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Commentary



Eliminating business personal property tax would hurt education funding

By Ted Boettner and Sean O'Leary

During the 2010 legislative session, the West Virginia House of Delegates passed a version (House Joint Resolution 101) of Governor Manchin's proposed constitutional amendment to allow counties to eliminate business personal property from taxation. When this measure was being debated, there was very little information about its fiscal impact on education funding. The local government sub-committee of the Tax Modernization Project is currently reviewing different scenarios for how to replace the tax.

Last month, we conducted an analysis of how eliminating this tax would affect local governments, including county school boards. The study showed that funding for schools would be drastically reduced if business personal property were removed from property tax rolls. In fiscal year 2010, taxes in business personal property brought in approximately \$166 million for county school districts. About \$86 million was raised through excess levies and bonds, while the remaining \$80 million was raised through the regular levy. If the tax were eliminated, school districts would lose all of the \$86 million in excess levy revenue, while the School Aid Formula would replace \$65 million of the \$80 million lost from the regular levy. Altogether, school districts would face a funding gap of over \$100 million (a year) absent additional legislative action.

The report also found that even if every county school board maximized its regular and excess levies – thus shifting the tax burden onto homeowners and other businesses – schools would still be short over \$10 million a year. The elimination of this tax would also cost the county governments \$67 million, municipalities \$18 million and the state

\$65 million due to the School Aid Formula. While county and city governments could (theoretically) raise their levy rates and the state could increase taxes to make up for lost revenue, many county school boards would have to cut education spending.

To understand how we arrived at these conclusions, let's start with some basic information about property taxes. Property taxes are the primary source of revenue for local governments and are the only instrument school districts have to raise revenue. Business personal property (inventory, machinery and equipment, furniture, etc.) accounts for an estimated 18 percent or \$252 million of the \$1.4 billion in all property taxes collected in fiscal year 2010. Businesses in West Virginia pay tax on both real and personal property. The average property tax rate for a business located in a municipality (Class IV) was 2.86 percent of assessed value and 2.18 percent for those located outside a municipality (Class III). Altogether, property taxes account for 29 percent of all taxes paid by businesses in West Virginia, below the national average of 36 percent. While West Virginia taxes business personal property at a higher rate than other states, it taxes real property at rates well below the national average. Overall, West Virginia taxes business property close to the national average.

Proponents of eliminating the business personal property tax often argue that it is a "job killer" and that its removal will increase investment and employment in the state. However, a review of existing research and our own analysis sheds considerable doubt on this assertion. This is largely because state and local taxes comprise only two percent of the cost of doing business, on average. Furthermore, businesses look at the tax rate on new business investment, not the average tax rate on existing business capital, when making investment decisions. And variations in business taxes can be easily offset by modest changes in wages, benefits, or labor productivity levels, as well as other costs of doing business, such as utility prices, occupancy, and transportation costs. When all variables are considered, rather than just one particular tax, West Virginia has one of the lowest costs of doing business in the nation (Forbes ranks West Virginia at fifth lowest).

Reducing business taxes is also an expensive and inefficient way to spur economic development. Our report estimates that exempting business personal property from taxation would have a cost of \$600,000 per job created over a 20-year period (holding public services constant). In other words, only if the \$252 million in lost local government revenue is replaced to avoid service cuts will there be any economic benefit.

According to Robert Ady, who is said to have assisted more businesses in site location decisions than anyone in the country, "the single most important factor in site selection today is the quality of the available work force." Cutting education funding to finance a business tax cut is bad economic development policy. A well-funded education system is crucial for economic development. West Virginia's schools provide the educational foundation that the state's future workforce needs to attract and gain employment. If the state wants to see job growth and economic development, taking \$100 million from schools is not the way to go.

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