



THE STATE OF

BOAT TAXES

THE RACE TO THE BOTTOM OF THE BAY: BOAT TAXES IN HAMPTON ROADS

Many regional citizens enjoy boating, so much so that 52,006 private and pleasure boats were registered in Hampton Roads in 2004. These boats ranged from very small vessels that might be most usefully classified as row-boats to large pleasure craft, yachts and vessels used for business purposes.

The collective thinking among most citizens of Hampton Roads is that boats are a good thing, socially and economically, for our region. One part of this notion is that boat owners are likely to be tax-paying, high-spending citizens whose patronage should be cultivated.

This perception has led to a series of reductions in taxes levied upon boats, especially pleasure boats, by the cities and counties of Hampton Roads. Indeed, there has been a race to the bottom by local governments where boat taxes are concerned. Acting competitively, the cities and counties have successively lowered the taxes they impose on boats. Virginia Beach, for example, lowered its boat tax rate per \$100 of valuation to a miniscule \$.000001 in 2002. Thus, even a yacht valued at \$10 million would pay only 10 cents in tax. Clearly, Virginia Beach, along with several other cities in the region, no longer has a meaningful tax on boats.

This is a wonderful circumstance for boat owners. However, from the standpoint of the cities, it represents a judgment (perhaps even a gamble) that their reduced boat tax revenues will be more than compensated for by increased tax revenues generated from the spending on other goods and services by a larger number of boat owners. **In fact, several cities believe that their tax stratagems have attracted additional boats.**

Alas, this is not what has occurred. Instead, the share of boats ported in each city or county within the region has hardly changed since 1998. Further, the number of boats overall within the region declined by 1.5 percent from 1998 to 2004, sinking the hopes of those who argued that Hampton Roads would become a magnet for boat owners on the East Coast. Hence, any additional tax revenue related to spending by boat owners is dramatically less than the boat tax revenue lost. **All in all, it is difficult to avoid the conclusion that the cities and counties of Hampton Roads have shot themselves in their proverbial feet if they hoped they would be better off economically by reducing boat taxes.** We risk sounding the unseemly trumpets of class warfare when we observe that the boat tax reduction has simply reduced the tax burden of a select group of the region's more wealthy citizens, thereby forcing all other citizens to pick up the slack. Rest assured we carry no brief for high taxes. Even so, we must wonder if the cities and counties are cognizant of what they have done in this public policy arena.

How Did We Get Here?

Data from the National Marine Manufacturers Association clearly suggest that Virginians enjoy boating. The Commonwealth ranked 20th among the states in 2001 in total boat registrations with more than 240,000 registered vessels. This compares with North Carolina, which ranked 12th with about 350,000 registered boats, and Maryland, ranked 26th with approximately 200,000 registered boats.

The city of Portsmouth initiated the trend toward reducing taxes on pleasure boats in 1987 when it dropped its tax rate to 50 cents per \$100 of assessed value. Virginia Beach responded with a tax reduction to \$1.50 per \$100 of assessed value the following year. Portsmouth again reduced its tax to only 1 cent per \$100 of assessed value in 1992. Hence, in 1992 in

Portsmouth, residents who owned a boat valued at \$10,000 saw their property tax drop from \$50 to \$1. In 2000, Norfolk reacted by reducing its tax rate to one penny per \$100 of assessed value. However, as we shall see, the cities weren't finished with their tax reductions.

The boat tax reductions are best viewed as attempts by the cities and counties to expand their tax bases. **The idea of reducing taxes in order to expand economic activity has been around for some time and was made popular by the argument issued by Arthur Laffer to then California Gov. Ronald Reagan (Laffer allegedly drew a graph on a paper napkin) that lowering the marginal tax rate on income would expand work effort, increase the tax base and generate more tax revenue. While this technique would not be expected to have as large of an impact at the local level as the federal level, the fundamental economic argument is the same.**

Table 1 summarizes recent boat tax reductions in Hampton Roads. Virginia Beach eventually trumped all of the cities and counties in 2002 when it effectively reduced its tax to zero by dropping its rate to \$.000001 per \$100 of assessed value. Even a boat valued at \$100 million would have tax due of only \$1 – so low that tax officials stated they would not bother to mail out such tax bills. The most recent drop to what is in essence a zero boat tax occurred in 2003 when the city of Hampton matched the Virginia Beach decrease.

City/County	Boat Tax Rate per \$100	Recent Modifications	City Decal Fee	Tax Rate Prior to Reduction
Chesapeake	\$1.58	None	None	NA
Hampton	.000001	Reduced in 2003	None	\$1.00
Newport News	1.00	None	None	NA
Norfolk	0.01	Reduced in 2000	\$10 or \$25, depending on length	1.50
Portsmouth	.01	Reduced in 1987 to 50 cents, most recent reduction in 1992	\$20	.50
Virginia Beach	.000001	Reduced in 2002	None	1.50

Sources: Commonwealth of Virginia and the Old Dominion University Economic Forecasting Project

What Are the Issues?

There are at least five issues relating to boat taxes that are worthy of discussion. The first of these relates to the significance of personal property tax collections on boats in the different cities. In the region's larger cities, the reduction in the tax rate on boats usually did not make a significant dent in their overall tax collections. However, in some communities, the personal property tax revenue from boats is quite significant. For example, the Daily Press (June 16, 2004) reported that boat taxes account for almost 10 percent of total tax collections in Middlesex County, where the tax on boats is \$1.223 per \$100 assessed value. By contrast, Hampton lost only about 1 percent of its total tax revenues when it reduced its tax rate on boats to virtually zero (Daily Press, June 16, 2004).

A second issue is the potential spillover benefits from the reduction in the tax due to increased economic activity associated with affiliated activities, such as restaurants located next to marinas and repair and maintenance expenditures at marinas. To the extent that this occurs, this will increase local sales tax revenues to the cities and counties.

A third issue relates more to the income distributional effects of the decline in boat taxes. A Chesapeake resident argued, via a letter to The Virginian-Pilot on July 28, 2004, that the boat tax is essentially a luxury tax and those who own boats should be required to pay the tax. The citizen's argument was that the foregone tax revenue would have to come from other revenue sources, which would have a greater impact on those who are less wealthy than on owners of expensive boats. That, he said, was unjust.

A fourth issue relates to the potential benefits that might spring from low taxes attracting boats to the region from other states. A letter to the editor of The Virginian-Pilot (July 26, 2004) argued that after Virginia Beach reduced its boat tax, the percentage of boats from non-Hampton Roads cities in Virginia Beach has increased from 15 percent to 22 percent. However, as we already have noted, the overall number of boats in Hampton Roads declined between 1998 and 2004.

A fifth issue focuses on how governments should respond to their constituents. The Virginian-Pilot editorialized on July 24, 2004, that the city of Chesapeake would be giving in to blackmail if it lowered its tax because of a threat by a local developer not to build a marina if Chesapeake did not do so. **The editorial board asserted that boat taxes should be significant and roughly equal across the cities and counties of the region, and that no jurisdiction should cave in to developers who threaten to move elsewhere.**

Fiscal Impacts

When a boat tax is reduced, there are two countervailing fiscal effects:

- The drop in the tax rate reduces tax revenues collected from boat owners unless the number of boats increases more than proportionately.
- If there is an increase in the number of boats, this will contribute to the local economy via increased local spending by the boat owners. The increased spending will create jobs and subsequently stimulate sales and business property tax revenue.

Which of these effects dominates? This is an empirical question. Are the costs of lowering the boat tax (measured by the direct reduction in tax revenue) less than the benefits of the boat tax reduction (measured by increased local spending)?

In order to weigh these offsetting effects we will use the results of a detailed Maryland study (Lipton and Miller, Maryland Sea Grant Extension publication, 1995) to estimate the impact of the reduction in the boat tax on the local economies in Hampton Roads. Maryland's situation is substantially similar to that of Hampton Roads and we have updated the data to 2005.

The Lipton and Miller study estimated the impact of recreational boating on the economic sectors associated with boat and trailer manufacturing, equipment manufacturing, marinas and boat yards, and marine trade and marine services. Further, the impact of spending on food and lodging, fishing supplies and fuel were included in order to account for the expenditures made by the boaters when they weigh anchor and travel.

The Maryland study compared spending and boat expenses for three different kinds of boats: powerboats on a trailer, in-water powerboats and sailboats. Sailboats were found to generate the largest maintenance and repair expenses – \$4,454 annually, plus individual average trip expenses of \$720. Lipton and Miller found trip expenses to be lower for sailboats than motorboats because of the lower fuel requirements, but to be greater than powerboats because of higher marina and yacht club costs and fees. Also, the cost of moving a sailboat on land usually is larger than for a motorboat.

When boat-related and trip-related expenditures were combined for all three classes of boats, sailboats averaged expenditures of \$5,174 per year; in-water powerboats averaged \$4,041 per year; and trailer powerboats averaged \$2,479 per year. When adjusted to 2005 prices, these expenditures climb to \$6,895 for sailboats, \$5,385 for in-water powerboats and \$3,304 for trailer powerboats. Note that even if we were to double expenditures on gasoline to reflect higher fuel costs, sailboat spending would still be greater than the spending on the other two classes of boats.

Since we do not want to underestimate the economic impact of pleasure boats, we will utilize the larger sailboat estimate (\$6,895 annually) for all three classes of boats. Thus, the following represents an upper-bound estimate of the economic benefit of attracting more boats to Hampton Roads.

The 2005 data are interesting, but Virginia Beach made the decision to lower its boat tax rate in 2001. Let's see what the effects of that decision were. In 2001 prices, the expenditures per boat were \$6,331. Let's assume there was a multiplier effect associated with these boat expenditures that rippled through the community. Generously, let's use a multiplier of 2.0. This yields a total additional expenditure impact per boat of \$12,662 in 2001.

How much additional sales tax revenue did these expenditures generate? A 1 percent local sales tax applied to these expenditures generated revenue of \$126.62 per boat, with another \$253.24 in revenues going to the Commonwealth. However, in a June 2003 memo prepared for the city manager of Virginia Beach, Catheryn R. Whitesell, a city economic analyst, argued that the sales tax benefits from the reduction in the boat tax rate still would be much less than the tax revenue lost. She also argued that the city of Virginia Beach incurred costs to maintain local waterways and hence a user tax on boats was appropriate.

In 2002, Virginia Beach's virtual elimination of its boat tax caused personal property tax revenue from that source to fall by approximately \$1.1 million. At the same time, the number of boats in Virginia Beach increased by only about 1.4 percent from the previous year to about 12,500. Between 1998 and 2004, the number of private boats in Virginia Beach increased only .78 percent.

The number of new boats necessary to recover the \$1.1 million of lost boat tax revenue, based upon sales tax revenues of \$126.62 per boat, is 8,687. This means that the number of boats in Virginia Beach would have had to increase by an astounding 69 percent simply for the city to break even. Even if all the sales tax revenue generated by the increased spending were distributed back to the city of Virginia Beach, with no tax revenue going to the Commonwealth, 2,896 new boats would be needed to compensate for the lost boat tax revenue. However, the number of private boats in Virginia Beach rose by only 213 between 1998 and 2004. And, even some of this modest growth must be attributed to population and income growth rather than to the boat tax reduction.

Does this assessment of the fiscal impact on a city suggest that it was a bad idea for the cities and counties of Hampton Roads to lower their boat taxes? The answer is yes, if they were concerned about tax revenues. Once one city reduced its boat tax, it was

**TABLE 2
NUMBER OF PRIVATE BOATS IN HAMPTON ROADS**

	Boats 1998	Boats 2002	Boats 2004	Regional Share Change (1998-2004)
Chesapeake	6,126	5,980	5,843	-0.36%
Franklin	198	231	240	0.09%
Gloucester County	4,069	4,199	4,132	0.24%
Hampton	4,352	4,220	4,283	0.00%
Isle of Wight County	2,059	2,169	2,155	0.25%
James City County	2,037	2,183	2,266	0.50%
Newport News	3,842	3,509	3,274	-0.98%
Norfolk	4,714	4,514	4,437	-0.39%
Northampton County	1,615	1,652	1,689	0.19%
Poquoson	1,333	1,467	1,384	0.14%
Portsmouth	3,317	3,081	2,967	-0.57%
Suffolk	3,214	3,321	3,268	0.20%
Virginia Beach	12,532	12,563	12,745	0.78%
Williamsburg	378	448	420	0.09%
York County	3,037	3,003	2,903	-0.17%
Totals	52,823	52,540	52,006	-1.5%

Source: Virginia Information Technologies Agency for the Virginia Department of Game and Inland Fisheries

inevitable that other cities and counties would follow suit. The fiscal impacts of these reductions are clear. **The boat tax reductions have decreased tax revenue without a noticeable increase in the number of boats, either regionally or in a particular city (see Table 2). Thus, it's difficult to avoid the conclusion that the cities and counties have made themselves worse off by their own actions. For example, it appears that Hampton has lost about \$553,000 in annual tax revenue, Norfolk about \$2.2 million and Virginia Beach approximately \$3.7 million.**

Conclusions

Citizens do not like to pay taxes, and boat owners are no exception. Boat owners, however, may be relatively more influential and articulate than many other citizen groups. Once they convinced one jurisdiction to make a dramatic reduction in its boat tax rates, competitive forces pressured other cities and counties to follow suit.

What has developed in the realm of boat taxes is a situation that game theorists label "the prisoner's dilemma" – where a group of decision makers compete themselves into a much less favorable position than they enjoyed before the competition began. We are familiar with this phenomenon in certain advertising scenarios – for example, where Coca-Cola and Pepsi-Cola both spend enormous amounts on advertising and these expenditures eventually appear to cancel out each other. Some argue that the same "cancel each other out" dynamic exists with respect to countries' military expenditures and universities' admission activities.

The end result of the prisoner's dilemma, as well as the competitive boat tax reductions, is a situation in which the various competitors end up worse off, often to their own surprise. In most cases, competition yields superior results; the prisoner's dilemma is one exception. If one city or county could have reduced its boat tax without other nearby jurisdictions matching that reduction, that city or county might have gained boats and revenue. When all jurisdictions followed suit, however, this was quite unlikely to occur. Other than boat owners, no one benefited from the boat tax reductions. Indeed, the boat tax reductions forced the cities and counties to find sources of replacement revenue for their lost boat tax receipts. The effect, then, was a transfer (some would say subsidy) from all taxpayers to boat owners.

