2017 FINANCE POLICY STATEMENT

Goals and Principles

The American economy is dynamic, transforming from agrarian to industrial, from industrial to services-driven, and evolving now to Internet-based businesses harnessing the power of the Digital Age. The growth in online-enabled platforms that connect customers with companies and private individuals offering services and property for sale or lease is fundamentally restructuring the business landscape. As the Internet takes a greater hold in American business and as Virginia weans itself from the economic stimulus of federal defense spending, local governments have to reexamine the services provided to citizens and the means to pay for them. State laws, local ordinances, tax structures, licenses and regulations will have to be re-evaluated and re-tooled without sacrificing the overall quality of basic government services, including education, public health, and public safety.

To that end, these principles are essential:

- Local revenue sources should be balanced and diversified over three broad bases – assets (property), consumption (sales), and income;
- The local tax system should be logical and professionally administered. Taxpayers should be treated fairly, and compliance costs should be minimized;
- The burden of taxation, as well as the benefits of services, should be shared and enjoyed by all whether they are residents or local businesses.
- Tax policy should recognize the different economic, demographic, and service demands among localities, and should foster local control to develop tax policies best suited for their communities;
- Tax policy should recognize and be responsive to the competitive nature of the free market, should refrain from enacting policies that are too generous for one group, and should not place undue burdens on particular groups, including business and industry;
- State-imposed changes on local tax structures should be simple to administer and, at a minimum, be revenue neutral; and
- State-mandated tax relief programs should not use local revenues. State-adopted tax relief programs should rely only on state revenues.
- The State should not create real estate tax relief programs unless it is willing to pay for the cost of the programs.
- Local tax dollars should not be claimed by the state to cover the Commonwealth's revenue needs. This includes, but is not limited to, local fines and forfeitures.
- Any legislation with local fiscal impact should be introduced no later than the first week of a General Assembly session. Such legislation should be pre-filed prior to the convening of a regular legislative session.
- Local government representatives should be included on any "blue ribbon" commission or other body established by the state that has as

its purpose changes to local revenue authority or governance.

Fiscal Challenges Confronting Local Governments

- The existing local tax structure is overly dependent upon general property taxes, specifically real estate taxes.
- Unfunded and inadequately funded state mandates and commitments strain local government budgets and place additional pressures on the real estate tax. State-initiated services and programs should be supported by state funds, not rely on local funds to supplant state dollars.
- Public demands for public services continue to increase. These services include education, mental health, other human services programs, juvenile programs, environmental initiatives, economic development, recreation, and public safety. These services have both operating and capital costs and must be funded.
- Local revenue collections and service demands are also influenced by variables outside the control of councils and boards of supervisors. These include changes in federal tax, budget, and fiscal policies; long-term economic trends; the aging of our citizens; and global events.

Strengthening the Local Tax Base

Depending on the particulars of any given proposal, possible options to broaden local tax bases include reserving a portion of the state income tax for locally-delivered programs, authorizing a local option income tax for both general and special purposes, increasing the local option sales tax rate, reducing the number of sales tax exemptions, expanding the sales tax base, and reducing the number of exemptions from the business license tax.

The state can also take actions to prevent the further erosion of local revenues **by not** restricting local tax authority, imposing new spending requirements or expanding existing ones on services delivered by local governments, shifting state funding responsibilities onto local governments, expanding retirement benefits, and placing administrative burdens on local governments for state or joint programs.

Specific Tax Issues

VML opposes the repeal or restriction of BPOL, machinery and tools, or excise taxes unless, at a minimum, suitable revenue-neutral replacement sources are provided.

The state and federal government should make payments-in-lieu-of-taxes for tax-exempt properties in amounts equal to the cost of the local services provided.

Counties should be granted taxing powers equal to those granted cities and towns, without decreasing, limiting or changing town taxing authority. County excise taxes must not be levied on town residents without the explicit approval by a town’s governing body.

VML supports the constitutional requirement for fair market valuation of property. State-imposed changes to the real estate tax must be “local option.” The state should not impose changes to processes governing assessments and appeals for real estate taxes that further degrade this revenue source.

VML supports current state statutory requirements governing the setting of real estate tax rates and the integration of this process with the budget development process. Changes to these processes cannot be addressed separately without placing undue hardship and increased costs on local taxpayers. Any future state legislative change should be simple to administer and not contradict, impede or hinder the others.

The Virginia Communication Sales and Use Tax was enacted to establish a statewide tax rate and to pre-empt local taxes on communication sales and services. As such, the revenues from this tax must be distributed exclusively to eligible local governments. Further the tax should be broadened to encompass newer services and technologies.

VML supports state legislation to make clear that transient occupancy taxes and sales taxes are applied on the cost of the room paid by the consumer, regardless of the means (such as on-line travel companies) used to reserve a room.

Specific Budget Issues

Almost 70 percent of Virginians live in communities served by police departments. The state has increasingly de-emphasized its statutory commitment to state financial assistance to local police departments through the "HB 599" program. VML calls on the state to honor its commitment to public safety by funding the program in amounts intended in the enabling legislation.

The state must be a reliable funding partner in accordance with the Virginia Constitution and state statutes. The Standards of Quality should recognize the resources, including positions, required for a high-quality public education system. The SOQ should reflect prevailing practices across the state, and the actual costs to educate Virginia's children. This includes the cost to educate at-risk students, students in jeopardy of failing the state's Standards of Learning tests, students with special needs, and school construction/renovation/maintenance.

The state should fully recognize and fund the costs of re-benchmarking of the various educational programs, including the Standards of Quality, incentive, categorical, and school facilities programs as well as support services. Changing the process of re-benchmarking to artificially lower recognized costs like inflation does not change what it actually costs to provide education. Instead, it simply transfers additional costs to local governments and the real estate tax base.

The Commonwealth should:

- Study the Standards of Accreditation and Standards of Learning to determine which standards impose costs on local governments that are not recognized in state funding formulas. In particular, changes adopted since 2009 to SOAs and SOLs should be examined, as state funding on a per-pupil basis remains below 2009 levels.
- Re-examine those Standards of Quality that the Board of Education has recommended, but that the General Assembly has not funded. These standards reflect prevailing practices necessary to improve children's academic performance. Student academic performance is required for schools to meet the accountability standards under the SOL and SOA. If

funding is not available to pay for prevailing practices, the accountability standards should be adjusted so that local governments are not in the position of having to bear the entire burden of meeting these unfunded mandates.

- Conduct a study that examines how other states fund education and whether the Commonwealth should use a funding strategy that establishes a more realistic base foundation amount per pupil – plus add-on funding to reflect higher costs for educating at-risk, disabled, ESL, and gifted students, etc. as well as funding for capital costs.

The state should provide sufficient funding for highway construction and maintenance, public transportation infrastructure and maintenance, ports, airports, and freight and passenger rail to promote economic development and public safety.

The state should base its funding of retirement plans based on the contribution rates certified by the Virginia Retirement System.

VML supports transparency in budgeting at both the state and local level. To that effect, the state should not disguise its budget reductions by using unidentified or non-specific reductions for aid to localities.

As a matter of fiscal reform, the state should develop financial priorities that take into account both spending and revenue actions. The debate on such priorities should be public, and should be transparent to the public in the Governor's Budget Bill and the General Assembly's Appropriation Act. For example, should education funding be afforded less priority than certain tax preferences?

Governmental Accounting Standards Board (GASB)

The Governmental Accounting Standards Board (GASB) has put in place standards regarding the reporting of unfunded liabilities of cost-sharing plans. A cost-sharing plan is one in which participating government employers pool their assets and their obligations for a defined benefit pension, such as Virginia's teacher retirement plan. While the costs are shared, the state sets the rules regarding what benefits are required and what the state contribution will be.

GASB requires that the unfunded liability be apportioned among the participating employers that pay the retirement contributions to the pension plan. Teachers are employees of the school boards, which send retirement contributions to VRS. Because of this the unfunded liability falls solely on the school boards, even though the retirement contributions are funded, in part, by the state and the school board. This means that the liability will be shown on the city, county or town financial statement. The intent of GASB rules is to encourage transparency in pinpointing liabilities and the current method of assigning those teacher pension liabilities only to school divisions contravenes the goal of transparency.

Because there was not a process for apportioning the liabilities for these cost sharing plans, they previously had not been reported at the local level.

The unfunded liability should be shared by the state and localities based on the state’s Standards of Quality and local composite index and reflected as such in reporting.

VML supports state policy changes that would provide for the Virginia Department of Education to pay the Commonwealth’s share of retirement costs directly to the Virginia Retirement System to facilitate the sharing of these liabilities.

Government Reform

VML supports a comprehensive review of the services provided by state and local governments. The purpose of the review is to ascertain which services are truly essential to support a productive economy and healthy society; determine the performance level of public services now in place; evaluate the policies and practices used by the state to assign responsibility and accountability between the state and local governments for providing public services; and determine the most effective, efficient and equitable ways to fund essential public services. Such a review must start with a dialog including state and local officials, business interests, academia, and other interested parties.

Tax and Spending Reform

Any state initiative aimed at tax reform should first include a focus on state tax reform and the financing of state services including revenue sources. If the state paid an appropriate share of its obligations for locally-administered state mandated or priority services, the reliance on local taxes would be reduced. Local officials should be included in any discussion that focuses on local taxing authority.