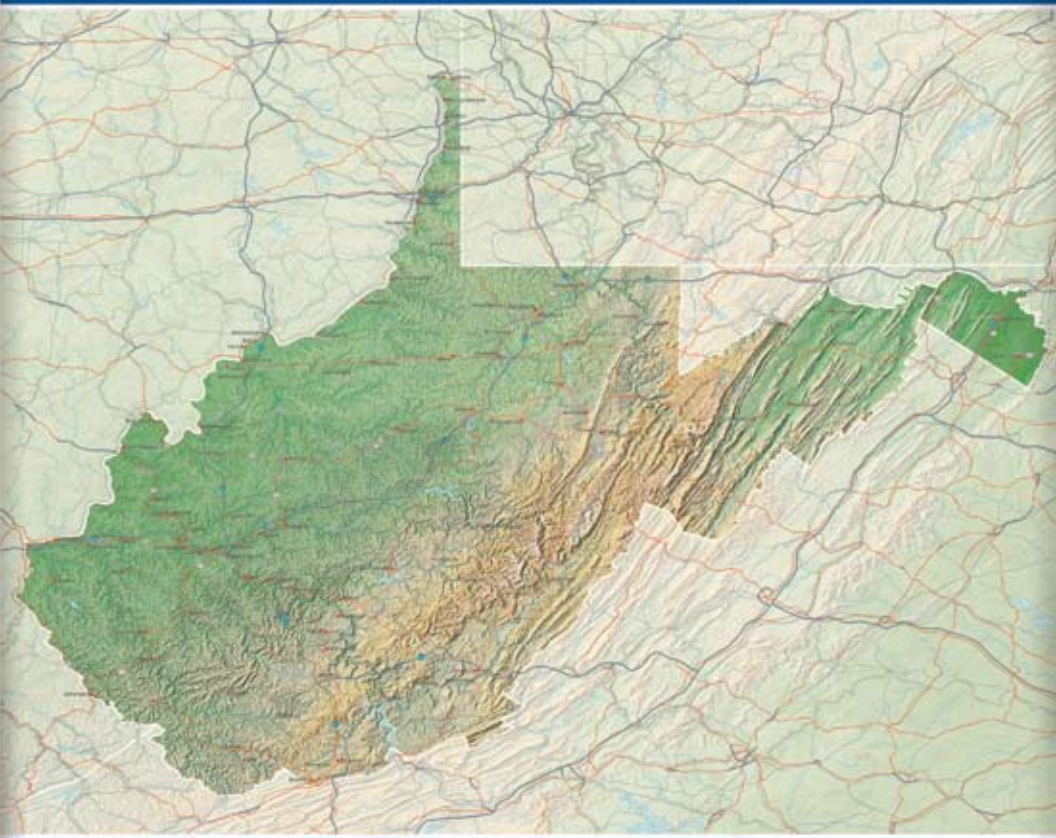


Your Map to the  
**STATE'S BUDGET**



west virginia  
**Center on  
Budget & Policy**



## About Us

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The **West Virginia Center on Budget and Policy (WV CBP)** is a statewide, nonprofit, nonpartisan, organization dedicated to informing the public about how state fiscal policy decisions affect all West Virginians, especially low- and moderate-income families, other vulnerable populations, and the important community programs that serve them.

## Acknowledgements

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## Executive Summary

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The state budget directly affects everyone living in West Virginia. It is the one law that makes state government function. It defines how we plan to use our resources to do things together that can not be done alone, such as creating good schools for our children, protecting the environment, making our communities safe, making car travel possible and ensuring that our constitutional rights are protected. The items contained in the budget not only reveal the important public structures that improve our quality of life, but also reflect what our priorities are as a state.

The central purpose of this report is to show citizens and policymakers how we fund these priorities. This means examining how state spending works, including where we choose to invest our money, how our money is collected and how we compare to other states.

Among the major findings of the report are the following:

1. Over three-quarters of our state budget is directed to public schools, higher education, transportation and health and human services.
2. 86 percent of the state budget is largely out of the hands of citizens and policymakers because law dictates that it goes toward a certain purpose.
3. When state revenues don't grow quickly enough to meet the demand for services, this is called a **structural deficit**. Unlike a budget deficit, this is a long-term problem. West Virginia is at risk of this due to a large and growing elderly population, federal tax changes, a large number of state residents out of the workforce due to disabilities, and other factors.
4. West Virginia's state and local tax system is regressive – meaning that the less money you make the higher the percentage of your income goes to taxes – largely because of our over reliance on sales and excise taxes.
5. Our state budget needs to be more transparent by including tax expenditures, which are revenues lost to preferential tax breaks.



# Introduction

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*“Government is the coming together of people to do for one another collectively what they could not do as well as or at all privately.”*

**Abraham Lincoln**

## Why is the Budget Important?

The state budget is one of West Virginia’s most important policy documents. It is the one law that makes state government function. It defines how we plan to use our resources to do things together that can not be done alone, such as creating good schools for our children, protecting the environment, making our communities safe, making car travel possible and a court system that upholds our constitutional rights. The items contained in the budget not only reveal the important public structures, services and programs that create our quality of life, but also reflect what our priorities are and how funding for programs and services will be shared among all West Virginians.

Just as a family budget reveals basic choices about how to live (does money go toward college education or an early retirement), the state budget consists of thousands of decisions about our shared responsibility to maintain and improve our state.

These decisions directly affect the lives of every one of the 1.8 million people living in West Virginia. They influence the quality of education that our children receive, the level of infrastructure that businesses need to thrive, who has health care insurance, and the sense of security we have in our communities.

In 2008, the state legislature passed several bills directly impacting our state budget. For example, lawmakers reduced the corporate income tax rate, completely phased out the business franchise tax and closed several corporate income tax loopholes. The estimated fiscal impact of these three measures is expected to decrease state revenues by \$210 million upon full implementation.<sup>1</sup> Lawmakers also invested \$50 million in research and development at our two research universities and invested almost \$68 million to increase teachers’ salaries.

The list below is a sampling of the many public services contained in our state budget. It helps underscore the many ways in which all of us use public services everyday that improve our quality of life.

## State Budget Priorities

- **Roads:** Thousands of miles of roads and bridges are maintained in West Virginia's 55 counties.
- **Colleges & Universities:** 65,000 students are enrolled in West Virginia's colleges and universities and 21,000 are enrolled in our community and technical college system.
- **Health Care:** About 390,000 seniors, people with disabilities, children and families receive health insurance and long-term care through the West Virginia's Medicaid Program and an estimated 35,000 children receive insurance through the West Virginia Children's Health Insurance Program.
- **Scholarships:** In 2007 the state invested about \$80 million in scholarships for in-state college students, including \$40 million for the PROMISE scholarship.
- **K-12:** 280,000 students are enrolled in West Virginia public schools.
- **Parks:** 6.7 million people visited West Virginia's 37 state parks in 2006.
- **Mining:** The Office of Mine Health and Safety made 6,100 inspections and issued 12,000 violations.
- **Protection:** Over 650 state troopers police our state.

While this list is only a small sampling of the public services that make our life better, it shows how all of us benefit from the state budget. However, without a strong and structurally balanced tax system many of these services and public structures would diminish or disappear. Our investments in roads, education, police protection, health care and other important government services hinge on a strong and efficient revenue system. This tax system keeps our communities safe, provides the necessary infrastructure that businesses need to compete and be profitable, and creates a better quality of life. Without these important public structures, it would be difficult or impossible to build a broadly shared prosperity and protect individuals and businesses against misfortune.

The purpose of this guide is to provide citizens and policymakers with a roadmap of how the West Virginia State Budget makes all of this possible. This will include how our state invests its resources and generates revenue, how the tax system is structured, how we compare to other states and a brief overview of the budget process. We hope this road map to the budget gives readers guidance on the fiscal decisions that shape their daily lives and how to influence, or change, these decisions.

## Where the State Spends Money

The purpose of this chapter is to show where we are spending our money in FY 2008, how spending has changed over time and how our spending compares to other states.

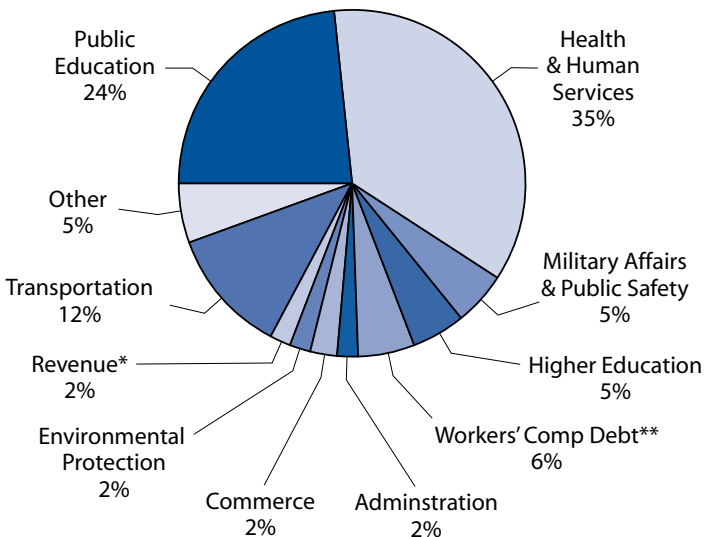
### Funding the Basics

The state will spend about \$10 billion in both federal and state funds for FY 2008. State-source spending accounted for approximately \$6 billion while federal spending accounted for \$4 billion. This distinction between federal and state-source spending is important because state controlled dollars are a better reflection of our priorities as a state.

CHART 1

### Total Appropriations (\$10 Billion) in State and Federal Funds Approved by the Legislature FY 2008

**Total FY 2008: \$9.987 Billion\***



\* \$9.987 billion does not double count the \$77.9 million transferred from Lottery Funds to the General Revenue Fund.

\*\* Workers Compensation Debt (6%) payments will not make up such a large percentage of total appropriations in future years as the move toward privatization is complete.

Source: FY 2008 Enrolled Budget with Governor's Vetoes



While appropriations for programs such as Medicaid or highways are partially driven by federal matching funds, most state appropriations are not.

Of the \$10 billion contained in the FY 2008 budget, over 75 percent goes to public education (K-12), higher education, transportation, and health and human services. Public Education and Health & Human Services make up the two largest pieces of the budget, accounting for over half of all spending.

### Big Ticket Items

As Table 1 illustrates, a dozen specific items contained within those major departments account for 69 percent of all appropriated spending. The two largest items are State Aid to Schools and the West Virginia Medicaid Program.

**State Aid to Schools**, which funds K-12 education in West Virginia's 55 counties, was the biggest item under state-source spending, amounting to \$1.67 billion. In addition, local governments also spend a portion of property tax revenue on K-12

TABLE 1  
**Big Ticket Items FY 2008**

State-Source Spending	Appropriated	% Total Spending
State Aid to Schools	\$1,674,567,849	16.8%
Medicaid	\$661,986,414	6.6%
Highways	\$576,557,908	5.8%
Workers' Comp Debt	\$550,000,000	5.5%
Colleges & Universities	\$277,735,124	2.8%
Corrections	\$145,425,273	1.5%
<b>State Total</b>	<b>\$3,886,272,568</b>	<b>38.9%</b>

Federal Spending	Appropriated	% Total Spending
Medicaid	\$1,875,000,732	18.8%
Highways	\$501,543,000	5.0%
K-12 Education	\$255,078,637	2.6%
Environmental Protection	\$138,554,420	1.4%
Temporary Assistant for Needy Families (TANF)	\$130,000,000	1.3%
School Lunch Program	\$106,017,566	1.1%
<b>Federal Total</b>	<b>\$3,006,194,355</b>	<b>30.1%</b>

<b>Total Big Ticket Items</b>	<b>\$6,892,466,923</b>	<b>69.0%</b>
-------------------------------	------------------------	--------------

education and the federal government also sends money to the state for programs such as the school lunch program. Our state share of K-12 funding is one of the highest in the nation, accounting for almost 60 percent of total public education revenue, while federal revenue accounted for 12 percent and local 28 percent.<sup>2</sup>

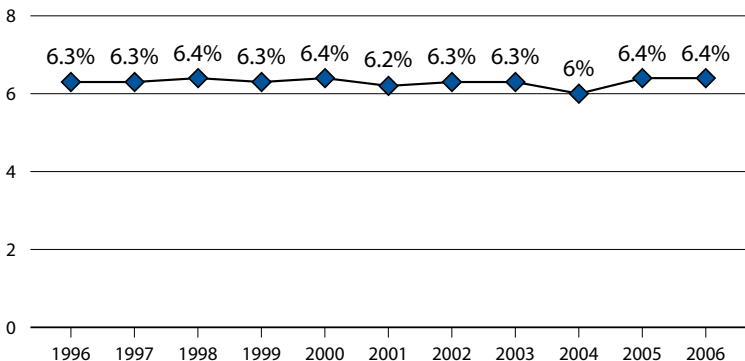
**The West Virginia Medicaid Program** provides insurance coverage to 390,000 state residents and is the single largest federal spending item contained in the budget, amounting to \$1.8 billion in 2008. West Virginia has one of the highest Medicaid federal match rate in the country. For every one dollar the state provides, the federal government provides almost three dollars.<sup>3</sup> We plan to spend up to \$662 million and the federal government could spend an estimated \$1.875 billion on Medicaid in FY 2008.

### State Spending Over Time

One way to put state spending in perspective is by examining it as a share of the state's economy or what's referred to as state Gross Domestic Product (GDP). State GDP is a measure of the overall size of a state's economy. It adds together the total income produced in the state in a given year, including salaries, dividends, and interest. State GDP is a good indicator of how much a state can afford to spend on various programs such as K-12 education.

If state spending as a share of state GDP remains relatively constant over time, then state expenditures are growing at roughly the same rate as the economy.

CHART 2  
**General Revenue Spending  
as a Share of State's Economy (1996-2006)**



Source: State of West Virginia Executive Budget 1998-2006 and US Bureau of Economic Analysis

An examination of General Revenue spending as a share of the state economy from 1996 to 2006 reveals a very steady ratio. Spending as a share of the economy in 1996 was 6.3 percent and moved only to 6.4 percent in 2006. The average across all eleven years was 6.3 percent, indicating that state General Revenue spending has mirrored the expansion of the overall economy.

### How West Virginia Spending Compares to Other States

When comparing spending across states, it's important to look not just at state spending, but combined state and local spending. This is because states differ in how they fund programs. In some states, expenditures for programs are the primary responsibility of state government, in others, of local government. For example, 60 percent of K-12 education funding in West Virginia comes from state funds whereas only 28 percent is derived from local government (i.e. property taxes). This differs sharply with the state of Nebraska where 31 percent of K-12 education funding comes from state government and 57 percent from local government. However, when you add together state and local spending on K-12 in Nebraska and West Virginia they both equal 88 percent, with the remaining amount coming from the federal government. Therefore, to meaningfully compare K-12 expenditures across states, all such expenditures, both state and local, must be included.

One way to compare state and local spending to other states is by measuring expenditures per resident. Because state populations vary, counting total expenditures in each state is not useful. Instead, the average expenditure for an individual resident of a state –a per-capita expenditure–is a better way to compare spending across states.

When total government spending is examined, West Virginia's per capita spending ranked 33rd lowest at \$6,738 in 2004, the latest year these figures are available. West Virginia also ranks below the national average on per capita spending on police protection, corrections, K-12 and higher education. The table below illustrates these findings and compares West Virginia government spending per capita to national averages.<sup>4</sup>

TABLE 2  
**West Virginia Spending vs. National Averages (2004)**

	<b>WV Per Capita State &amp; Local Spending</b>	<b>National Average</b>	<b>West Virginia Ranking</b>
<b>Total Spending</b>	\$6,738	\$7,714	33rd
<b>Corrections</b>	\$119	\$192	46th
<b>K-12 Education</b>	\$1,329	\$2,232	32nd
<b>Higher Education</b>	\$568	\$589	32nd

## Where the State Gets its Money

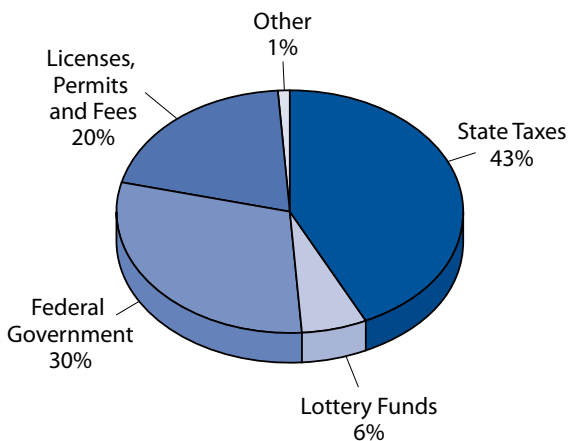
Chapter one discussed where we spend our money. This chapter will deal with how we collect this money to pay for our programs. Unlike the previous chapter that used total appropriated revenue for FY 2008, this chapter will focus on FY 2006. This is because revenue data for FY 2008 will not be available until the fiscal year is complete after July 2008. This chapter will also include a brief discussion of each type of major state tax and how our revenue collections compare to other states.

### Paying for Priorities

West Virginia collects revenue through a combination of sources, including a variety of taxes, lottery funds, federal payments, licenses, permits and fees. In FY 2006, the state collected \$9.79 billion from state residents, businesses, and the federal government (Chart 3).<sup>5</sup> Of each dollar collected, 43 cents came from state taxes, 30 cents from federal government, and 27 cents came from licenses, permits, fees and other sources of revenue. As Chart 3 indicates, our single largest source of revenue comes from state taxes.

CHART 3  
**Appropriated Revenue by Source, FY 2006**

**Total: \$9.79 Billion**



Source: WV Budget Office: State of West Virginia FY 2008 Executive Budget, Volume I

## State Tax Revenue

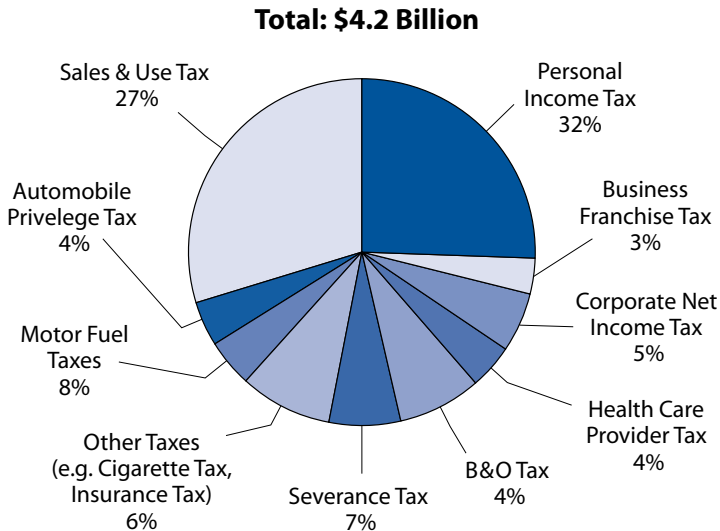
In FY 2006, state taxes made up 43 percent or \$4.2 billion of all state appropriated revenue. Approximately 84 percent of all tax revenue goes into the General Revenue Fund, while 12 percent goes into the Road Fund (Automobile Privilege and Motor Fuel Tax) and four percent goes into the Special Revenue Fund (Health Care Provider Tax).

The sales and personal income tax are the two biggest taxes, accounting for almost 60 percent of total tax revenue. Motor fuel taxes account for eight percent of state tax revenue and the severance tax on natural resources accounts for seven percent.

### Personal Income Tax

The personal income tax is the state's largest source of tax revenue, accounting for 32 percent or \$1.3 billion in FY 2006. West Virginia is one of 43 states that levy a personal income tax. Among states with an individual income tax, West Virginians paid on average less in income taxes than residents in 30 other states, ranking 31st lowest in personal income taxes paid per person (\$714) in 2006.<sup>6</sup> The only surrounding state with lower per capita income taxes was Kentucky with \$694.

CHART 4  
**State Tax Revenues by Source, FY 2006**



Source: WV Budget Office: State of West Virginia FY 2008 Executive Budget, Volume I

In general, about 70 percent of all personal income tax receipts come from employee withholding taxes on wages and salaries.<sup>7</sup> Other taxable income includes dividends, interest, capital gains and other income of individuals. The income that is taxable in West Virginia is defined generally as a person's adjusted gross income (AGI) for federal income tax purposes.

As Table 3 illustrates, we have a graduated, marginal income tax rate that begins at three percent and ends at 6.5 percent. This means as income increases so does the rate at which it is taxed. However, the marginal tax rate is not your overall tax rate – it is the top rate you're paying on your taxable income. Your effective rate is the average rate of taxation for all your taxable income.

For example, if your total taxable income is \$65,000 after deductions this does not mean that all of your income will be taxed at the top rate of 6.5 percent. While your first \$60,000 of taxable income will be taxed at six percent, only the

TABLE 3  
**WV Personal Income Tax Schedule**

(AGI) Income Bracket	Marginal Rate
0-\$10,000	3%
\$10,000-\$25,000	4%
\$25,000-\$40,000	4.5%
\$40,000-\$60,000	6%
\$60,000	6.5%

Source: WV State Tax Department

TABLE 4  
**West Virginia Personal Income Tax  
Effective Rates: 2005**

(AGI) Income Bracket	Effective Rates	Average WV Personal Income Tax Paid
Under \$20,000	1.54%	\$151
\$20,000-\$50,000	3.04%	\$1,003
\$50,000-\$80,000	4.01%	\$2,531
\$80,000-\$100,000	4.63%	\$4,115
\$100,000-\$200,000	5.13%	\$6,585
Over \$200,000	5.71%	\$27,538

Source: WV State Tax Department



additional \$5,000 will be taxed at 6.5 percent. As Table 4 shows, even those with taxable income above \$200,000 pay an effective tax rate well below 6.5 percent.

Both Tables 3 and 4 also illustrate that our personal income tax is progressive – meaning that those with higher incomes pay more as a share of their income.<sup>8</sup>

## **Sales and Use Tax**

The sales and use tax is the second largest source of tax revenue, accounting for 27 percent or \$1.1 billion in FY 2006. The state applies a rate of six percent to sales of goods and services unless specifically exempted from the tax. Exemptions to the sales tax include automobiles, prescription drugs, and cellular services. In recent years, West Virginia has lowered its sales tax on groceries. The sales tax on food was lowered from six to five percent in 2006 and will be further reduced to three percent in 2008. Thirty one states and the District of Columbia exempt most food purchased for consumption at home from the state sales tax.<sup>9</sup>

In general, retail sales and taxable services make up 80 percent of all sales and use tax collections.<sup>10</sup> Among the 45 states that impose a sales tax, West Virginia ranked 12th highest in sales taxes paid each year, with an average of \$619 paid per person.<sup>11</sup> Sales taxes are considered a regressive tax because the lower a family's income, the more they pay in tax as a share of their income.

Because the U.S. economy has shifted from producing goods to providing services, this has reduced the growth of state sales tax revenues. By expanding the sales tax base to include more services, this will help keep revenue stable over time. West Virginia does a better job than most states in terms of taxing services. In fact, it taxes more services than all but five states.<sup>12</sup>

## **Corporate Net Income and Business Franchise Tax**

These two business taxes accounted for eight percent of tax revenue. The corporate net income tax collected \$228 million in 2006 while the business franchise tax brought in \$120 million in tax revenue.

The corporate net income tax is a tax on the net profits of incorporated entities doing business in West Virginia. It applies only to C corporations, not S corporations (e.g. Limited Liability Companies) or unincorporated entities. This is because S corporations do not have to pay income tax and have a limit on the number of shareholders, unlike a C corporation that has no limit on the number of shareholders.

The corporate income tax rate is 8.75 percent, down from nine percent in 2006. Under current law, the rate will drop to 8.5 percent in 2009, 7.75 percent in 2012, seven percent in 2013, and finally to 6.5 percent in 2014. The annual estimated revenue loss due to these changes is \$76 million once fully implemented.<sup>13</sup>

Another measure recently adopted into law is “combined reporting” of corporate income taxes. Combined reporting is a method of taxation that closes corporate tax loopholes that large multi-state companies have used to avoid paying in-state corporate income taxes. Combined reporting is expected to begin generating revenue in FY 2011, yielding \$32.7 million in revenue per year upon full implementation. Twenty-one states have adopted combined reporting and West Virginia was the first southeastern state to do so.

The business franchise tax applies to the net equity of a business for the privilege of conducting business and applies to most corporations, partnerships, and limited liability companies. The business franchise tax was lowered in January 2007 from 0.70 percent to 0.55 percent and, under current law, will be completely phased out by January 2015. The estimated annual revenue loss of ending the business franchise tax upon full implementation is \$165 million.<sup>14</sup>

### **Other Significant Taxes**

**Motor Fuel Taxes:** The motor fuel excise tax and motor carrier road tax accounted for eight percent of tax collections or \$321 million. The state motor fuel excise tax rate is 20.5 cents per gallon of gasoline.

**Automobile Privilege Tax:** The automobile privilege tax is a five percent tax imposed on the value of a vehicle at the time of registration. In 2006, this privilege tax accounted for \$170 million or four percent of total revenue. In 2007, the state legislature added an exception to the privilege tax by excluding new residents from paying the tax.

**Severance Tax:** Making up seven percent of tax revenue, the severance tax on natural resources brought in \$315 million. The severance tax is a five percent gross receipts tax levied on businesses that sever, extract and /or produce natural resource products in West Virginia. This would include oil, coal, natural gas, timber, limestone or sandstone quarried or mined, and other natural resource products. There are reduced rates for underground thin seam coal (1-2 percent), waste coal (2.5 percent) and timber (3.22 percent).

**Health Care Provider Tax:** The health care provider tax is a 0.70 percent to 5.95 percent tax on gross receipts from various medical services providers. This tax was enacted for the specific purpose of providing state matching funds for the Federal-State Medicaid Program. This tax accounted for \$172 million or four percent of tax revenue in FY 2006.

**B&O Tax:** The Business & Occupation Tax accounted for four percent of total tax revenue or just about \$185 million. The B&O tax is a gross receipts tax that applies to public utilities, electric power generators, natural gas storage, and producers of synthetic fuel from coal.

# Federal Revenue

As Chart 3 indicates on page 10, federal sources accounted for about \$3 billion or 30 percent of state revenue in 2006. This money is sent to the state from various federal departments, including the United States Departments of Transportation, Education, Interior, Defense, and Health and Human Services and others.

Funding from these agencies can come to the state in the form of block grants or partial reimbursements. The largest federal block grant that West Virginia receives is for Temporary Assistance for Needy Families (TANF), which is a program that helps move low-income residents into the workforce through cash assistance, job preparation, transportation and childcare. The state also receives large reimbursements on road construction and maintenance. For every \$1 the state spends on interstate roads and other federal road projects, they receive \$9 in matching funds from the federal government.<sup>15</sup>

As discussed earlier, the biggest source of federal revenue pays for the West Virginia Medicaid Program. For every \$1 the state spends on Medicaid, the federal government contributes about \$3 in matching funds.

TABLE 5  
**Licenses and Fees**

Fees	
WV Physical Therapist License Verification Fee	\$25
Copy of WV Birth Certificate	\$10
Solid Waste Assessment Fee	\$8.25 per ton
Copy of WV Marriage Application	\$10
Exam Fee for Embalmers License	\$200 (non-refundable)
Concealed Weapons Permit Fee	\$90

Licenses	
WV Resident Fishing License	\$18
Private Investigator License	\$100
Security Guard License	\$100
Bingo License at State Fair	\$500
Sparklers & Novelties Registration Certificate	\$15
Daily Dog Racing License Tax	\$150
Drug Paraphernalia Sales License	\$150
Apprentice Embalmer	\$60

Source: WV State Tax Department



### Additional Appropriated Revenue

The remaining revenue from appropriated funds is derived from licenses, permits, fees and state lottery funds. Licenses, permits and fees make up the second largest portion of state revenues at 20 percent or \$1.9 billion. This revenue is generated for services provided either to the public, other state agencies, or non-state government entities. The Lottery Funds accounted for six percent of all state revenues or \$565 million. This revenue consists of the sale of lottery tickets or games and video lottery. The gross revenue from the Lottery Funds in 2006, before payouts and administrative costs, was \$1.5 billion or nearly three times the net revenue used for state programs. A sampling of licenses and fees is in Table 5 on page 15.

### How West Virginia’s Revenue System Compares to Other States

Table 6 is a per capita comparison between West Virginia’s taxes and total revenues in 2005 and U.S. averages.<sup>16</sup> Overall, West Virginia’s total revenue and tax collections are below the national average per person. That means on average we pay less in taxes than most other states per resident. West Virginia also ranks below the national average on personal income taxes, property taxes, and sales tax. West Virginia receives its highest ranking (almost \$200 above the national average) on selective sales taxes, such as gasoline, cigarettes and alcohol, per person.

TABLE 6  
**WV Revenue vs. National Averages (2005)**

	<b>WV Per Capita State &amp; Local Revenue</b>	<b>National Average</b>	<b>WV Ranking</b>
Total Taxes	\$3,060	\$3,698	35
Total Revenue	\$8,125	\$8,509	23
Personal Income Tax	\$646	\$813	33
Property Tax	\$556	\$1,132	44
General Sales Tax	\$604	\$887	42
Selective Sales	\$605	\$406	4

## CHAPTER THREE

# A Fair and Reliable Tax System

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The previous section looked at how West Virginia collects its taxes from different revenue sources. This section will concentrate on the principles of a fair and reliable state tax system. It will analyze West Virginia's tax system and how taxes are distributed among state residents and businesses.

### Principles of a Strong Tax System

A high quality revenue system must meet certain standards if it's going to be considered a fair and reliable tax system. While state tax systems differ, there's general agreement among government leaders, policymakers, economists and others that an effective tax system achieves equality and fairness, efficiency, stability and simplicity.<sup>17</sup>

#### Equality and Fairness

A fair and equal tax system is one that demonstrates both “vertical” and “horizontal” equity. Vertical equity means that people with a greater ability to pay should pay more. It demands that taxes not absorb a greater share of income from a low-income person than a high-income person. The rationale for this concept is because a high-income person has a greater ability to pay taxes and a greater share of his/her income will be devoted to consuming non-necessities and luxuries. Horizontal equity means that people in similar situations with the same ability to pay should pay equally. For example, the tax on \$10,000 in wage income should be no higher than tax on \$10,000 in capital gains (stocks, dividends, etc) income.

If a tax system is one in which those with lower incomes pay a smaller portion of their income in taxes than those with high incomes it is **progressive**. In contrast, if those with lower incomes pay a larger portion of their income in taxes then it is **regressive**. A **proportional tax** (or flat) system takes the same percentage of income from everyone regardless of his or her ability to pay. A progressive tax system most exemplifies the “ability to pay” principle and has been endorsed by the West Virginia Tax Modernization workgroup members in 2006 and the 1999 WV Commission on Fair Taxation.<sup>18</sup>

Another related concept pertaining to a fair tax system is the “benefits principle.” This principle maintains that each taxpayer's burden should reflect the benefit received from the government service. For instance, West Virginia imposes a motor fuel tax in order to pay for highway maintenance. Since the amount of gasoline a driver uses reasonably determines the benefits he or she receives from publicly maintained roads, the motor fuel tax follows the benefits principle. The downside of using the benefits principle is that it does not adhere to “the ability to pay” principle discussed earlier.

## Efficiency

An efficient tax system encourages neutrality by staying out of the way of economic decisions. In other words, tax rules should not favor one industry or investment over another. This lack of efficiency can cause labor and capital to flow to areas for reasons not supported by economic factors and can cause negative economic consequences in the long run.<sup>19</sup> For example, giving poorly targeted tax credits to businesses can not only distort the market, but can be a wasteful investment for all other taxpayers.

Another way a tax system can be neutral is by ensuring that state taxes are applied the same regardless of where a purchase is made. For instance, a book purchased online should be subject to the same sales tax rate as a book bought at a local bookstore.

## Stability

A stable tax system can produce revenue in the face of changing economic circumstances. Income and sales taxes, for example, can vary greatly according to phases in the economic cycle while the property tax is more stable but tends to grow more slowly than the cost of services that state and local governments provide. However, the income tax is the best indicator of the overall state of the economy.

Having a predictable rate of revenue growth is important in creating revenue adequacy and for funding the normal increases in government services. To this end, it is important that agencies providing government services depend on a variety of taxes to soften the impact of downturns in the economy.

Another aspect to consider regarding stability is whether the normal growth of revenues is sufficient to finance the normal growth of expenditures. The “normal growth of expenditures” refers to the amount it would cost us to continue providing the existing level of programs and services. When states consistently cannot grow enough revenues to meet the costs of providing government programs and services, it is called a **structural deficit**. A structural deficit is different from a budget deficit in that it is a long-term chronic problem.

West Virginia is at a risk of a structural deficit due to:

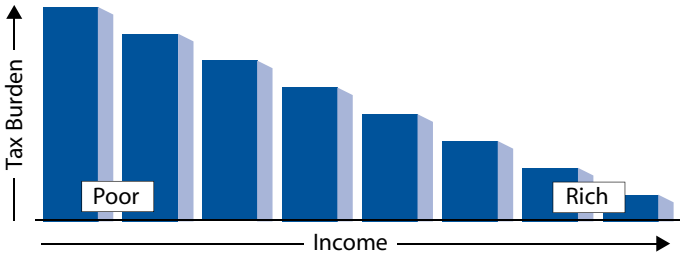
- Growing elderly population
- Linkage to the federal phase out of the estate tax
- Greater than average share of non-elderly population on (SSI) Supplemental Security Income
- A statutory property tax limitation set to three percent
- A decline of corporate income taxes as a share of total income taxes.<sup>20</sup>

Two other national studies also found we have a structural gap.<sup>21</sup>

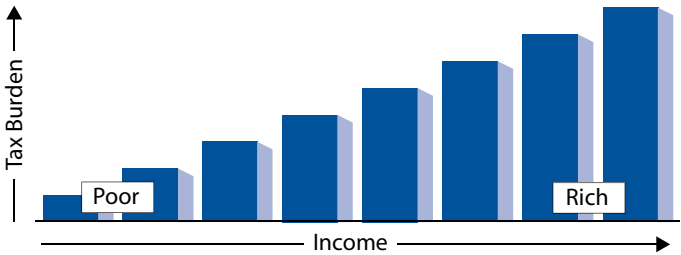


CHART 5

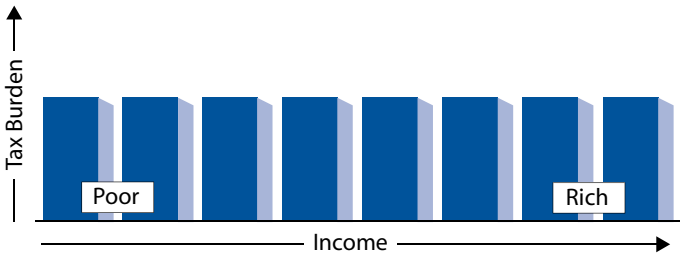
**Regressive Taxes**  
(Taxes as a Percent of Personal Income)



**Progressive Taxes**  
(Taxes as a Percent of Income)



**Proportional Taxes**  
(Taxes as a Percent of Income)



Other factors, especially our demographics, contribute to growing budget demands. For example, West Virginia has a high percentage of its population over 65, which tend to need more state services but spend less and concentrate more of their expenditures in non-tax areas such as health care services. As a result, sales and use tax collections, which comprise 27 percent of state tax revenues, could be affected as the population ages.

Factors that also make it difficult for us to collect sufficient revenue include our low population growth, workforce participation and the wealth of our residents. As Table 7 illustrates below, West Virginia's population is just above 1.8 million. However, it remains under what it was in 1950 when the population was just above two million. The greater than average share of non-elderly population on SSI income, as discussed above, is also reflected in our very low worker participation rates. The wealth of state residents is reflected in our close to last place rankings in per capita income and median household income.

TABLE 7  
**West Virginia Demographic and Economic Indicators**

Indicator	Amount	Rank	Year	National Average
<b>Demographic</b>				
Population	1,814,083	37	2005	5,811,969
Percent of Population above 65	15.3%	2	2005	12.4%
<b>Economic</b>				
State Per Capita Personal Income	\$26,419	48	2005	\$34,471
Real State Gross Domestic Product (in millions)	\$45,003	49	2006	\$221,399
Median Household Income	\$35,059	49	2006	\$48,451
Unemployment Rate	5.1	40	2006	4.6
Percent of Children Below Poverty Level	25.2	5	2006	18.3
Labor Participation Rate	55.9	50	2006	66.2
Lack Health Insurance Coverage	16.9	39	2005	15.3
Percent of People Below Poverty Level	17.3	5	2006	13.3
Percent of 65 and Older Below Poverty Level	10.5	15	2006	9.9

Source: U.S. Census Bureau, U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics.



## **Simplicity and Transparency**

A tax system should be easy to understand, accountable and transparent. Taxpayers should not have to navigate through complex requirements. Complexity should not make it harder for governments to monitor and enforce tax collections. A tax system is accountable when it provides sufficient knowledge to evaluate the system. For instance, tools like fiscal notes, which provide an estimate of the revenues lost or gained by the adoption of legislation, gives the public an understanding how a piece of legislation might affect state revenues.

## **Who Pays State Taxes?**

West Virginia's overall tax structure is regressive, meaning that low-income families pay more taxes as a share of their income than high-income families. As shown above in Table 7 our state per capita personal income is \$26,419 and our household median income is just over \$35,000 a year. Chart 6 and Table 8 indicate that families with incomes in this range pay more in taxes as a share of their income than high-income families. For instance, those with average incomes between \$24,000 and \$41,000 pay 9.5 percent of their income in state and local taxes, while those with incomes above \$252,000 pay 7.8 percent.

The three main state and local taxes outlined in Chart 6 are income, sales and excise taxes and property taxes. Sales and excise taxes (e.g. motor fuel tax) are regressive while the income tax (including both personal and corporate) is progressive and the property tax is only slightly regressive. For example, notice how the medium blue part of the graph (sales and excise taxes) gets smaller as you move up into higher income groups and how the dark blue part (income taxes) gets bigger. This means sales and excise taxes make up a larger portion

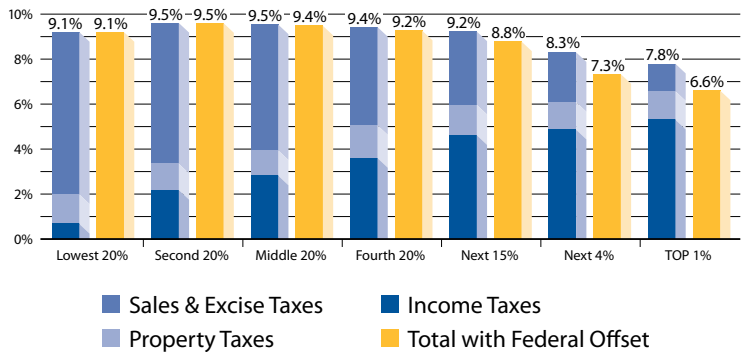
of taxes among low and middle-income groups. The progressive features of the income taxes are not enough to offset the impact of the sales and excise taxes thus making the overall system regressive.

The offsetting of federal taxes also plays an important role in determining how much each income group pays. High-income taxpayers (top 20 percent) can effectively export between 0.5 and 1.2 percent of their tax burden to the federal government while lower and middle-income taxpayers cannot. After taking into consideration the federal deduction offset, the top one percent of income earners pay 6.6 percent of their income in taxes while those in the bottom 80 percent pay over nine percent.

A recent study by the Bureau of Business and Economic Research at West Virginia University has found similar results, concluding that our 14 biggest state taxes are “moderately regressive.”<sup>22</sup> In addition, the study concluded that the regressive quality of our state tax system has grown from 1999 to 2004. The regressive nature of our tax system, according to the study, is due to our state’s over reliance on sales and excise taxes.

The most progressive feature of our state tax system is the personal income tax, which accounts for about 32 percent of total state tax revenue. As discussed before, this is because our personal income tax rates rise as our income gets higher.

CHART 6  
**Who Pays? A Distributional Analysis  
of West Virginia’s Tax System**



Source: Institute for Taxation and Economic Policy, (ITEP)

TABLE 8

## West Virginia State and Local Taxes in 2006: Shares of Family Income for Non-Elderly Taxpayers

Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
					Next 15%	Next 4%	TOP 1%
Income Range	Less than \$14,000	\$14,000 – \$24,000	\$24,000 – \$41,000	\$41,000 – \$68,000	\$68,000 – \$119,000	\$119,000 – \$252,000	\$252,000 or more
Average Income in Group	\$8,300	\$19,300	\$32,600	\$52,400	\$86,100	\$157,100	\$597,300
<b>Sales &amp; Excise Taxes</b>	<b>7.1%</b>	<b>6.2%</b>	<b>5.6%</b>	<b>4.4%</b>	<b>3.3%</b>	<b>2.2%</b>	<b>1.2%</b>
General Sales—Individuals	3.8%	3.6%	3.4%	2.7%	2.1%	1.5%	0.8%
Other Sales & Excise—Ind.	2.4%	1.7%	1.3%	1.0%	0.6%	0.4%	0.2%
Sales & Excise on Business	1.0%	0.9%	0.8%	0.6%	0.5%	0.4%	0.2%
<b>Property Taxes</b>	<b>1.3%</b>	<b>1.2%</b>	<b>1.1%</b>	<b>1.4%</b>	<b>1.3%</b>	<b>1.2%</b>	<b>1.2%</b>
Property Taxes on Families	1.1%	0.9%	0.9%	1.3%	1.2%	1.0%	0.6%
Other Property Taxes	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.7%
<b>Income Taxes</b>	<b>0.7%</b>	<b>2.2%</b>	<b>2.8%</b>	<b>3.6%</b>	<b>4.6%</b>	<b>4.9%</b>	<b>5.3%</b>
Personal Income Tax	0.6%	2.0%	2.7%	3.5%	4.5%	4.7%	4.9%
Corporate Income Tax	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.4%
<b>TOTAL TAXES</b>	<b>9.1%</b>	<b>9.5%</b>	<b>9.5%</b>	<b>9.4%</b>	<b>9.2%</b>	<b>8.3%</b>	<b>7.8%</b>
Federal Deduction Offset	—	–0.0%	–0.0%	–0.1%	–0.5%	–0.9%	–1.2%
<b>TOTAL AFTER OFFSET</b>	<b>9.1%</b>	<b>9.5%</b>	<b>9.4%</b>	<b>9.2%</b>	<b>8.8%</b>	<b>7.3%</b>	<b>6.6%</b>

Note: Table shows 2008 tax law at 2006 income levels.

Source: Institute for Taxation and Economic Policy

## CHAPTER FOUR

# How State Spending Works

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The purpose of this chapter will be to explore the budget process, describe the various budget documents and illustrate the central sources of funding contained in the state budget. This chapter will focus on spending that is specifically appropriated in the Budget Act and conclude with an examination of expenditures not in the Budget Act.

### How the Budget is Created

Each year, the legislature, state agencies and the Governor's Office wrestle with a spending plan for West Virginia. This process begins one year prior to the beginning of the fiscal year (FY), which begins on July 1 and ends on June 30.

The first step in the budget process is for state agencies (e.g. Department of Environmental Protection) to submit budget requests to the State Budget Office. The budget requests are based on specific guidelines provided by the Secretary of Revenue and the State Budget Office. The requests are due on September 1st and then reviewed by the State Budget Office. Between September and October, state agencies hold private budget hearings with the State Budget Office and the Governor's Office in order to answer questions, submit additional requests, and discuss any future capital projects. When the hearings are complete, the Governor submits a state budget, known as the Executive Budget, to the legislature for the next fiscal year that includes recommended spending levels for state agencies, estimated revenue from tax collections and other sources, and state debt and liability. The West Virginia State Budget Office is responsible for estimating revenues and developing a budget that reflects the Governor's priorities. The Governor's Executive Budget consists of three important documents – the Budget Bill, the Budget Report and Operating Detail. These documents are discussed in detail below.<sup>23</sup>

**Budget Bill:** The Budget Bill is the legislation that appropriates the expenditures required to operate state government for each fiscal year. It contains line items from each department and broadly outlines how that money will be spent. The Governor's Budget Bill is introduced on the second Wednesday of January of each year, except following a gubernatorial election. While the Governor is not legally required to submit a balanced budget, the legislature is constitutionally required to pass a balanced budget – meaning that spending cannot exceed revenue for the upcoming fiscal year. The House and Senate will both introduce Budget Bills that they will reconcile at the end of the legislative session. Upon approval of the legislature, the Budget Bill becomes the Budget Act and can now appropriate funds to the different spending units contained in the Budget Bill.



**Volume I Budget Report:** Volume I of the Budget Report provides not only the Governor's estimated revenues and proposed expenditures for the upcoming fiscal year but looks into long-range economic issues, revenue forecasting, and provides a six-year financial plan for the state. The Budget Report also contains information on capital projects, a state profile, an overview of the budget process, and an executive message (the state of the state address) from the Governor on major goals and objectives addressed in the budget.

**Volume II Operating Detail:** The Operating Detail contains narrative and financial information on all the departments, bureaus, divisions, commissions, agencies, and programs of the state. The narrative section details the structure, responsibilities, and activities of each agency, commission and department. The financial section contains expenditure information for the upcoming fiscal year and two years prior by fund type. The Operating Detail gives a more detailed account of expenditures, while the Budget Report provides more detailed information on state revenues and forecasting.

The second step in the budget process is for the legislature to review the Executive Budget and hold hearings before the House and Senate Finance Committees. At this point, the budget is an appropriation bill that can be amended to change the funding recommendations of the Governor. Each amendment to the budget must contain a fiscal note to describe the revenue impact. Both the House and Senate will each pass a Budget Bill and the differences between the two bills are worked out in the Budget Conference Committee, which is made up of appointed members of the House and Senate Finance Committees. This usually takes place at the end of each legislative session. The legislature is constitutionally required to pass a balanced budget and the Governor is required to sign a balanced budget.

After passage by the legislature, the third step is for the Governor to either sign the Budget Bill or wait five days and the Budget Bill will become law. Before signing the bill the Governor can choose to veto certain expenditures or increase spending while ensuring a balanced budget. The legislature can override the Governor's veto of any budget item with a two-thirds vote. The Budget Bill adopted by the legislature and approved by the Governor represent spending authority for the next fiscal year and is referred to as the Budget Act.

The last step in the budget process is for expenditure schedule guidelines to be sent to each state agency that outline in detail how they will spend the appropriated funds. These schedules are then reviewed by the State Budget Office and then approved by the Revenue Cabinet Secretary. On July 1, the appropriations contained in the Budget Act are ready for agencies to process and make payments.

TABLE 9  
**State Budget Timeline**

<b>July</b>	The Secretary of Revenue, along with the Governor's Office and the State Budget Office, issues appropriation guidelines for state agencies.
<b>July - September</b>	State agencies prepare budget requests and submit them on September 1 <sup>st</sup> and the Secretary of Revenue and the State Budget Office reviews them.
<b>September - October</b>	The State Budget Office holds budget hearings with state agencies to discuss their appropriation requests and capital expenditures plans. During this time, agencies also have the opportunity to provide additional information to the Governor's Office and the Department of Revenue and any answer questions or bring to the forefront any specific needs such as legislative or federal mandates or court ordered funding.
<b>November</b>	The Department of Revenue makes official revenue estimates for the upcoming fiscal year.
<b>December</b>	The Governor releases final revenue estimates and budget recommendations based upon program priorities, requirements, court orders, and the availability of funds.
<b>January</b>	The Governor presents the Executive Budget to the legislature on the second Wednesday of January, except following a gubernatorial election when the budget is submitted on the second Wednesday of February.
<b>January - March (Legislative Session)</b>	The Governor's Executive Budget is referred to the Senate and House Finance Committees for review and consideration. During this time, finance committees hold budget hearings with state agencies to determine their recommended funding for the upcoming year. Both finance committees pass a Budget Bill and present it to their respective legislative bodies for approval. The Budget Conference Committee, made up of House and Senate Finance Committee member, works out any differences and agrees to a single Budget Bill.
<b>March (Legislative Session)</b>	The legislature passes a balanced budget and presents it to the Governor. The Governor may veto the Budget Bill or disapprove or reduce items or parts of items contained in the Bill. If approved, the Bill becomes law and it referred to as the Budget Act. To override the Governor's vetoes, the legislature needs a two-thirds vote.
<b>April - July 1</b>	Expenditure Schedule Guidelines are filled out by State Agencies and submitted in April. The State Budget Office reviews Schedules and they are approved by the Cabinet Secretary and entered into the WV Financial Information System. On July 1, appropriations are ready for Agencies to process payments.

Source: State of West Virginia, Executive Budget FY 2008, Volume I Budget Report

## What's not in the Budget Bill?

Throughout the year the legislature or the Governor may amend the Budget Act by introducing supplementary appropriation bills. The Budget Act may need to be adjusted as revenue comes in higher or lower than estimated. The Governor may call a special session to pass a supplemental appropriations bill that can raise or reduce spending. The legislature can also introduce a supplementary appropriations bill granted that it provides the source of revenue necessary to pay the appropriation unless there is sufficient revenue currently available.

### Non-Appropriated Funds

For FY 2008, the state is estimated to spend \$14.19 billion. The state spends money from two central funds, appropriated and non-appropriated. Non-appropriated funds are not included in the Budget Act and are considered Special Revenue Funds that derive spending authority from general law and language contained in the Budget Act.

For instance, when West Virginia University spends money collected from college tuition payments it is a state expenditure of non-appropriated funds and is not included in the Budget Act. For FY 2008, non-appropriated funds are estimated to account for more than a quarter of all state expenditures, or \$4.19 billion.<sup>24</sup> About 80 percent of all non-appropriated funds consist of college tuition payments and public employee retirement pensions. Because non-appropriated spending is derived solely from the money it receives in fees or established rates it is not subject to much debate and its authority is largely out of the control of state residents and lawmakers.

This report of the state budget focuses on appropriated funds. However, there are other ways the state spends money.

### Tax Expenditures

In addition to non-appropriated funds, we also spend hundreds of millions of dollars each year through the tax code by providing targeted tax exemptions to particular groups of individuals or corporations. These tax cuts are referred to as “tax expenditures.” Tax expenditures are forgone revenue that would otherwise be payable to the state. They include special exemptions, deductions, rebates, credits, and rate reductions that reduce the amount of tax owed. The stated reasoning behind providing tax expenditures is to encourage certain kinds of activities and to aid taxpayers in “special circumstances.”<sup>25</sup>

For example, thin-seam coal is subject to a reduced severance tax rate of one to two percent (depending on thickness) instead of the standard five percent. This reduction is offered to encourage greater coal production due the perceived increase in the cost of producing thin-seam coal. As this example illustrates, tax expenditures are similar to spending in the state budget in that they both work

to achieve a certain public policy goal. However, tax expenditures are not given a line item in the budget and are therefore not subject to the scrutiny of the appropriations process. Despite this difference, both direct state spending and exemptions in the tax code compete with government spending priorities.

### **Tax Expenditure Reports**

The State Tax Department is required by law to submit to the legislature every year a tax expenditure report on most taxes. The reports include a brief overview of revenue collections in recent years for each major tax being examined, a rationale for why the state supports each exemption, estimated cost of every expenditure and the statute under which the expenditure falls.

However, these reports focus on different types of expenditures in the tax code depending on the year. For example, the 2007 report focused on expenditures regarding the sales and use tax, while the 2006 report examined excise, property, and certain business taxes. In 2005, the focus was the business franchise, corporate net income, and personal income tax.

### **Sources of Appropriated Funds**

In order for our state to spend money, it must appropriate it from a specific account. The state appropriates money from five central accounts or funds contained in the Budget Act:

1. General Revenue Funds
2. Federal Funds
3. State Road Funds
4. Lottery Funds
5. Special Revenue Funds

The state collects this money through taxes, fees and fines, the lottery, and federal dollars. For FY 2008 the State Budget contained nearly \$10 billion dollars in appropriated funds.<sup>26</sup> Appropriations from state sources accounted for approximately 60 percent of overall appropriated funds while federal spending accounted for 40 percent.

### **General Revenue Funds**

The money from the General Revenue Fund comes from taxes, fees and licenses that pay for many of the state's key budgetary items, including public education, corrections, health care, and public safety. About three-quarters of this revenue supports K-12 education, Medicaid, social services, and higher education.

In FY 2008, the General Revenue Fund made up about 37 percent of overall spending or \$3.77 billion. Most of the revenue collected in this fund comes from

8 major taxes including the sales and use tax, personal income tax, corporate income taxes, severance taxes, and so-called “sin taxes” on items such as cigarettes. During the legislative session (January-March), the biggest debates usually focus on appropriations from the General Revenue Fund.

**General Revenue Discretionary Funds**

Debates on the state budget focus heavily on spending contained in the General Revenue Fund because it contains the only source of discretionary (non-earmarked) money that is not restricted for a specific purpose. By law, about 60 percent of the money contained in the General Revenue Fund, and all the money contained in each of the other funds, is restricted by either major constitutional or statutory requirements. For example, State Aid to Public Schools and Medicaid are earmarked in the budget while funding for State Police and Corrections is non-earmarked.

About 40 percent of the money contained in the General Revenue Fund can be used for discretionary purposes.<sup>27</sup> This means that only a tiny portion, 14 percent, of the overall budget can be used to sustain existing programs like corrections, universities and the state police.

However, despite this small amount of spending flexibility many of the programs that fall into “discretionary funding” are an essential part of what we’ve come to expect from state government. The State Children’s Health Insurance Program, which is a relatively new program that provides health care to children of families with low and moderate incomes, is one popular state program that contains discretionary spending.

Table 10 shows examples of spending programs that are set aside by law for specific purposes and programs that are not required to be funded each year.

TABLE 10  
**Examples of General Revenue Fund Discretionary  
and Non-Discretionary Programs**

Discretionary	Non-Discretionary
Children’s Health Insurance Program	State Aid to Schools
Corrections	Public Employees Health Insurance
State Police	Medicaid
Universities & Colleges	Public Defenders Services
Financial Aid for College Students	Legislative Branch
Rehabilitation Services	Judicial Branch

## **Federal Funds**

Federal funds are considered earmarked because primarily the federal government, not the state legislature, determines where this money is spent.

The state legislature does have some limited spending flexibility depending on the program. Federal funds account for the single largest portion of spending contained in the state budget, making up 40 percent of overall appropriations or almost \$4 billion dollars. Federal funds typically consist of any financial assistance made directly to state agencies by the federal government. For example, in FY 2008 the Department of Health and Human Resources will receive almost \$2 billion in federal matching funds for the West Virginia State Medicaid Program and the Department of Transportation will receive \$500 million in reimbursements for road construction and repair.

## **State Road Funds**

The revenues collected in the State Road Fund are used solely for building and maintaining public highways, paying the interest or principle on road bonds and for administrative expenses of the Division of Highways and the Division of Motor Vehicles.

The State Road Fund receives money from federal sources and state sources. For FY 2008, 45 percent of State Road Fund appropriations will come from the federal government and 55 percent from state sources. Other major sources of revenue include the motor fuel tax, motor vehicle registration fees, and the automobile privilege tax.

Excluding the federal funding of the State Road Fund, this fund accounts for just over six percent of overall state spending.

## **Lottery Funds**

Lottery Funds make up the smallest revenue source, accounting for three percent of all appropriated revenue or \$396 million. This revenue source is supported by the sale of lottery tickets or games and limited video lottery. This revenue source is funded once prizes are paid out and administrative costs are paid.

The Lottery Funds are broken into two separate categories, the Lottery Fund and the Excess Lottery Fund. The Lottery Fund can only be used for education, senior citizens, and tourism and parks, while the Excess Lottery Fund may be used for PROMISE scholarships, senior tax credits, higher education, and other programs. In FY 2008, approximately \$77.9 million was transferred from the Excess Lottery Fund to the General Revenue Fund.



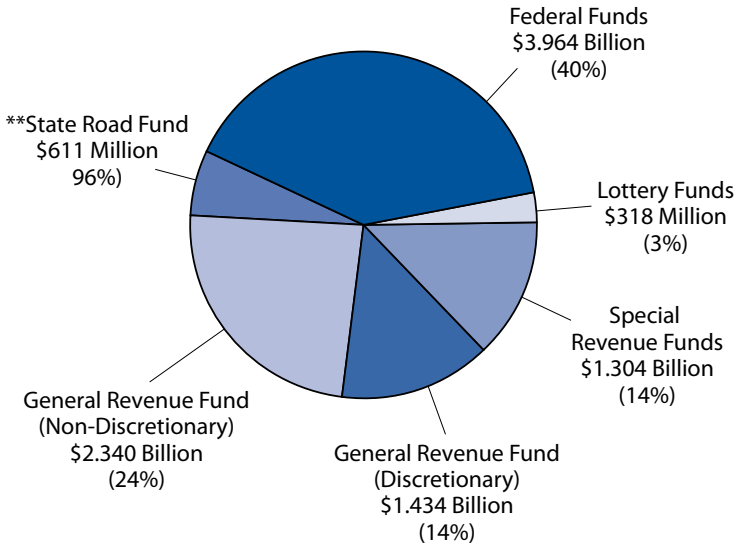
## Special Revenue Fund

Making up 14 percent of the budget, the Special Revenue Fund consists of individual accounts created for a specific purpose. These accounts are mostly supported from permits, fees, licenses, services provided to the public, other state agencies, or non-state governmental agencies. However, other accounts created in the Special Revenue Fund can be supported through special taxes. For example, the Medicaid State Share Fund collects matching funds for the Medicaid Program by utilizing a health care provider tax. In FY 2008, the state collected \$174 million taxing various medical service providers. Because spending is limited to the amount collected, this fund is not generally subjected to the same debate as the general funds.

Chart 7 breaks apart state appropriations by revenue source for FY 2008. It includes \$3.7 billion in general revenue funds, \$3.9 billion in federal funds, \$1.3 billion in special funds, \$611 million in road funds and \$318 million in lottery funds.

CHART 7  
**Total Appropriations by Fund Source, Fiscal Year 2008**

**Total FY 2008: \$9.9 Billion\***

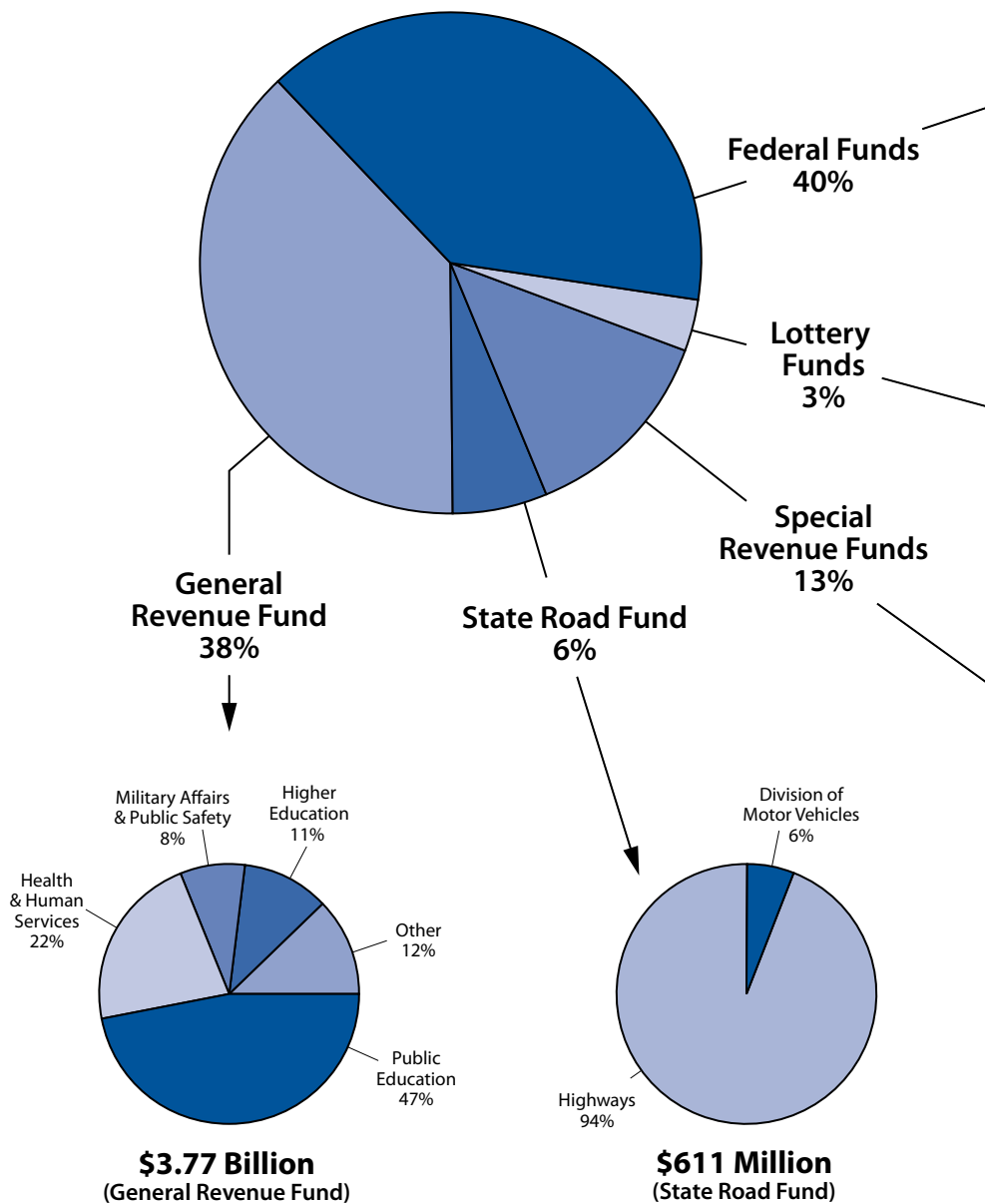


\* This total does not double count the \$77.9 million transfer from Excess Lottery Funds to the General Revenue Fund nor is it reflected in the Lottery Funds total.

\*\* The State Road Fund total does not include federal reimbursements; they are included in Federal Funds.

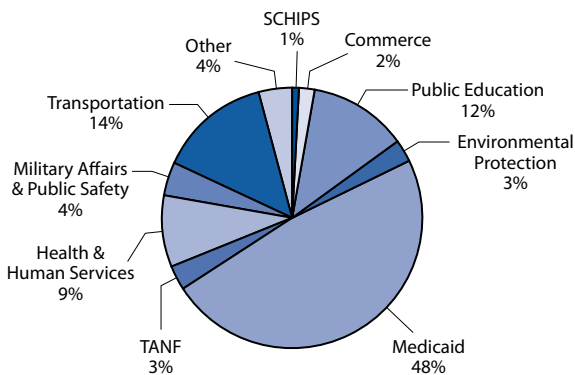
Source: WV Budget Office

CHART 8  
**Appropriations by Fund Source FY 2008: \$9.987\***

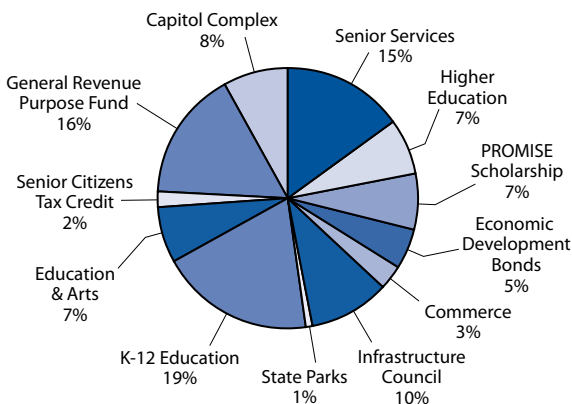


\*Does not double-count the \$77.9 million transfer from Lottery Fund to General Revenue Fund.

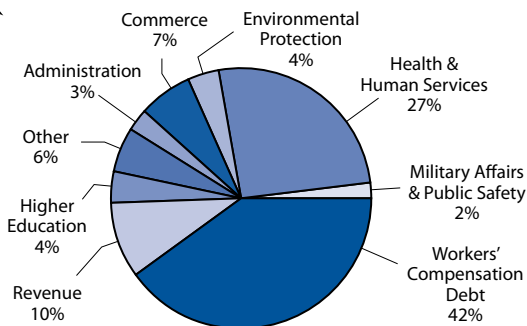
Source: FY 2008 Enrolled Budget with Governor's Vetoes



**\$3.96 Billion**  
(Federal Funds)



**\$396 Million**  
(Lottery Funds)



**\$1.3 Billion**  
(Special Revenue Funds)

## Conclusion

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*“In football, the noted coach, Vince Lombardi, is quoted as saying that ‘Winning isn’t everything—but it is the only thing.’ The same is almost true in State Government. The State Budget isn’t everything, but sometimes it comes close to being the only thing. The budget determines the services which every resident of West Virginia will receive in such varied fields as schools, roads, police protection, health and welfare. The budget not only dictates the number of services—it also governs the level and quality of these services. It is, therefore, an instrument of policy formation, as well as a means of delivering needed funds to government agencies. It is the most important bill passed by the legislature each year. This is true because every citizen of the State is affected by the Budget—not once, but many, many times in the course of a fiscal year. Yet, despite its importance, the budget process in West Virginia is one which is really understood by only very few people in State Government.”*

**Ivor F. Boiarsky,  
Speaker of the West Virginia House of Delegates  
September 1970**

The purpose of this map to the state budget was not only to introduce policymakers and citizens to how we invest our money in the public structures that strengthen and build our state, but to give you the necessary information to steer you through the twists and turns of state budget and tax system.

Through this analysis of the state budget we’ve seen that the vast majority of state spending goes toward the important programs and services that we all depend on. We invest over three-quarters of our state budget in public schools, higher education, transportation and health and human services. This investment toward the common good not only helps contribute to a better quality of life for each and every one of us, but also lays a foundation upon which our economy can prosper and grow.

Our tax system is equally important since it determines how we collect our resources to pay for these important public structures. We’ve learned that a good tax system is one that is fair, efficient, stable, and simple and that there should be vertical equity, meaning that those with greater ability to pay should pay more, and horizontal equity, meaning that people in similar situations should pay similar taxes.

Along the way we've also discovered that our state suffers from a long-term problem — a structural deficit, which hampers our ability to meet the demand for government services.

We've also determined that the budget doesn't contain all the money that we spend each year. Tax expenditures, or special tax breaks, are not appropriated every year or contained as a line item in the budget.

To help West Virginia meet its budget and tax challenges we need a clear understanding of how we use and direct our state resources. In order to achieve this goal, the state budget must be as transparent as possible and include all expenditures.

However, in the end it will be up to each of us to make sure that the programs and services in the budget reflect our priorities and meet our needs.



## Glossary

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**Appropriation** – an amount of money approved by the Legislature for a specific purpose.

**Adjusted Gross Income (AGI)** – the amount of income that is subject to tax after all adjustments have been made, but before subtracting deductions or exemptions.

**B&O Tax** – a gross receipts tax that applies to public utilities, electric power generators, natural gas storage and producers of synthetic fuel from coal.

**Balanced Budget** – an income and spending plan for which projected income is equal to or greater than projected spending. West Virginia law requires the Legislature to balance the budget every year.

**Bill** – a proposed piece of legislation to be considered by the Legislature for passage into law.

**Budget Deficit** – the amount by which revenues fall short of expenditures during a fiscal year.

**Business Franchise Tax** – a tax that applies to the net equity of a business for the privilege of conducting business. It applies to most corporations, partnerships and limited liability companies.

**“C” Corporation** – a business which is completely separate entity from its owners, unlike a partnership.

**Capital Projects** – related to the expansion, acquisition and upkeep of state government’s infrastructure.

**Corp. Net Income Tax** – a tax on the net profits of incorporated entities doing business in West Virginia. It applies only to “C” corporations, not “S” corporations (e.g. Limited Liability Companies) or unincorporated entities.

**Demographics** – the characteristics of human populations and population segments, especially when used to identify consumer markets.

**Discretionary Funds** – funds that are used toward certain requests rather than funds whose purpose is predetermined.

**Earmarked** – the practice of setting aside – through constitutional provisions or statutory law – revenues from a particular sources for particular budget items.

**Estate Tax** – a tax imposed on the property held by an individual at the time of his or her death, before any transfers to heirs. West Virginia's estate tax is linked directly to the federal estate tax, which is currently being phased out.

**Excise Tax** – a special sales tax levied on the purchase of a particular type of product or service, such as alcohol, tobacco, or gasoline.

**Exemptions** – not subject to taxation

**Expenditures** – money paid out for the purchase of goods or services.

**(Federal) Matching Funds** – federal funds available for a state program that require the state to contribute a lesser, equal or greater amount, according to a match formula.

**Federal Poverty Level** – a method of measuring poverty developed by the federal government for statistical, planning and budget purposes. It is a measurement widely used to determine eligibility for federal and state government programs.

**Fee** - a fixed charge for a privilege or service by the party who benefits from the service.

**Fiscal Year (FY)** – an accounting period of 12 months. West Virginia's fiscal year runs from July 1st thru June 30th

**Federal Revenue** – or federal funds, is U.S. government money approved by Congress to support a program or project.

**Flat Tax** – (also called a proportional tax) a tax that takes the same percentage of income from all income groups.

**General Revenue Fund** – contains the only source of discretionary state tax revenues that are not dedicated to a specific purpose and require legislative appropriations for expenditure.

**Governor Budget Proposal** – the Governor's suggested allocation of state moneys presented at each regular session of the Legislature on the second Wednesday of January.



**Gross Domestic Product (GDP)** – is a measure of the total income produced in the state in a given year, including salaries, dividends and interest. As a measure of the state's income, state GDP is useful for determining how much the state can afford to spend on public priorities.

**Household Income** – annual income of all family members living in the same residence.

**Income Tax** – a tax on earned and unearned income.

**Legislative Session** – a period when the legislature meets, either in regular session or special session.

**Licenses** – permission granted by an authority to engage in a certain activity, often for a fee.

**Median Income** – the middle value in the income distribution. It is similar to a road median that's in the middle of the road. Median income looks at the income of the person in the middle of the income distribution or the 50th percentile.

**Medicaid** – a health insurance program, funded by federal and state governments and operated by the state, for persons below a certain income level.

**Non-Appropriated Funds** – funds that generate revenue from established rates or fees and must be expended for a specific purpose. The funds are expended from general law.

**Per-Capita Expenditure** – for each person (a means of expressing the distribution of a collective factor such as cost, consumption, or income equally across the population).

**Progressive Tax** - a tax that takes a larger percentage of income from high-income groups than from low income groups.

**Proportional Tax** – see Flat Tax

**Revenue** - money collected by a government from the public in taxes and fees.

**“S” Corporations** – a form of corporation, allowed by the IRS for most companies with 75 or fewer shareholders, which enables the company to enjoy the benefits of incorporation but be taxed as if it were a partnership. It is sometimes called a “Subchapter “S” Corporation.”

**Sales Tax** - a tax levied by a state or locality on the retail price of an item, collected by the retailer.

**Severance Tax** - a tax imposed on the extraction of natural resources, such as oil, coal or gas that will be used in other states.

**Special Revenue Fund** - consists of revenues from fees, permits, licenses, services or other purposes and may be used only for that specific purpose for which the individual account is intended unless otherwise directed by the legislation.

**Special Session** – a period when the legislature meets upon the Governor's request.

**Supplemental Appropriations** – an appropriation by the Legislature to meet current needs not met in the budget passed in an earlier session. A supplemental appropriation is contingent upon excess funds being available after all regular appropriations have been funded.

**Supplemental Security Income (SSI)** – a federally funded needs-based disability program for adults and children that provides monthly cash benefits and eligibility for Medicaid.

**State-Source** – money that is collected and spent from in-state residents and businesses.

**Structural Deficit** – the inability of a government's revenue system to keep up with the normal increases in program costs.

**Taxable Income** – amount of income subject to income tax (after subtraction of all deductions and exemptions).

**Tax Credits** – a direct reduction in tax liability (not dependent on the taxpayer's tax bracket)

**Tax Expenditures** – potential revenue loss through tax credits and exemptions.

**Use Tax** – a tax on goods bought outside a locality or state for use inside it. The use tax is designed to offset the loss of sales tax on such goods.

## Endnotes

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- 2 See our report “High Cost, Dubious Benefits: The Fiscal Impact of Tax Cuts in SB 680 and SB 465,” [http://www.wvpolicy.org/downloads/high\\_costs.pdf](http://www.wvpolicy.org/downloads/high_costs.pdf)
- 2 US Census Bureau, *Public Education Finances*, April 2007 p.5
- 3 Cindy Mann, Joan C. Alker and David Barish, “*Medicaid and State Budgets: Looking at the Facts*,” Center for Children and Families: Georgetown University Health Policy Institute, October 2007 p.8-9
- 4 Morgan Quinto Press, *State Rankings 2007*, 18th Edition 2007
- 5 WV Budget Office: State of West Virginia FY 2008 Executive Budget, Volume 1 *Budget Report*
- 6 WV CBP analysis of U.S. Census Bureau, *State Finances and Population Estimates*
- 7 WV Budget Office: State of West Virginia FY 2008 Executive Budget, Volume I p. 65
- 8 Ibid. Please note that marginal tax rates apply to taxable income, not total income. Moreover, if a family has a taxable income of \$50,000, only the last \$10,000 of that will be taxed at six percent.
- 9 Center on Budget and Policy Priorities, “Which States Tax the Sale of Food for Home Consumption in 2007,” November 2007.
- 10 Ibid. p.64
- 11 WV CBP analysis of U.S. Census Bureau, *State Finances and Population Estimates*
- 12 Federation of Tax Administrators, *Sales Taxation of Services*, 2004. West Virginia taxed 110 out of a possible 168 possible services in 2004 <http://www.taxadmin.org/fta/pub/services/services04.html>
- 13 WV State Tax Department
- 14 Ibid.
- 15 The exact reimbursement rate is determined by the federal agreement on each project. All federal funds are received as a reimbursement to the State Road Fund after the expenditure has been incurred.
- 16 Center on Budget and Policy Priorities tabulations based on data from the U.S. Census Bureau.

- 17 West Virginia Department of Revenue, “The 2006 Report of the West Virginia Tax Modernization Project,” October 2006 and National Center for State Legislatures, “Principles of a High Quality Revenue System,” available online at <http://www.ncsl.org/programs/fiscal/fpphqrs.htm#principles>.
- 18 Ibid, p.25
- 19 See American Institute of Certified Public Accountants, “Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals,” quoted in West Virginia Department of Revenue, “The 2006 Report of the West Virginia Tax Modernization Project,” October 2006 p. 24
- 20 Lav, Iris, E.C. McNichol, and R. Zahradnik, “Faulty Foundations: State Structural Budget Problems and How to Fix Them” 2005. Center on Budget and Policy Priorities
- 21 Boyd, Don, *State Spending for Higher Education in the Coming Decade*; National Center for Higher Education Management Systems; October 2002. National Education Association; *The Outlook for State and Local Finances: The Dangers of Structural Deficits for the Future of Public Education*; 1998.
- 22 Pavel A. Yakovlev, Mehmet Tosun and Arzu Sen, “The Economic Incidence of West Virginia Taxes,” College of Business & Economics (WVU), May 2007. <http://www.be.wvu.edu/bber/pdfs/BBER-2007-11.pdf>
- 23 These documents are available at the West Virginia Budget Office website, [www.wvbudget.gov](http://www.wvbudget.gov).
- 24 WV Budget Office: State of West Virginia FY 2008 Executive Budget, Volume 1 Budget Report and Volume 2 *Operating Detail*
- 25 West Virginia Tax Expenditure Study, “Expenditures for Consumer Sales and Service Tax and Use,” *West Virginia State Tax Department*. p. 9
- 26 See FY 2008 Enrolled Budget and Governor Veto letter at WV State Budget Office website. This figure does not include nonappropriated funds, only those funds contained in the enrolled budget bill.
- 27 WV Budget Office: State of West Virginia FY 2008 Executive Budget, Volume 1 *Budget Report*



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