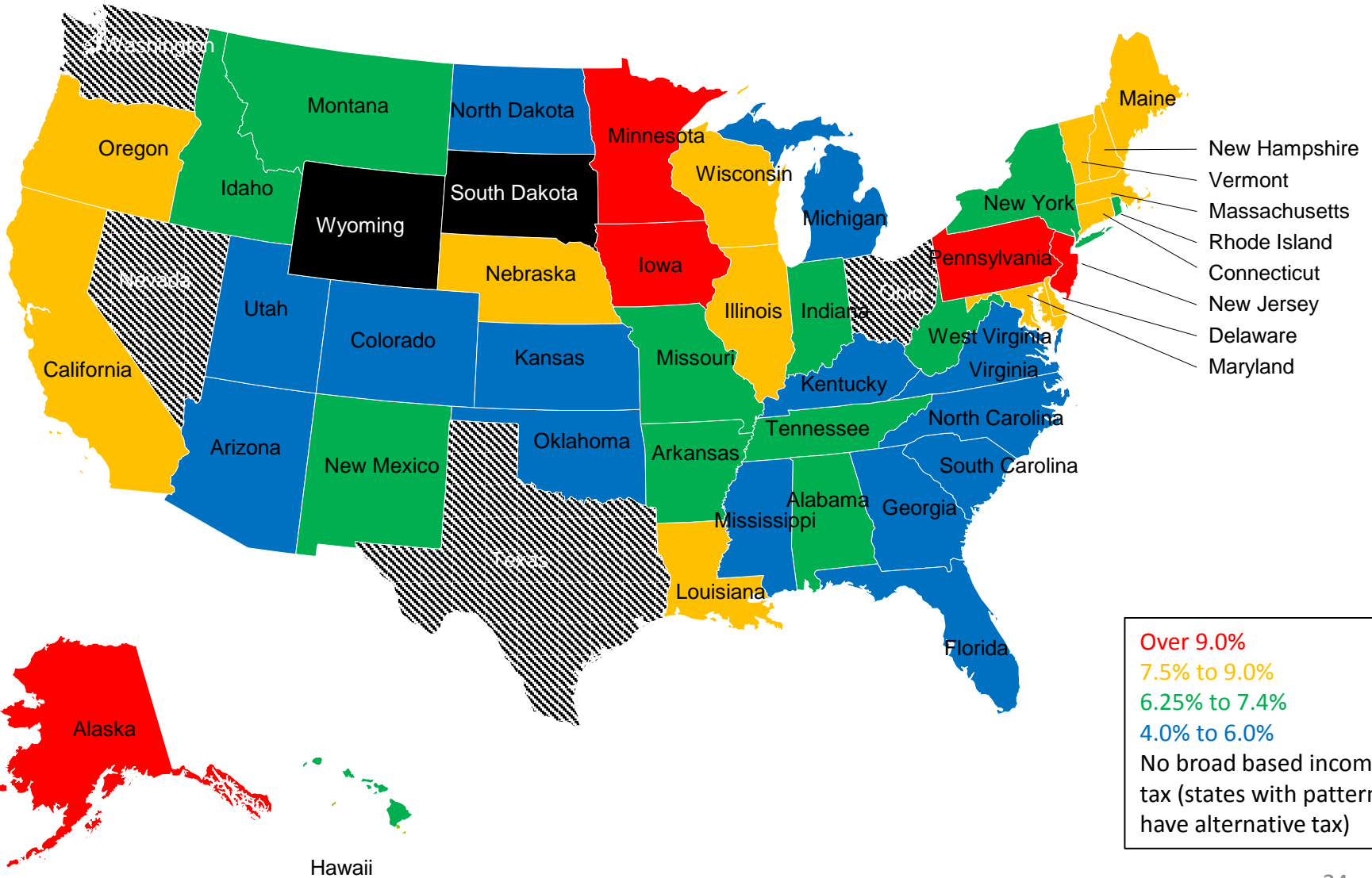
Allocation & Apportionment

- Multi-state firms apportion WV adjusted FTI to determine share to be taxed in WV
 - 50% weight on sales
 - 25% weight on property
 - 25% weight on payroll
 - Special formula for financial organizations
- Non-business income is allocated to source state
 - rents, royalties, capital gains, interest, dividends
 - cost of pollution control facilities
 - gain on sale of natural resources
- Allocated West Virginia Net Operating Loss Deduction

Hypothetical Tax Calculation for Single Multi-State Corporation

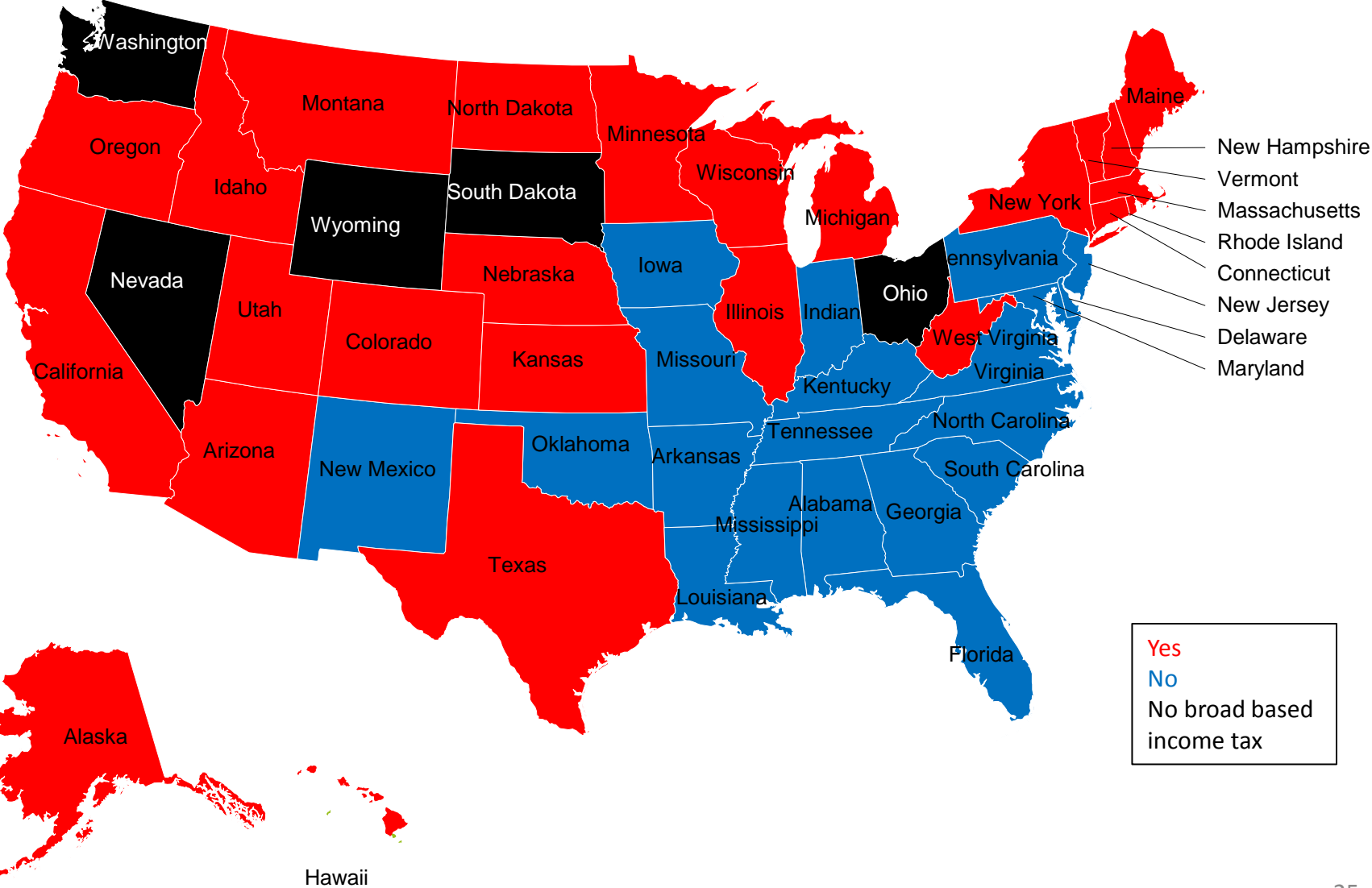
- ABC has \$10,000,000 in federal taxable income
- ABC has \$500,000 in increasing modifications and \$800,000 in decreasing modifications
- ABC has \$50,000 in allocated income outside of West Virginia
- Apportionment Factor = $[1.3334\% + 1.3334\% + 6.25\% + 9.0\%]/4 = 4.4792\%$
 - Property: \$0.4 million in WV & \$30 million everywhere = 1.3334%
 - Sales: \$5.0 million in WV & \$80 million everywhere = 6.25%
 - Payroll: \$0.18 million in WV & \$2 million everywhere = 9.0%
- Pre-credit tax: \$10,000,000 in FTI - \$300,000 in net modifications - \$50,000 in allocated income = \$9,650,000 x 4.4792% apportionment = \$432,243 + \$0 in WV allocable income = \$432,243 in West Virginia taxable income x 6.5% WV tax rate = \$28,096 in WV tax liability

Corporate Net Income Rates



Over 9.0%
 7.5% to 9.0%
 6.25% to 7.4%
 4.0% to 6.0%
 No broad based income tax (states with pattern have alternative tax)

Does Your State Have Mandatory Combined Reporting?



What is Combined Reporting?

- (1) Members of a **unitary group**
- (2) Determine net income based on the activities of the unitary group **as a whole**.
- (3) Each unitary group member with WV nexus apportions **total group income** to West Virginia, and pays its tax.

What is combined reporting?

The Taxpayer will typically file a **separate return**, along with a combined report, but the income shown will be the unitary group income apportioned to WV based on the unitary apportionment factors of the Taxpayer.

What is combined reporting?

Unitary business” means a **single economic enterprise** that is made up either of **separate parts of a single business entity** or of a **commonly controlled group of business entities** that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts.

UNITARY DETERMINATION

Unitary business” means a **single economic enterprise** that is made up either of **separate parts of a single business entity** or of a **commonly controlled group of business entities** that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts.

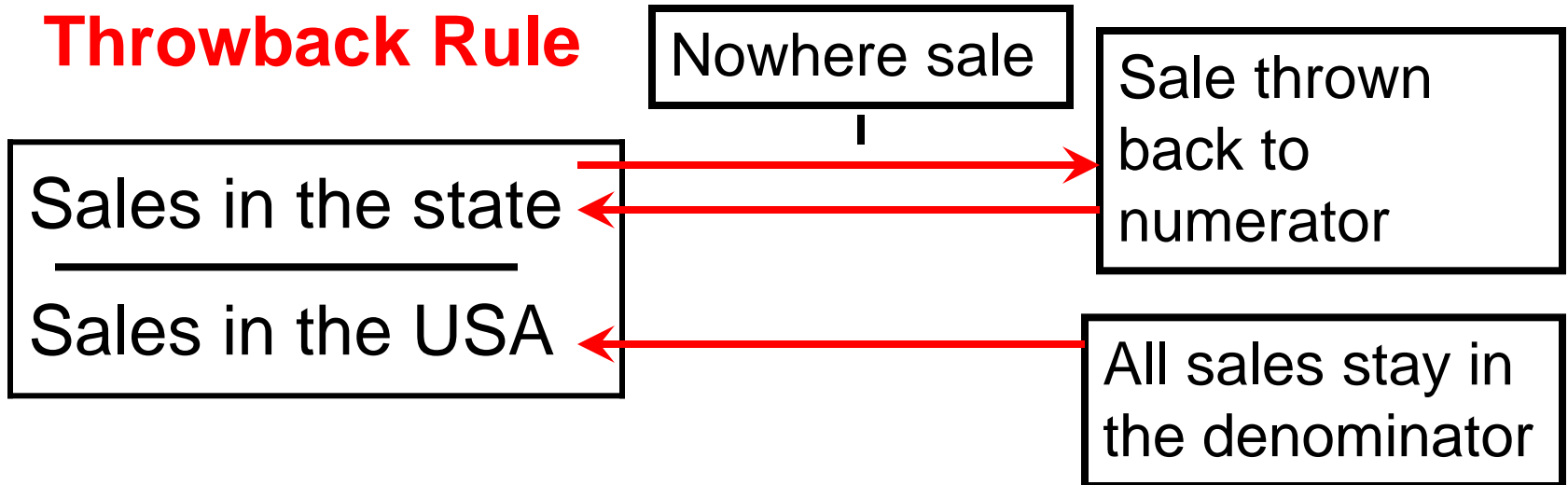
Joyce or Finnigan

West Virginia is a Joyce State with a Throw-Out Rule

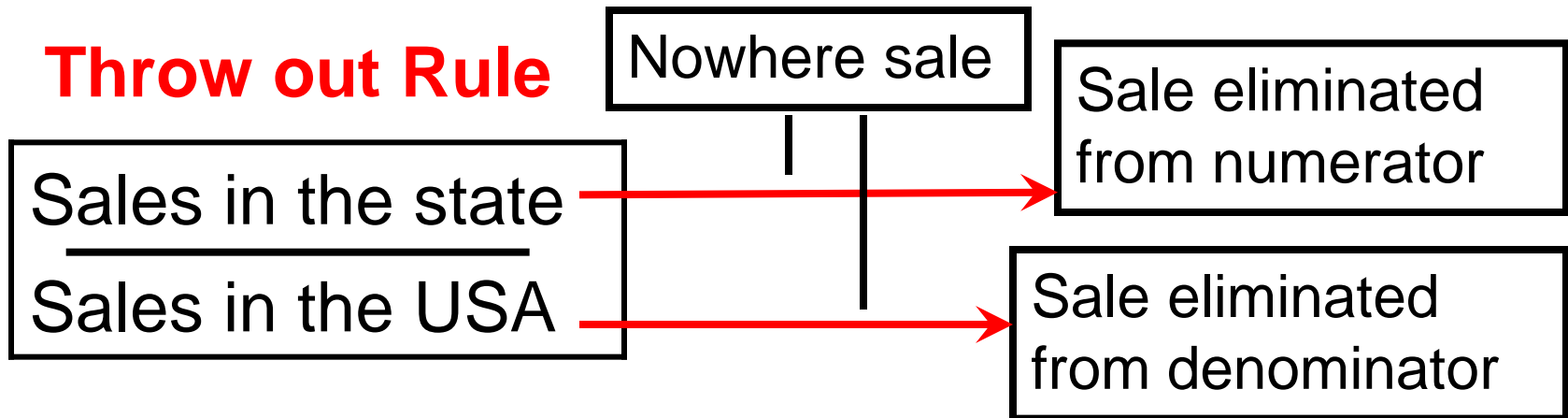
Joyce – If a member has nexus, then WV sales are included in the sales factor numerator.

Finnigan – If a member is a unitary group member, **regardless of nexus**, then sales are included in the sales factor numerator.

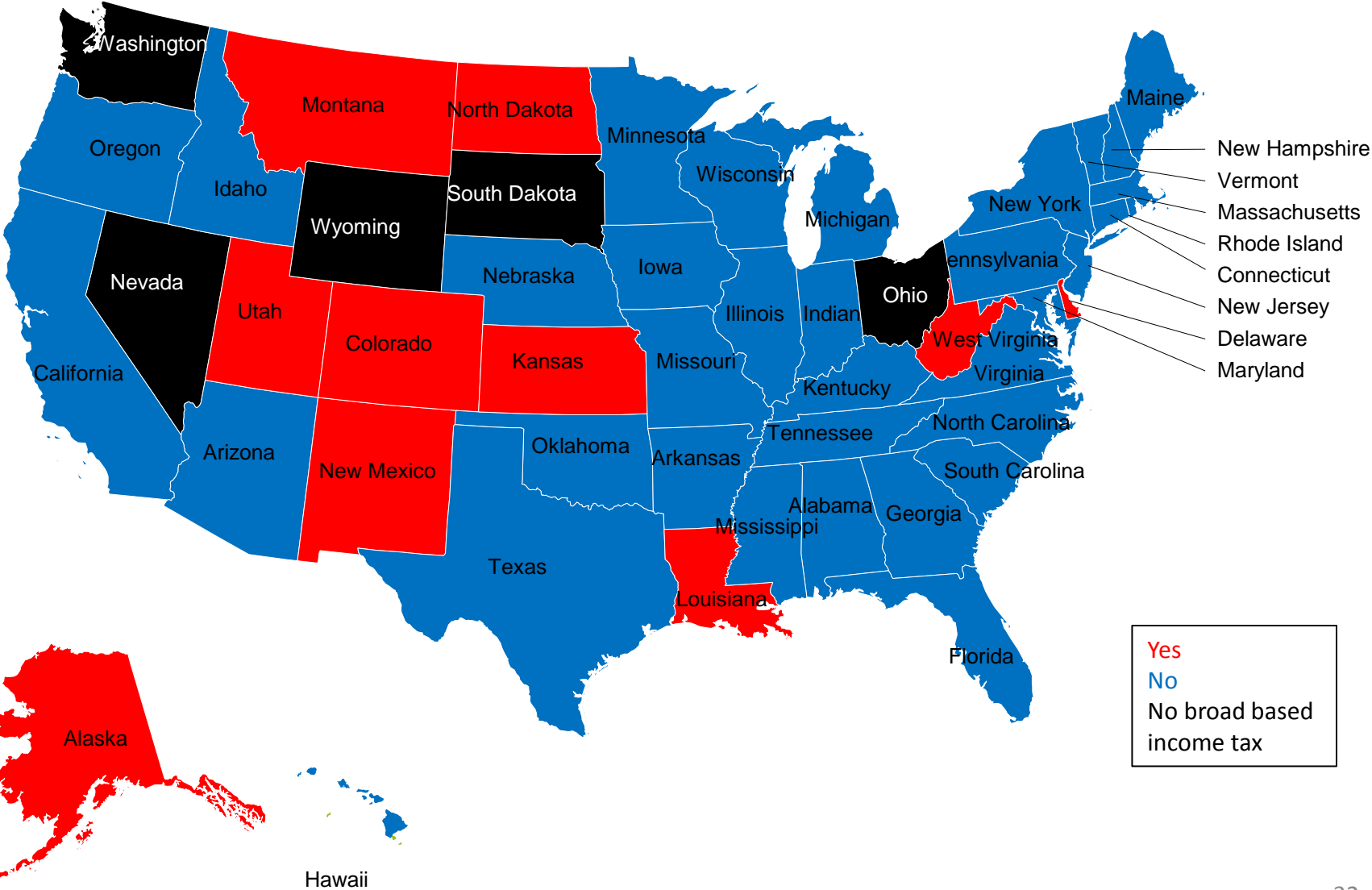
Throwback Rule



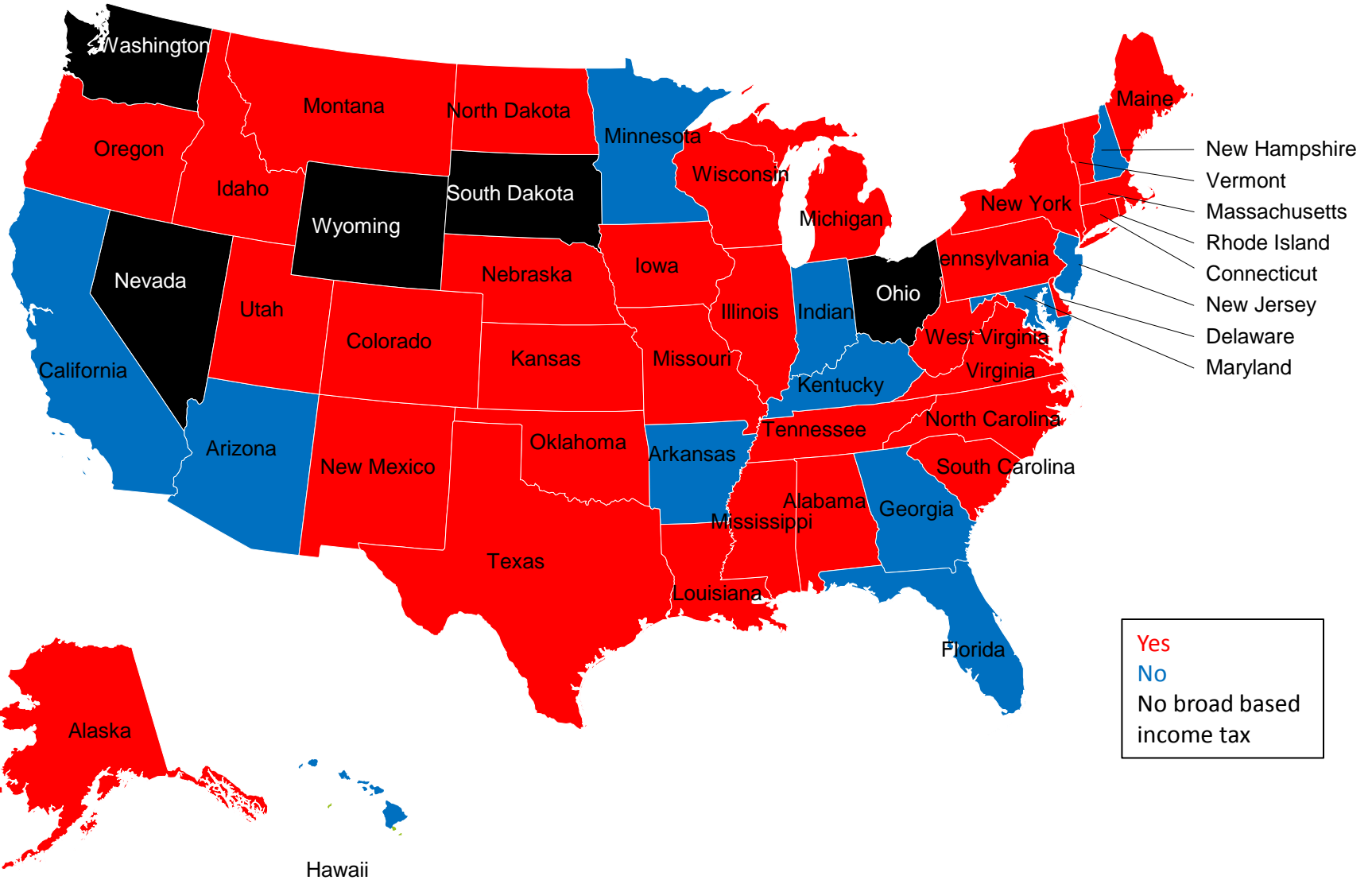
Throw out Rule



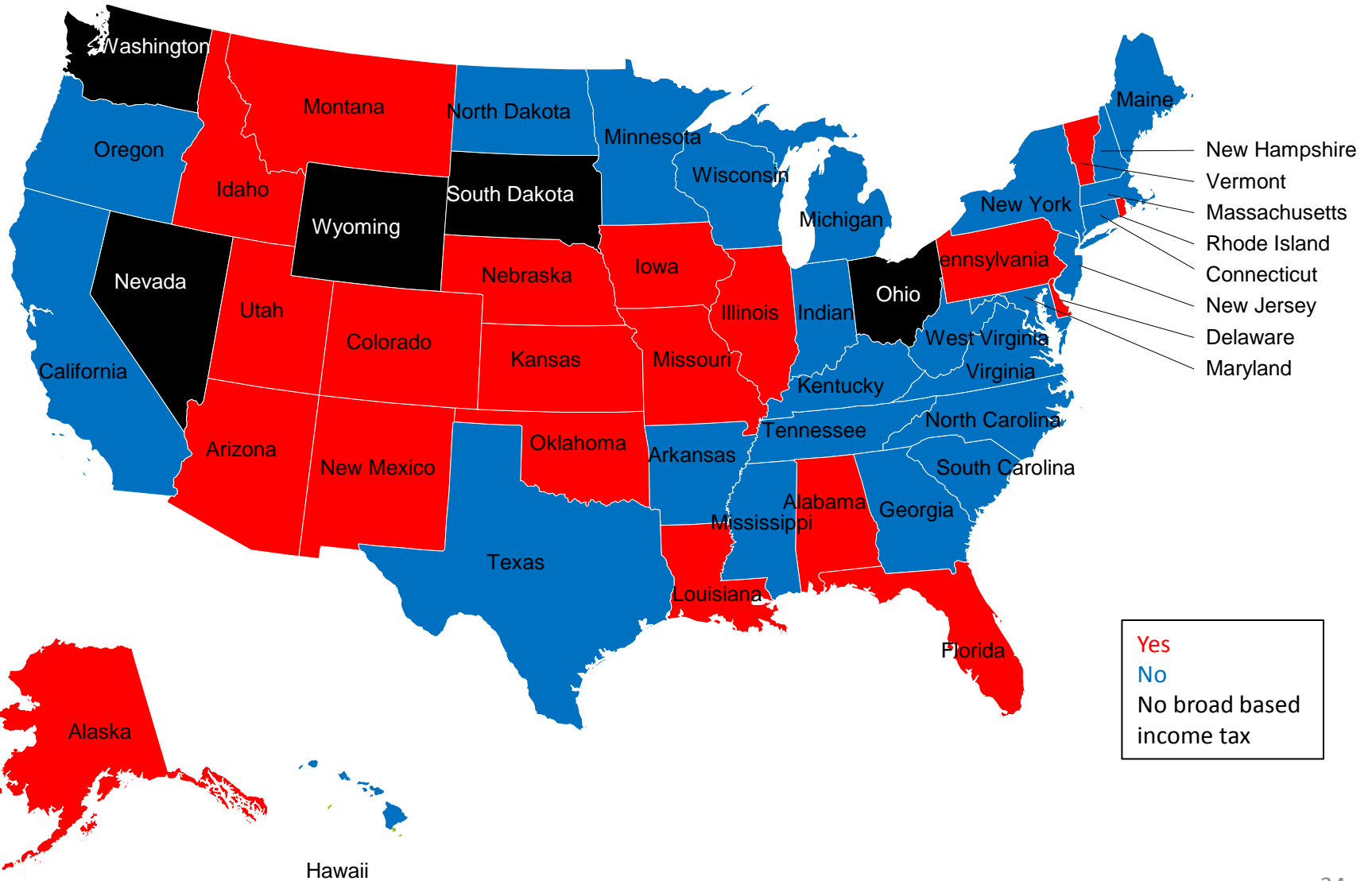
Consistent Conformity with Federal Bonus Depreciation



Conformity with §179 Federal Small Business Expensing Rules



Conformity With Section 199 Qualified Production Income Deduction



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Questions?

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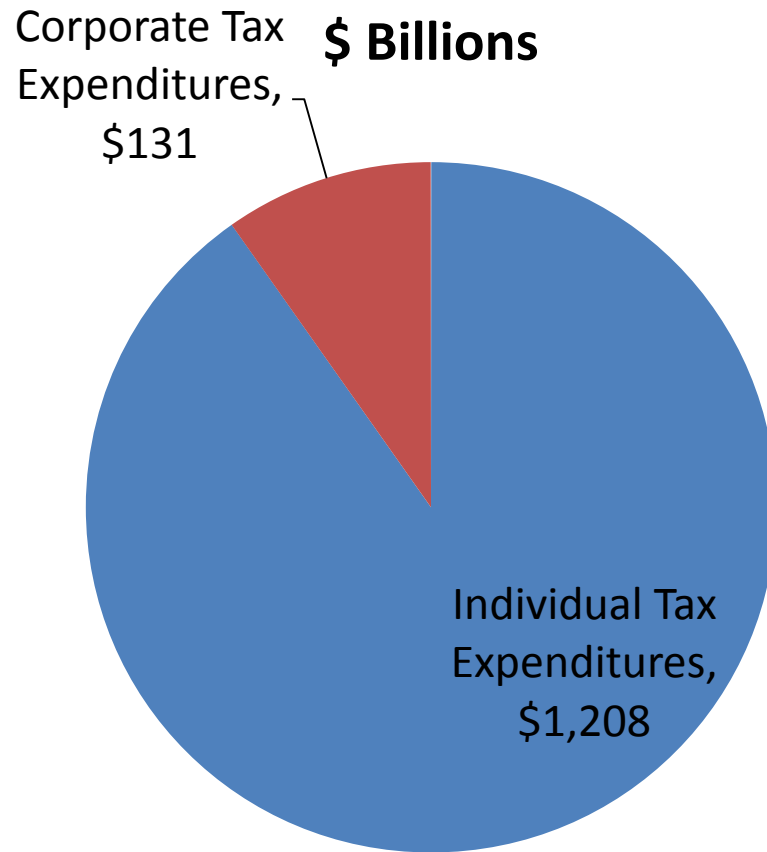
Joint Select Committee on Tax Reform West Virginia Tax Credits

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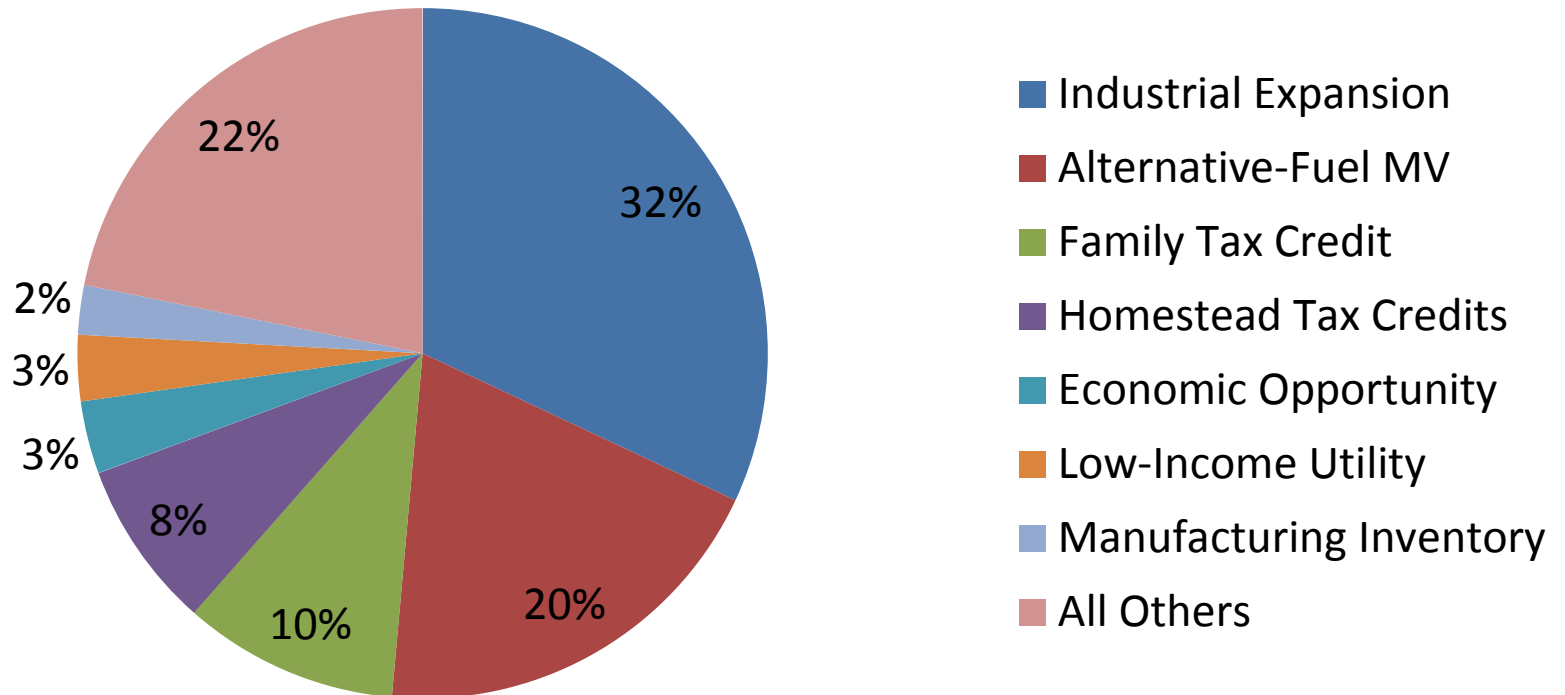
90% of Federal Tax Expenditures in 2015 Go to Individuals

Source: *Corporate and Individual Tax Expenditures* by Alan Cole, Tax Foundation Fiscal Fact August 2015 No. 476



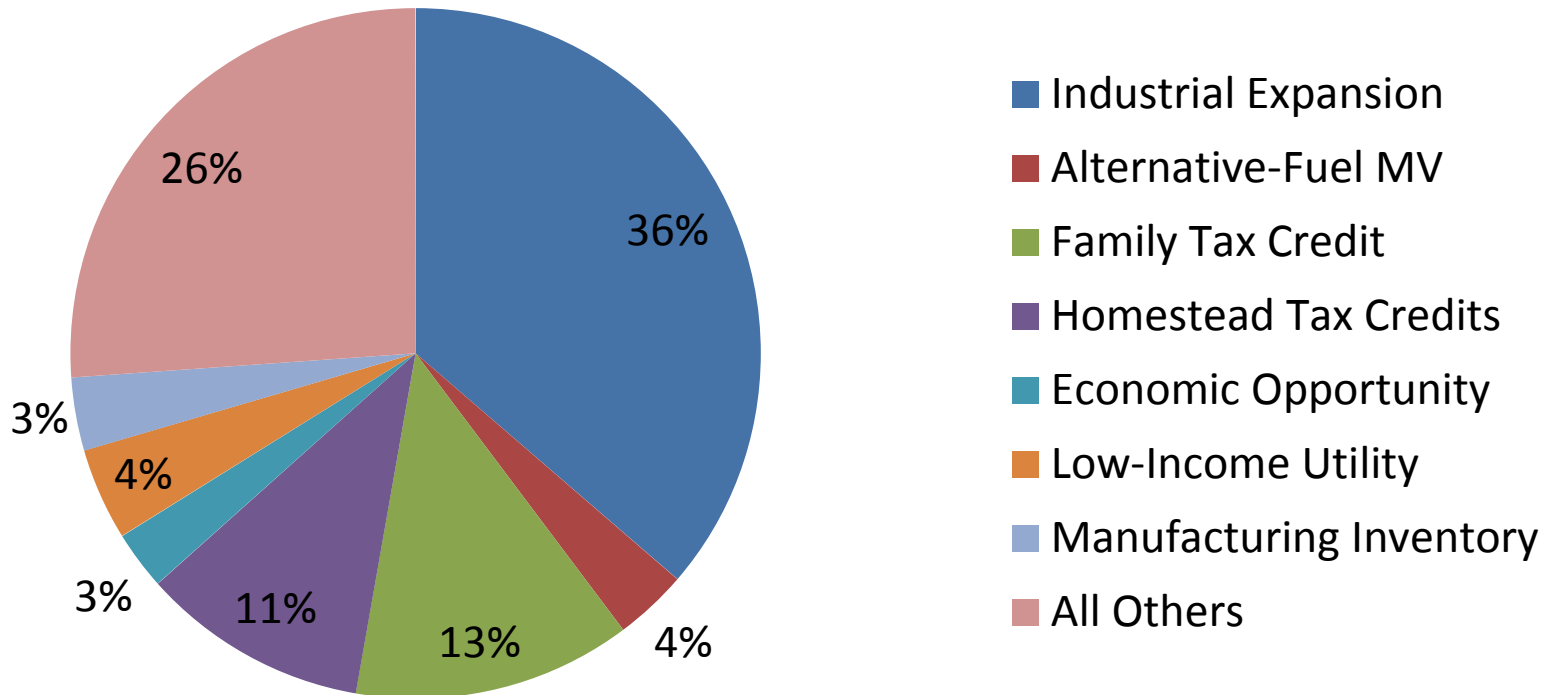
Distribution of WV Tax Credits:2012

\$ 175 Million



Estimated WV Tax Credits: FY2016

\$ 146 Million



Why are Tax Credit Costs Falling?

- Repeal of > 95% of Alternative Fuel Motor Vehicle Tax Credit Program in 2013
- Electric Power Industry factors
- No more Business Franchise Tax
- Lower Corporate Net Income Tax rate
- Elimination of several tax credit programs

Alternative-Fuel Motor Vehicle Tax Credit

Total Cost from TY2011 to TY2014 to date is \$75 million

- Original Tax Credit: 2011-April 14, 2013
 - \$7,500 tax credit for buying natural gas, electric, hybrid or flex-fuel vehicle
 - Up to \$25,000 for a qualified commercial vehicle
 - Home infrastructure tax credit of up to \$10,000
 - Commercial infrastructure tax credit of 50% up to \$312,500
- Modified on in 2013 with new sunset date of December 31, 2017
 - Tax credits restricted to natural gas vehicles
 - Commercial infrastructure of 20% up to \$0.4 million

Electric Power Industry

Cost Likely to Decrease Significantly Over Next Couple Years

- Industrial Expansion Tax Credit
 - 10% of qualified capital investment
 - Tax credit pro-rated for use over 10 years
 - Applies against B&O Tax
 - Unique tax to West Virginia
 - Most Other States tax consumer sales of electricity
- Huge Investments in Scrubber Technology & Other Environmental Remediation (2007-09)
 - 2007 tax credits expire after 2016
 - 2009 tax credits expire after 2018

No More Business Franchise Tax

- Business Franchise Tax absorbed significant tax credit claims in past years
 - Average of more than \$14 million/year since 1992
 - 2008-2012: between \$10-\$15 million per year
 - More than \$13 million in TY2012
- As of 2015, the Business Franchise Tax expired

Lower Corporation Net Income Tax Rate

From 9% to 6.5%

- Use of Tax Credits Against Corporate Tax
 - Average of roughly \$10 million/year since 1992
 - 2008-2012: Average of less than \$9 million/year

Legislative Action Repealing Tax Credits

List of Repealed Programs

| <u>Name of Program</u> | <u>Code</u> | <u>Expiration Date</u> |
|--|-------------|------------------------|
| Capital Company | §5E-1 | 2007 |
| Business Investment & Jobs Expansion | §11-13C | 2003 |
| Industrial Expansion/Revitalization* | §11-13D | 2003 |
| Research & Development | §11-13D | 2003 |
| Residential Housing Development | §11-13D | 2003 |
| Management Information Services Facilities | §11-13D | 1993 |
| Coal-Based Synthetic Fuels | §11-13D | 2003 |
| Aerospace Industrial Facilities | §11-13D | 2003 |
| Increased Generation of Electricity | §11-13H | 2002 |
| Former Colin Anderson Center Employment | §11-13I | 1999 |
| High-Growth Business Investment | §11-13U | 2008 |
| Value-Added Wood Manufacturing | §11-13M | 2002 |

Legislative Action Repealing Tax Credits continued

List of Repealed Programs

| <u>Name of Program</u> | <u>Code</u> | <u>Expiration Date</u> |
|---|-------------|------------------------|
| New Steel Manufacturing Operations | §11-13N | 2002 |
| New Aluminum or Polymer Operations | §11-13O | 2002 |
| Medical Liability Insurance Premiums | §11-13P | 2005 |
| Strategic Research & Development | §11-13R | 2014 |
| Combined Medical Malpractice & Tail Liability | §11-13T | 2004 |
| Residential Solar Energy | §11-13Z | 2013 |
| Non-Incentive | §12-7-8a | 2005 |

Active Tax Credits

List of Current Programs

| <u>Name of Program</u> | <u>Code</u> | <u>Sunset Date</u> |
|--|-------------|--------------------|
| Alternative-Fuel Motor Vehicles | §11-6D | 2017 |
| Industrial Expansion/Revitalization (Electric) | §11-13D | No |
| Coal-Loading Facility | §11-13E | No |
| Utility Low-Income | §11-13F | No |
| Telephone Low-Income | §11-13G | No |
| Neighborhood Investment | §11-13J | 2016 |
| Environmental Agricultural Equipment | §11-13K | No |
| Natural Gas Industry Jobs Retention | §11-13L | No |
| Economic Opportunity | §11-13Q | No |
| Manufacturing Investment | §11-13S | No |
| Film Industry Investment | §11-13X | No |
| Commercial Patent Incentives | §11-13AA | 2016 |

Active Tax Credits

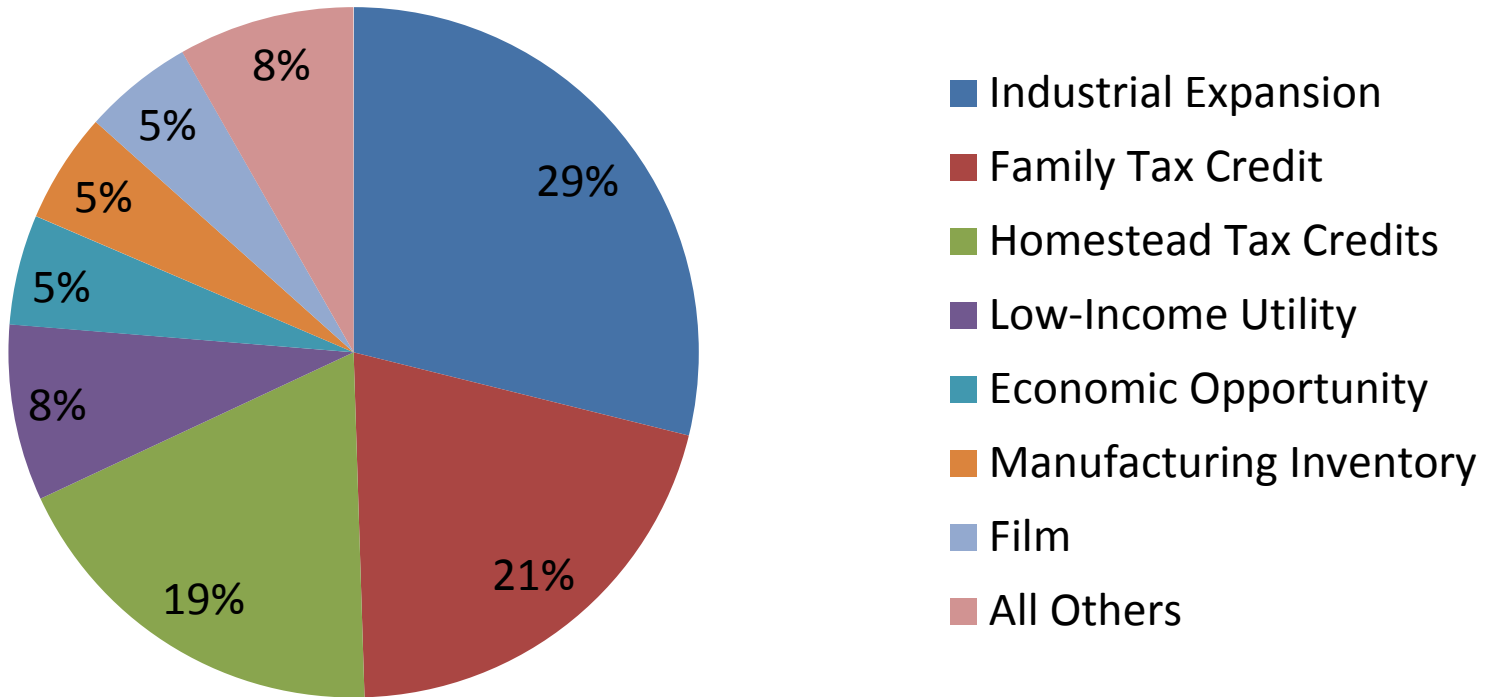
List of Current Programs

| <u>Name of Program</u> | <u>Code</u> | <u>Sunset Date</u> |
|---|-------------|--------------------|
| Mine Safety Technology | §11-13BB | 2018 |
| Energy Intensive Industrial Consumers | §11-13CC | 2021 |
| Tourism Development | §5B-2E | 2019 |
| Rehabilitated Buildings Commercial | §11-21-8a | No |
| Residential Rehabilitated Buildings | §11-21-8g | No |
| Non-Family Adoption | §11-21-10a | No |
| Senior Citizen Homestead | §11-21-21 | No |
| Low-Income Family | §11-21-22 | No |
| Excess Homestead | §11-21-23 | No |
| Utility Taxpayers With Net Operating Loss Carryover | §11-24-11b | No |
| Military Incentive | §11-21-42 | No |

Estimated WV Tax Credits: FY2020

Assuming No Policy Changes To Add or Modify Programs

\$ 97 Million



Conclusions: Tax Credit Expenditures

- Values are decreasing due to:
 - More emphasis on lower tax rates
 - No Franchise Tax
 - Repeal or sunset of many programs
- Outlook for FY2020
 - \$97 million – decrease of 45% from TY2012
 - Roughly 50% relate to individuals
 - Electric power still accounts for nearly 30%
 - Roughly \$20 million relate to economic development
 - Economic Opportunity: Job Creation
 - Manufacturing Investment
 - Manufacturing Inventory
 - Film
 - Tourism
 - Historic Building Rehabilitations