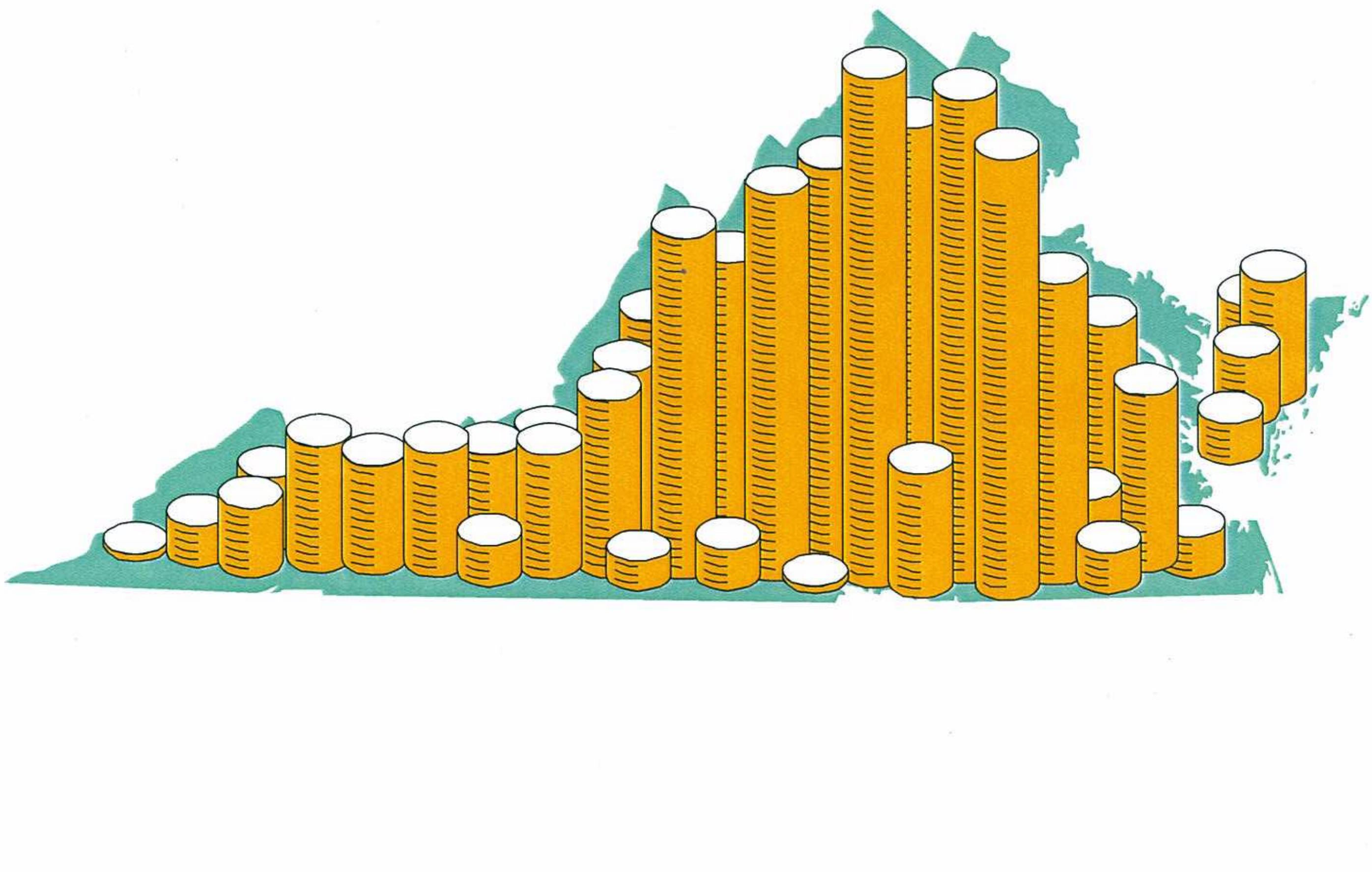
Reforming Virginia's Tax System



HAMPTON ROADS
PLANNING DISTRICT COMMISSION

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REFORMING VIRGINIA'S TAX SYSTEM

ISSUES AND RECOMMENDATIONS

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Prepared by the staff of the
Hampton Roads Planning District Commission

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INTRODUCTION

For some time, Virginia has attempted to reform its tax system. Two Commissions of the General Assembly (the Commission on the Condition and Future of Virginia's Cities and the Commission on Virginia's State and Local Tax Structure for the 21st Century) examined the problem of funding state and local governments. A further effort by the Joint Subcommittee to Study and Revise Virginia's State Tax Code extended the work of the earlier Commissions and has recently been reconstituted into the Commission on the Revision of Virginia's State Tax Code and the Streamlined Sales Tax Project Agreement. This new Commission will build on earlier work and complete its meetings by November 30, 2003. It will submit findings and recommendations to the General Assembly no later than the first day of the 2004 regular session. At the same time, Governor Warner will be working to prepare his own recommendations on tax reform, also to be concluded in 2003 for use by the General Assembly in 2004. As these efforts suggest, tax reform continues to be an issue of great concern to Virginians.[1]

Several issues must be addressed as Virginia prepares to overhaul its tax system. These are outlined in this document. A successful effort to revise the state's tax system will address many of the matters discussed in this report and will incorporate many of its recommendations. The momentum developed in the past several years to reform the state's tax system must not be lost. This report has been prepared in the hope that it will further public understanding of tax reform efforts now underway in the Commonwealth.

INDIVIDUAL INCOME TAX

Background[2]

Virginia enacted an individual income tax in 1843. Numerous changes have been made to the tax since then. Today the individual income tax has become the single most important source of general fund revenue for the Commonwealth. **In fiscal year 2000, the Commonwealth collected $6.8 billion in individual income tax revenue representing 63.3 percent of the revenue going to the general fund.** In fact, Virginia ranks fourth among all states in the percent of total state tax collections coming from the income tax (Bowman 2001). Additionally, revenue generated by the individual income tax has grown more rapidly than revenue from any other tax in recent years since it captures the income resulting from real economic growth, population growth, and inflation.[3] Due to the important role that the income tax plays in financing

[1] The need for tax reform was highlighted recently by a review of the tax systems of all fifty states in *Governing* magazine. Virginia was given two stars across all three measurements criteria out of a possible four stars.

[2] Much of this section comes from Virginia Division of Legislative Services. *A Legislator's Guilde to Taxation in Virginia, Volume 1: State Taxes.* June 2001.

[3] Growth in the income tax is being retarded to some degree by the increase in the share of income that is not subject to state taxation. For example, earnings which are taxed are falling as a proportion of personal income. By contrast, there has been an increase in the non-taxable forms of income such as

state government, the future of the income tax is of critical importance to the financial health of the Commonwealth.[4]

The income tax has been primarily a state tax over the years. However, the 1989 General Assembly Session allowed Northern Virginia localities, as well as Norfolk, to levy a local income tax of up to one percent for transportation purposes. However, approval by referendum is required before the tax can be imposed. So far, no locality has placed the tax on the ballot.

To make the calculation of the tax easier, the Virginia individual income tax was made to conform to the federal income tax.[5] Because of conformity, the process of computing the tax begins with the federal adjusted gross income (AGI) from which Virginia allows various additions and subtractions. The resulting number is Virginia AGI. **If AGI is $5,000 or less for a single taxpayer or $8,000 or less for a married couple, no tax is owed**.

The state allows tax filers to subtract exemptions and deductions from the Virginia AGI. Virginia provides an exemption of $800 for the taxpayer and each dependent. An additional exemption of $800 is provided for each taxpayer 65 and over as well as another $800 if the taxpayer is blind. **These amounts are comparatively low since only one other state (Wisconsin) has a lower personal exemption.**

In addition, the taxpayer is also permitted to subtract the standard deduction or the itemized deduction from the Virginia AGI. The standard deduction in Virginia is $3,000 for single taxpayers and $5,000 for a married couple. These deductible amounts are not adjusted for inflation but instead are changed on an irregular basis. Subtracting exemptions and deductions from AGI reduces taxable income. Finally, before calculating the tax liability, Virginia grants a number of credits which, if used, further reduce the tax owed.

After determining the taxable income, the tax rate is applied to the tax liability to arrive at the tax owed. In Virginia, taxable income levels and their associated state tax rates are as follows: the first $3,000 of income, 2%; $3001 to $5,000, 3%; $5,001 to

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Social Security and employee fringe benefits (National Conference of State Legislatures and National Governors' Association 1993).

[4] Virginia's heavy dependence upon the income tax has worked to the advantage of its citizens since state income tax payments are tax deductible at the federal level. This deductibility provides a strong argument for using the deductible state income tax as opposed to relying heavily on the nondeductible sales tax. Utilizing the state income tax makes it possible for the residents of a state to export a portion of the income tax to the residents of other states who must make up for the loss in federal revenue that results from the state income tax deduction. As a result, because of the state's heavy reliance on the income tax, Virginians enjoy public services at a lower effective cost than if the state relied on a mix of nondeductible taxes.

[5] While conformity makes it easier to compute the tax, a drawback is that it makes the state individual income tax dependent upon federal law so that changes in federal income tax law can directly affect state revenue collections.

$17,000, 5%; greater than $17,000, 5.75%**.** **Virginia's top marginal tax rate is relatively low when compared to other states**.[6]

Selected Issues and Recommendations

The individual income tax in Virginia has been studied extensively over the years. These investigations have identified a number of concerns that the Commonwealth needs to address as it confronts the issue of tax reform. Because the basic elements of the tax have not changed in over 75 years, the tax needs to be modernized so that it reflects the changes that have occurred in the economy over the last several decades.

The first difficulty with the tax as currently structured is that, while its rates are graduated, it functions in many ways like a flat tax since it taxes a great many tax filers of very unequal incomes at similar rates. This violates the widely accepted principle of vertical equity that simply asserts that persons with different incomes should have different tax burdens. **The flat tax nature of the current state income tax results from both the number and width of its tax brackets as well as its schedule of statutory rates.**

Virginia utilizes four income tax brackets. This is one less bracket than the median of all the states that use graduated rates. Among those states with graduated rates, the smallest number of brackets is two (Connecticut) and the largest is ten (Missouri and Montana). **Using a limited number of brackets tends to reduce the progressivity of Virginia's income tax** (Bowman 2002).

Further reducing the progressivity of the tax is that the ceiling for the lowest bracket is $3,000. This ceiling is relatively low since the median first bracket ceiling is $3,575 for the thirty-four states that define their own graduated-rate structure while the mean of those states is $6,060. With the ceiling for the next higher bracket only slightly higher than the ceiling for the first, the brackets do not significantly differentiate between the income levels of low-income taxpayers. Furthermore, the floor for Virginia's top bracket is $17,000 as compared to the median of $30,000 and the mean of $44,454 for the states with graduated tax structures (Bowman 2002). The result of the state's compressed tax brackets is that the rate graduation tops out in the poverty range for many families. Stated differently, a considerable amount of the income of persons living in poverty is subject to taxation. **Virginia needs to widen its tax brackets so that tax filers with significantly different taxable incomes pay different tax rates. Further, the ceiling for the lowest bracket needs to be raised so that poverty-level taxpayers pay little or no tax.**

The problem of compressed brackets is compounded by the fact that there is little effective difference in tax rates between taxpayers of different income levels since the tax rates are only slightly graduated. Furthermore, unlike neighboring states, Virginia's highest marginal tax rate is low. Virginia's top marginal tax rate of 5.75

[6] Thirty-four states have a graduated income tax system according to the Federation of Tax Administrators. Twenty-seven of those have a higher top marginal tax rate than does Virginia.

percent compares to the highest marginal tax rate of 8.7 % in the District of Columbia, 4.75% in Maryland, 8.25% in North Carolina, 7.0% in South Carolina, and 6.5% in West Virginia.[7] **The individual income tax can be made more progressive by increasing the graduation of the tax rates and by widening the tax brackets**.[8]

In order to ease the tax burden of low income and poverty level taxpayers, Virginia allows tax filers to utilized personal exemptions and standard deductions to reduce their tax liability. Since both exemptions and deductions are subtracted from adjusted gross income to arrive at taxable income, the effect of these subtractions is to assist low-income taxpayers in meeting their basic needs by lowering their tax liability. In 1986 Virginia set its standard deduction at $3,000 for single filers and $5,000 for married couples, which were the amounts allowable under federal law. Unfortunately, while the federal deduction was indexed to inflation, the Virginia deduction was not. As a result, the standard deduction remains at the $3,000/$5,000 levels set in 1986 as compared to $4,550 and $7,600 for the federal tax in 2001. Similarly, in 1986 the personal exemption was set at only $800 in Virginia as compared to $2,000 for the federal tax. The federal amount was indexed to inflation and has risen to $2,900 in 2001 as compared to the state exemption, which has remained at $800. The state exemption was set lower at the beginning and, on a relative basis, has declined when compared to the federal exemption due to the failure of Virginia to index its exemption. Ignoring the need to increase the exemption and standard deduction over the years has been a major reason that Virginia leaves a very large percentage of poverty level income in the tax base (Bowman 2002).

Virginia can make its individual income tax more progressive by increasing the personal exemption and standard deduction. The Commission on Virginia's State and Local Tax Structure for the 21st Century recommended in 2000 that the standard deductions be raised to $7,000 for married couples filling jointly and $3,500 for single persons and married persons filing either separate or combined returns. This change in the tax code was projected by the Virginia Department of Taxation to reduce state income tax revenues by $65.6 million by 2006 (Virginia Department of Taxation 2002a). The Commission further recommended that the exemption be increased to $2,500. According to the Virginia Department of Taxation, this increase in the personal and dependent exemption would cost the state $469.6 million by 2006 (Virginia Department of Taxation 2002b). The Commission concluded that these adjustments would be sufficient to accomplish the goal of removing poverty-level income from the tax base for most taxpayers (Commonwealth of Virginia 2000).

The elderly have a special place in the Virginia Tax Code. Virginia grants three age-based preferences to elderly taxpayers even though changes to federal social

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[7] The income tax in Tennessee is limited to dividends and interest only.

[8] Over the years, concern has been expressed that higher marginal tax rates can cause high-income taxpayers to flee Virginia for states with lower tax rates. This is not likely to be a problem for Virginia since marginal tax rates are already at low levels. Giving a moderately greater degree of progressivity to the state's income tax rates is not likely to lead to the migration of high-income taxpayers out of state – especially if they perceive that their taxes are being used to provide services of value to them such as for improvements to education and transportation.

security have helped to ensure that the elderly are not especially needy. These preferences are (1) an additional $800 personal exemption for persons 65 and over; (2) full exemption of social security income from the state tax base; and (3) a deduction of $6,000 for each person age 62-64 and a deduction of $12,000 for each person age 65 and over.[9] **These exclusions from the tax base are very costly to the state and will become more costly as the baby boomers retire and more retirees move to Virginia**.

These preferences have the effect of reducing the tax liability of low-income elderly persons but also benefit those elderly whose incomes are far above the poverty level. This violates the principle of horizontal equity, which asserts that taxpayers of similar income levels should face similar tax burdens. For example, two couples, one elderly (65 or over) and the other not elderly, of similar incomes would experience quite different individual income liabilities since their total exemptions and deductions are differ. **The elderly couple that takes the standard deduction can disregard $32,200 of otherwise taxable income as compared to $6,600 for the couple under 62.**[10] In other words, the elderly couple has nearly five times the tax-free income as compared to the non-elderly couple. This disparity is even larger than these numbers suggest since the elderly couple could exclude whatever social security income they receive from their state tax liability (Bowman 2002).

Virginia needs to reassess its age-based preferences. Age alone is not a measure of need. Historically, age was correlated with need but this has not been the case in recent years. Using age as a proxy for ability to pay is imprecise and leads to inequities between taxpayers and shifts the burden of the tax to others who are often less able to pay. Excluding social security from the tax liability of the elderly further shifts the burden of the individual income tax away from the elderly, many of whom have incomes considerably above the poverty level. The Commission on Virginia's State and Local Tax Structure for the 21st Century recommended that the age-based exemptions and deductions be eliminated and that social security be made taxable in Virginia just as it is taxable at the federal level. Eliminating Virginia's age deduction would increase state income tax collections by $338.5 million in 2006 (Virginia Department of Taxation 2002d). Eliminating Virginia's social security subtraction from the tax code would increase state income tax collections by $109.4 million in 2006 (Virginia Department of Taxation 2002b). These adjustments to the tax code will have the effect of improving the horizontal equity of the individual income tax.

Finally, in addition to the tax preferences (subtractions and deductions) listed above, others have been added to the tax code over the years. An examination of all of the state's income tax preferences is in order since many have not been reviewed in

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[9] Giving favorable treatment to the elderly is not unique to Virginia. In fact, senior citizens receive more income tax preferences from both federal and state governments than the non-elderly (National Conference of State Legislatures).

[10] The elderly couple would claim two personal exemptions for $800 each, a standard deduction of $5,000 for couples filing jointly, two elderly deductions for $6,000 each, and two elderly exemptions for $800 each. The non-elderly couple would claim only the two personal exemptions and the standard deduction for couples filing jointly.

many years. The cumulative impact of these preferences has been estimated to be $594.7 million in FY 2004 (Task Force #1 Issues 2002c). Given the expense to the Commonwealth and the need to generate revenue to meet the state's many needs, each of these preferences should be reviewed to determine whether the benefits being received by Virginians justifies the loss of revenue.

SHARING THE INCOME TAX

Virginia's localities have struggled for some time to meet the public service needs of their residents. In recent years, many have been forced to raise taxes, reduce services, and/or cut staff in an effort to balance their budgets. While these fiscal stresses have been experienced by nearly all of the communities in the state, they have been most acute in the state's core or central cities.

In recognition of the fiscal stresses being experienced by the state's local governments, the Commission on Virginia's State and Local Tax Structure for the 21st Century recommended that the Commonwealth share at least six percent of its income tax collections with local governments. The Commission estimated that sharing the income tax would generate approximately $500 million in FY 2002 for Virginia's local governments.

While the Commission recommended that the income tax be shared, it did not set forth a mechanism for allocating the shared revenue to local governments. However, in an effort to help the Commission frame its recommendations, the Virginia Municipal League (VML) and the Virginia Association of Counties (VACO) proposed that a 50/40/10 allocation formula be used. This formula would be applied to the revenue to be shared to arrive at each community's payment from the state. As formulated by VML and VACO, the formula would allocate 50 percent of the income tax revenue based upon the place of residence of taxpayers, 40 percent based upon where wages are earned, and 10 percent based upon an equal allocation to all jurisdictions regardless of size. The Commission recommended that while the details of the allocation formula be worked out later, the basics of a sharing program should be put in place as soon as possible. Generally speaking, without a needs element in the 50/40/10 formula, Hampton Roads would be disadvantaged compared to regions with higher incomes and less tax-exempt property.

The revenue-sharing recommendation made by the Commission has merit given the difficulty that local governments have faced in recent years in meeting the needs of their residents. **Even though the Commonwealth is facing budget shortfalls, it is important that the state institute reforms to the system of taxation that will simultaneously provide both state and local governments with additional revenues so that needs can be met**. Further analytical work needs to be done so that an equitable distribution formula can be developed. This formula should take into consideration differences in the communities of the state in terms of their needs and their revenue raising capacity and level of revenue effort. Ultimately, the formula should include such factors as local per capita income, average local wage, the number of persons living in poverty, population size, and revenue effort.[11]

THE SALES AND USE TAX

Background[12]

The sales and use tax was enacted in 1966 and was intended to be a broad-based tax with a limited number of exemptions. Today, it is second to the income tax as a revenue source and accounts for approximately 20 percent of the Commonwealth's general fund revenues. Presently, the tax rate is 4.5 percent, which is levied on the gross price of tangible personal property sold at retail in Virginia. Of the 4.5 percent, two percent goes to the state's general fund, one percent is returned to localities based on the number of school-age children, one percent is distributed to local governments based upon point of sale, and one-half of one percent is distributed to the Transportation Trust Fund.[13]

The use tax is levied upon the use or consumption of tangible personal property in Virginia or the storage of tangible personal property outside the state for use or consumption in Virginia. The purpose of the use tax is to ensure that Virginia merchants are not at a competitive disadvantage with retailers from outside the state that are not required to collect the Virginia sales tax. Since out-of-state sellers do not ordinarily collect the use tax, individuals are required to declare the tax, which they owe when they file their state income tax. Since few residents of the state are aware of the existence of the use tax, there is most likely a low level of compliance. In 1999, the use tax generated only $689,920 in revenue from individuals as compared to the total collected from the sales and use tax of $2,410,366,000. In other words, the use tax accounted for less than 0.03 percent of the total collected from the combined sales and use tax. By contrast, businesses paid $29 million in use tax to the Commonwealth, still a small proportion of the total collected. The future impact of internet sales is also a consideration.

Selected Issues and Recommendations

The state needs to address two issues concerning the sales and use tax. These are the utilization of exemptions and the taxation of services.

The first of these issues concerns the number of exemptions to the tax. All tangible property sold in the state is subject to the sales and use tax unless exempted under Virginia law. These exemptions have proliferated over the years. **While there**

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[11] Revenue effort is estimated each year by Virginia's Commission on Local Government. It compares the revenue a community collects with its theoretical ability to raise revenues.

[12] Much of this section comes from Virginia Division of Legislative Services. *A Legislator's Guilde to Taxation in Virginia, Volume 1: State Taxes*. June 2001.

[13] Of the revenue distributed to the Transportation Trust Fund, 4.2 percent goes to the Commonwealth Port Fund, 2.4 percent goes to the Commonwealth Airport Fund, 14.7 percent goes to the Commonwealth Mass Transit Fund, and the remainder is retained in the Transportation Trust Fund.

were just 24 exemptions when the tax was enacted in 1966, as of July 1, 2001, there were 453 (Bowen 2002). Additionally, the pace at which exemptions have been granted by the General Assembly may have accelerated in recent years since one new exemption was issued in 1999, 80 in 2000, and 79 in 2001. These exemptions have narrowed the retail base against which the tax can be applied resulting in a reduction in the revenues collected by the state and increasing the cost of government to those persons and institutions that do not benefit from an exemption. **In fact, according to an estimate developed by the Virginia Department of Taxation, the revenue lost by Virginia as a result of not taxing transactions exempted from the sales and use tax was $3.6 billion in 1999.**

The large number and rapid growth in the number of exemptions to the sales and use tax was of concern to the Commission on Virginia's State and Local Tax Structure for the 21st Century. After studying this issue for some time, the Commission recommended that a moratorium on the issuance of new exemptions be instituted so that all new and existing exemptions could be critically reviewed. This recommendation has considerable merit. Virginia fails to collect significant revenues each year because of the exemptions and must set its sales and use tax rate higher than would otherwise be necessary were fewer exemptions awarded. **Each exemption should be reviewed to determine whether or not the value from the benefit which Virginia receives from the use of exemptions exceeds the revenue being lost by the state**.

A second issue of concern is whether or not additional services should be taxed in Virginia. At the time that the sales and use tax was introduced, Virginia's economy was based primarily on the production of tangible property. Services constituted a relatively small portion of all the state's economic activities. Now that much of the economy is devoted to providing services, Virginia leaves a considerable part of its economic activity untaxed.[14]

Unlike many other states, Virginia taxes relatively few of its services. For example, a nationwide survey done in 1996 by the Federation of Tax Administrators ranked Virginia 44th among the states in the number of services taxed. Only seven states taxed fewer services. Further, the average number of services taxed was 53.5 whereas Virginia taxed just 18 (Bowen 2002).

The potential to raise revenue or to lower the sales tax rate by extending the sales and use tax to services in Virginia is considerable. After a review of the issue of taxing services, John L. Knapp of Virginia's Center for Public Service concluded that taxing personal services; admissions/amusements; and fabrication, repair, and installation services offer the most attractive taxing opportunities. For various reasons,

[14] Virginia taxes the following services: services provided in connection with the sale of personal property, meals served in restaurants and hotels, transient accommodations of less than 90 days, the fabrication of tangible personal property for consumers who furnish the materials used in the fabrication process, and the rental of tangible personal property (Bowen 2002).

he rejected the option of taxing business, computer, and professional services.[15] His estimate of the tax which would be collected from extending the sales and use tax to personal services, amusements, and repair services was $146 million in calendar 1999 or 6.5 percent above actual collections (Bowen 2002).

A further benefit, and one not commonly acknowledged, is that the sales and use tax can be made less regressive by taxing services. Most experts who have studied the sales tax view it as regressive since the tax takes a higher proportion of the income from lower income persons than it does for higher income persons. In fact, the regressivity of the sales and property taxes is the primary reason that state and local taxes combined are generally regarded as mildly regressive while the federal tax on individuals is regarded as mildly progressive. The regressivity of the sales and use tax can be moderated to some extent by taxing services since services tend to be more widely used by higher income persons than by lower income persons. **Virginia should extend its sales and use tax to cover additional services so as to raise additional revenue and to diminish the regressivity of the tax.**

In recognition of the added revenues which might be generated by taxing services, the Commission on Virginia's State and Local Tax Structure for the 21st Century recommended that the state begin the extension of the sales and use tax to selected services. It recommended that the extension into services should begin with amusements, and personal and repair services. The Commission's recommendation has considerable merit. If additional services are taxed, Virginia will have the option of lowering the sales tax rate or leaving the tax rate at its currently level and using the enhanced revenue to provide additional public services.

REVENUE NEUTRALITY

Efforts to improve the state's tax system have frequently maintained that the net effect of reforms should leave total revenue collections at or very near existing levels. This objective has been referred to as revenue neutrality. The argument for revenue neutrality has centered on the need to gain widespread public support for efforts to reform the tax system. Failing to achieve revenue neutrality runs the risk that the general public will perceive efforts to reform the tax system as a disguise for tax increases. As the argument goes, raising taxes to enhance the level of public services should be regarded as a separate issue and should not be a part of any overall effort to reform the state's system of taxation.

Unfortunately, Virginia does not have time to separately pursue revenue-neutral tax reform along with a later effort to enhance state and local government revenues. The state's revenue shortfalls are too large, its unmet needs are too great, and its tax

[15] Business and computer services are frequently inputs into the work of other businesses. Taxing those services would lead to "pyramiding" or piling one tax upon another and would discourage outsourcing. Professional services have typically been difficult to tax because professional groups have vigorously and successfully fought efforts to extend the sales tax to the services that they provide.

system is too inadequate to permit the Commonwealth the time that two separate efforts would require.

Numerous studies have pointed out the need for additional revenue to meet anticipated needs. One study, which took a comprehensive review of the fiscal gap facing Virginia if existing tax and spending patterns are not adjusted, comes from the Barents Group that is a consulting unit within KPMG Consulting Inc. **Barents estimated in 1999 that a continuation of current trends would produce a funding shortfall of $4.6 billion in FY 2008 (Knapp 2001).**

Several studies have focused on the need to support the state's transportation needs at higher levels. In 1998 the Commission on the Future of Transportation projected the need for $74.5 billion in additional highway spending and another $14.2 billion in spending for other transportation needs over a twenty-year period. After allowing for projected revenue, the funding shortfall was projected to be $53.8 billion for highways and $11 billion for other transportation needs. A further needs assessment was performed by VDOT in 2001 as a part of its long-range forecast. VDOT's moderate scenario was projected to cost $82.2 billion. This compares to the $1.7 billion that VDOT expected to spend in FY 2002. Finally, JLARC estimated the cost of completing planned highway projects over the next ten years at $15.6 billion. **The unfunded gap was projected to be $7.9 billion (Knapp 2001).**

Studies on the needs for additional spending on higher education have come to similar conclusions. In 2000 the Joint Subcommittee on Higher Education Funding Policies estimated that state support for four-year institutions and community colleges would fall short by $187 to $206 million in FY 2002. Similarly, the State Council of Higher Education for Virginia in 2001 projected that enrollment demand in public colleges and universities would outstrip aggregate enrolled capacity by between 9,172 and 14,466 students. Comparable numbers for The Virginia Community College System were 7,827 and 13,189 students (Knapp 2001).

Needs assessments have also been done for K-12 education in Virginia. In 2001, JLARC released a detailed review of the financing of education in Virginia. The study presented financing options in three tiers. **If all three tiers were funded, the state would need to increase its spending on education by a projected $1.5 to $1.8 billion in FY 2002-2004 (Knapp 2001).**

There are further indications that Virginia is falling behind other states in providing public services and infrastructure. Most compelling of the statistical indicators is Virginia's rank among the fifty states in public expenditures made by state and local governments expressed as a percent of the state's total personal income.[16] Perhaps most distressing of these comparisons is the state's ranking on educational spending

[16] At best, spending as a percent of income should be regarded as only a broad and general indication of the level of public service being provided to state residents. Shortcomings of this metric are that the statistic fails to allow for geographical differences in the cost of providing services and well as differences in productivity.

since Virginia ranks 35th in state and local spending on higher education as a percent of total state personal income and just 39th in spending for K-12 education. Virginia also spends comparatively little in other areas since the state ranks 45th in spending for welfare, 32nd in spending on health, 30th in spending for parks and recreation, and 27th in highway spending. Further, Virginia is ranked 50th in the nation in natural resource protection, state parks, and historic preservation spending per capita (Governor's Natural Resource Leadership Summit 2003). More than half of all states exceed Virginia in spending per dollar of personal income in each of these important public service areas (Governing 2002).

Numerous studies and statistical comparisons suggest that Virginia is falling behind other states in providing basic public services and making infrastructure investments. While states cannot afford to get far ahead of adjacent states in terms of their tax burden, neither can they afford to fall far behind in the range and quality of public services that they provide. Unfortunately, the state's people, institutions, and economy are now suffering from the under funding of public services and infrastructure. Virginia needs to pursue tax reform aggressively and include in its efforts adjustments to the tax system which will lead to a sufficient revenues so that public needs can be met. **Since the state ranks 45th among all states in state and local tax collections as a percent of total personal income, there appears to be ample room to raise new revenues without overburdening taxpayers or making Virginia economically uncompetitive with nearby states**. Reforms should be made to ensure the adequacy of funding for public services today. Further, the state's system of taxation should be structured so that revenues will grow at approximately the same rate as the growth in the state's economy so that Virginia will be able to meet future needs throughout this decade and the next.

CONCLUSIONS

Virginia is at a crossroad. It can continue to provide limited public services and run the risk of losing people and businesses to neighboring states with better transportation and educational systems or enhance the level of its public services and encourage the growth in resources that will lead to a higher standard of living for all Virginians. The communities of Hampton Roads believe the choice is clear. State revenues need to be increased so that adequate public services can be provided. Many of the recommendations suggested here will contribute to that discussion. It is hoped that members of the Commission on the Revision of Virginia's State Tax Code and the Streamlined Sales Tax Project Agreement as well as the Governor's tax reform initiative will consider the recommendations offered by the Hampton Roads Planning District after its deliberations.

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