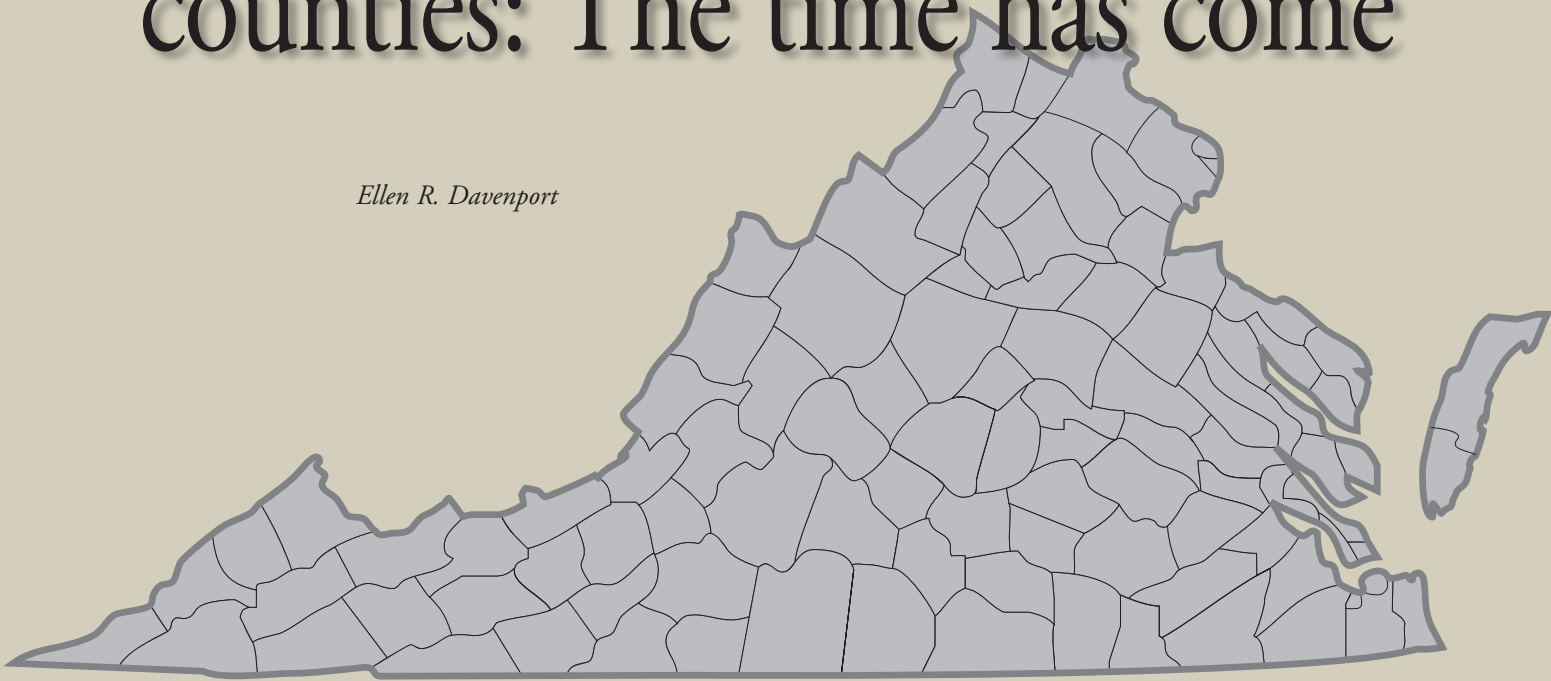


Tax restructuring in Virginia's counties: The time has come

Ellen R. Davenport



Background

The relationship between local governments and the state—taxing authority and service responsibility—has been discussed at least since the 1980s and in the past nine years has received serious attention from the General Assembly. In fact, the legislature has taken several actions during that period:

- In 1994 House Joint Resolution (HJR) 160 established the Local Revenue Resources Subcommittee to begin examin-

ing all local taxes and fees and to review their equity and efficiency.

- In 1995 HJR 487 broadened the focus of the HJR 160 study, establishing the Commission on State and Local Government Responsibility and Taxing Authority to examine not only the revenue side of the equation but also service responsibility and delivery. This commission recommended legislation to create a uniform business, professional, and occupational license (BPOL) tax, and this legislation was passed in the 1996 General Assembly session. The commission introduced its report on revenue authority and service responsibility that same year. The major recommendation of the study was to transfer the local share of funding for the standards of quality in education from

localities to the state.

- In 1997, under House Joint Resolution 532, the legislature authorized a continuation of the Commission on State and Local Government Responsibility and Taxing Authority. This commission found the current local systems for taxation and debt approval to be inconsistent between counties, cities, and towns. Recommended actions included a modification of local government financing so that counties, cities, and towns would have the same taxing and borrowing systems. Moreover, the commission recommended that cities and counties be treated by the commonwealth as identical units of government, with all attendant rights and responsibilities.

- In late 1997 and 1998, attention focused on gubernatorial candidate James

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Gilmore's campaign platform to eliminate the personal property tax on personally owned vehicles and the 1991 state freeze on "599 Law Enforcement Funding"—the funding stream that was established in 1979 to compensate cities and towns for the right to annex. This money was to have increased every year based on the rate at which state general fund revenues grew (the freeze was lifted almost 10 years later). These discussions gave rise to the

- Commission on the Condition and Future of Virginia's Cities in 1998;
- Commission on Virginia's State and Local Tax Structure for the 21st Century (House Joint Resolution 578) in 1999; and
- Governor's Commission on Government Finance Reform (established by former Governor James Gilmore's Executive Order 75) in June 2001.

Both the Commission on Virginia's State and Local Tax Structure for the 21st Century and the Governor's Commission on Government Finance Reform recommended that county taxing authority be made comparable to the taxing authority of cities and towns. Former Governor Gilmore's Commission on Government Finance Reform concluded that local governments need the same set of financial tools to address local priorities.

Another study, which began in 2001 under House Joint Resolution 685 and Senate Joint Resolution 387, is now in its second year and is encompassed in House Joint Resolution 60: the Joint Subcommittee to Study and Revise Virginia's State Tax Code. The scope of this study, which was scheduled to be completed by November 30, 2002, includes analyzing local taxes like the BPOL tax, the merchants capital tax, and the personal property tax on cars.

The differences in county and city taxing authority

For scores of years, distinctions between the financial authority of cities, counties, and towns were based on the sentiment that counties were primarily rural in nature. It was assumed that they had a lesser need to provide services and hence had less need for revenue or that

they did not demonstrate a significant need for a diversified revenue base. With the distinctions between counties and cities blurring in recent years, the growth of suburbs in the second half of the 20th century, and the expected continued growth of suburban counties in the 21st century, these distinctions are no longer valid—if they ever were.

Virginia Code section 15.2-1104 sets forth the financial powers of cities and towns. In essence, a municipal corporation can annually raise taxes and assessments on property, persons, and other subjects of taxation that are not otherwise prohibited by law. Counties, on the other hand, do not have comparable language in the code. Instead, county taxing powers are expressly conferred by the General Assembly since Virginia is a Dillon Rule state (see *Virginia Issues & Answers*, vol. 7, no. 1, spring 2000, for a discussion of the Dillon Rule).

The four differences between county taxing authority and the taxing authority of cities and towns is summarized below.

Admissions tax

Under *Virginia Code* section 58.1-3818, only the counties of Arlington, Brunswick, Dinwiddie, Fairfax, and Prince George may charge a tax on admissions at a rate not to exceed 10 percent. Of the counties allowed to levy the tax, only Dinwiddie currently does so. The counties of James City, New Kent, and Nelson are also allowed to charge a tax on admissions (they are not specifically named in the code section but are set out by population brackets). Any county in which a major league baseball stadium with a seating capacity of 40,000 seats is to be located is allowed to levy an admissions tax of up to 10 percent. No other counties may charge an admissions tax.

Cities and towns, on the other hand, are unrestricted in the percentage they can charge on admissions. As of last fiscal year, admissions taxes in cities ranged from a low of .5 percent in the City of Petersburg to a high of 10 percent in the Hampton Roads localities of Portsmouth, Norfolk, Chesapeake, and Hampton.

Cigarette tax

Cigarette taxes can be imposed by any city or town if the city or town was imposing the tax before January 1, 1977.

There is no limit on the tax that these cities and towns can impose on a pack of cigarettes. The highest rate currently charged on a pack of cigarettes is 40 cents per pack in some of the Hampton Roads area cities. Arlington and Fairfax are the only counties that have received legislative authority to levy a cigarette tax at a rate of 5 cents per pack (*Virginia Code* section 58.1-3831).

It is particularly ironic that rural, tobacco-growing counties do not have the authority to levy a tax on a pack of cigarettes.

Transient occupancy tax

The transient occupancy—or lodging—tax can be imposed by cities and towns without restriction. Counties are capped at 2 percent unless they have special legislative authority. The tax may be imposed on hotels, motels, boarding houses, travel campgrounds, and other facilities offering guestrooms on a continuous basis for less than 30 consecutive days.

Counties requesting authority to charge a tax of more than 2 percent must seek approval from the General Assembly. Recently, any counties trying to exceed 2 percent must demonstrate that the increment above 2 percent is earmarked for tourism. For example, the counties around the Richmond area—Chesterfield, Hanover, and Henrico—may levy up to 6 percent, with the increment above 2 percent being set aside to pay debt service for expanding the Richmond Convention Center and for tourism. Arlington has a 5 percent transient occupancy tax and an additional one-fourth of 1 percent tax above 5 percent that is designated and spent to promote tourism and business travel in the county. This one-fourth of 1 percent increment was originally authorized in 1990, but following four extensions, it will expire on December 31, 2006.

At the end of FY 2001, the City of Portsmouth was levying the highest locality-wide transient occupancy tax: 6.5 percent. In Virginia Beach, a rate of 5.5 percent was imposed except in special districts such as the oceanfront, where a 9.9 percent rate was in effect.

Meals tax

With the exception of four counties that have received approval from the

General Assembly to levy a meals tax without a referendum, all other counties must have the meals tax approved in a voter referendum, with the tax capped at 4 percent. Voters in the County of Orange received authority to levy a meals tax in November 2001, bringing the total number of counties with a meals tax to 34 out of 95 counties.

No referendum requirements or any caps are imposed on cities and towns. As of the end of FY 2001, the highest meals tax was being levied in the City of Portsmouth at 6.5 percent.

The current landscape for county equal-taxing authority and tax restructuring

The time is ripe for local tax restructuring in Virginia. In addition to the need to equalize the taxing structure between counties, cities, and towns in the areas mentioned above, localities overall rely heavily on the real property tax primarily because they have a limited number of options available. Gerald Hyland, president of the Virginia Association of Counties (VACo), writing to Senator Emmett Hanger, outlined the growing need for a broader tax base at the local level:

The direction all of you need to be moving in is helping localities diversify and broaden their tax bases, not further restricting the few tools we have available. Localities collect taxes to provide essential public services to our residents such as public education, fire and police, social services, etc. Localities have already had to absorb their share of state budget cuts based on the \$1.4 billion shortfall that occurred last biennium, and we are bracing for a further round of budget cuts I cannot stress to you enough the importance of giving localities more, not fewer, options to help us balance our budgets and provide these critical services.

On August 19 Governor Warner announced \$1.5 billion more reductions to the state budget for the FY 2002-04 biennium based upon revised forecasts from his Board of Economists and advice from his Advisory Council on Revenue Estimates. The \$1.5 billion reduction is derived from the following facts and assumptions:

- Some \$216 million of the \$234 million revenue shortfall from FY 2000-02 cannot be absorbed and must roll forward.
- The \$523 million drop in FY 2003 is based on revised revenue growth of .8 percent.
- The \$760 million drop in FY 2004 is based on revised revenue growth of 4.6 percent.

In order to adjust expenditures accordingly, Governor Warner called for

1. All state agencies to produce additional reduction plans of 7, 11, and 15 percent by September 20, 2002;
2. Some state agencies to reduce more than the percentages announced in No. 1 or eliminated entirely;
3. Reducing non-general fund agencies;
4. Other specific actions to halt discretionary spending, including the institution of monthly spending limits on agencies and no new contracts for construction with consultants.

VACo anticipates that localities will be affected by state budget cuts, either directly or indirectly, but the magnitude of any reductions were not expected to be apparent until late September or early October 2002. Unfortunately, by that time local governments had already set their tax rates and had their budgets well underway for FY 2003. Heretofore, most local governments have already raised taxes or scaled down programs to accommodate state spending reductions. But as both VACo and the Virginia Municipal League (VML) have stated, localities cannot keep absorbing cuts without serious consequences to local programs. Nonetheless, plans were under way by early September 2002 for the governor's office to ask localities to begin scaling back their own expenditures in anticipation of the state budget cuts.

The current limited number of revenue resources available to Virginia's localities—and particularly to Virginia's counties—combined with the state's budget shortfall, which will be shared with localities, may help citizen taxpayers and

the legislature realize that it is way past time to change revenue options for localities. Otherwise, it will not be possible for localities to continue providing critical services for Virginia's citizens. **VVA**