

# Sales Tax Reform

Modernizing WV's Sales Tax

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# CURRENT SYSTEM

## HOW WE GOT HERE

- After property taxes, levies on transactions (sales and excise taxes) are one of the oldest methods of taxation
- The modern sales tax in the U.S., however, is much younger. West Virginia became the first state to adopt a sales tax in 1921, although the current tax dates to 1933.
- Sales tax structures tend to reflect the economy and administrative limitations of the time, hence the exemption of most services.

# CURRENT SYSTEM

## HOW WE GOT HERE

- Partly because the sales tax excludes most services, it is regressive when measured as a percentage of income.
- Economic shift toward services has forced rate increases.
- Grocery, prescription drug, and other exemptions adopted for policy reasons (e.g., to combat regressivity).

# IDEAL SYSTEM

## WHAT A SALES TAX SHOULD BE

- Ideal sales tax applies to all final consumer transactions, both goods and services.
- Exempts business inputs to avoid tax pyramiding.
- Broad base permits lower rates and shifts incidence toward higher-income individuals even without exemptions for select goods.

# SALES TAX REFORM

## REVENUE ESTIMATES

- Challenges associated with estimating revenue from currently untaxed transactions
- Overlap in tax expenditure report
- Importance of excluding B2B transactions from estimates
- Our approach: using West Virginia's Personal Consumption Expenditures (BEA data)
- States wise to take conservative approach to projections

# SALES TAX REFORM

## HOW TO GET THERE

- Tax triggers can help reduce uncertainty
- Immediate partial reduction, further rate reductions subject to revenue availability, on revenue neutral or revenue positive basis
- West Virginia has past experience with tax triggers

# BASE BROADENING

## OPTION A

- Revenue Estimate: \$75 million
- Revenue-Neutral Rate: 5.65 percent
- Expands base to –
  - Currently untaxed durable goods  
(motor vehicles taxed at same rate as other durable goods)
  - Currently untaxed personal services
  - Water and sewage
  - Miscellaneous medical products & devices (not drugs)
  - Motor Vehicle Rental

# BASE BROADENING

## OPTION B

- Revenue Estimate: \$340 million
- Revenue-Neutral Rate: 4.75 percent
- Expands base to –
  - All transactions taxed under Option A
  - Food for home consumption
  - Professional services purchased by end-users
  - Financial service charges, fees, and commissions



# BASE BROADENING

## OPTION C

- Revenue Estimate: \$910 million
- Revenue-Neutral Rate: 3.5 percent
- Expands base to –
  - All transactions taxed under Option B
  - Prescription drugs
  - Outpatient health care services & proprietary hospitals
  - Insurance (*also subject to premium tax*)
  - Telecommunications services & deliveries

# BASE BROADENING

## OPTION D

- Revenue Estimate: \$1.30 billion
- Revenue-Neutral Rate: 3.0 percent
- Expands base to –
  - All transactions taxed under Option C
  - Nonprofit and governmental hospitals
  - Nursing homes
  - Public transportation (*within legal authority*)
  - Elementary school lunches

# AVOIDING PITFALLS

## WHAT'S THE MATTER WITH KANSAS?

- The Kansas experiment –
  - Large tax cuts (\$1B+) without offsetting spending cuts
  - Pass-through exemption (costly, arbitrage opportunity)
  - Unrealistic expectations of economic growth
  - Excessively optimistic revenue estimates

# STATE BUDGETARY NEEDS

## ADDRESSING THE CURRENT BUDGET SHORTFALL

- Sales tax reform is not only possible during a budget shortfall—it can help solve the problem
- Eroding sales tax base contributes to budget issues
- Base broadening with initially only partially offsetting rate can provide a short-term revenue infusion
- Triggers can reduce rate to either revenue neutral or revenue positive goal

# QUESTIONS AND FEEDBACK

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