REDUCING PROPERTY TAXES IN GEORGIA: DESCRIPTIONS AND ANALYSIS OF RECENT PROPOSALS

John Matthews, David L. Sjoquist and *John V. Winters,* Georgia State University

INTRODUCTION

OVER THE PERIOD MARCH 2007 THROUGH APRIL 2008, several proposals were advanced to eliminate, reduce, or control the growth of property taxes in Georgia. This paper describes the major proposals that were made and some of the related analyses conducted by the Fiscal Research Center. While the proposals evolved and changed over time, one can point to three distinct proposals.

Proposal One

The first proposal was made at the end of the 2007 session of the Georgia Legislature in the form of HR 900, a proposed Constitutional amendment for a comprehensive revision of Georgia's state and local tax structure.[1] The legislation was introduced with the expectation that it would be studied and refined before the 2008 session. HR 900 called for a change in the current personal income tax, the adoption of a value added tax, and the elimination of nearly all other state and local taxes, including all property taxes.

HR 900 proposed a flat rate income tax. Presumably, the intent of HR 900 was to start with adjusted gross income and eliminate personal exemptions, the standard deduction, and itemized deductions, but deductions for: charitable contributions, mortgage interest, Social Security benefits, federal unemployment insurance benefits, and other designated tax-exempt benefits, and rental payments made for primary shelter.

The base of the value added tax (VAT) would equal total sales less purchases from other firms, including purchases of depreciable assets, bad debts, and charitable contributions. Firms could also deduct the depreciation of previously purchased assets. The tax rate for both taxes was set at the rate of 5.75 percent, although that could be changed through legislation.

HR 900 called for a "local revenue guarantee" that would "provide that each local taxing jurisdiction should not be impaired financially" from the elimination of local tax revenue sources. It called for each local taxing jurisdiction to receive "revenue essentially equivalent to the amount of revenue it received in the 2006 tax year" from the taxes that would be eliminated. The language specifying the procedure by which the local revenue guarantee is determined was not clear, but it is assumed that the following procedure was contemplated. First, the ratio of the jurisdiction's "total revenue" in 2006 to the total of all revenue collected in 2006 by state and local governments in Georgia would be determined. Second, multiply the revenue generated by the revised personal income tax and the VAT by the ratio. The resulting product would be the amount allocated to the jurisdiction.

Each year, each local jurisdiction would get a transfer of funds from the state government equal to a fixed percentage of the total revenue collected by the state from these two revenue sources. Whatever is not allocated directly to local governments goes to the state government. Thus, the proposed amendment would fix the allocation of the tax revenue between the state and local governments.

No allowance was made for new jurisdictions or for growth in the size of a jurisdiction. The proposed amendment did not preclude the General Assembly from providing additional revenue to new or growing jurisdictions. However, the proposed amendment freezes the minimum percentage share of total revenue that would go to local governments, and thus any revenue allocated to new jurisdictions would have to come from the state's share of tax revenue.

Proposal Two

By late spring HR 900 was dropped. The new proposal called for the elimination of all property taxes, but not the elimination of any other tax.[2] The plan was christened the GREAT Plan, which stood for "Georgia Repealing Every Ad-valorem Tax." There was no written document; details of the proposal were gleaned from presentations of the plan's chief proponent, Speaker of the House Glenn Richardson.

To replace property tax revenues, the proposal initially called for increasing sales tax revenue by eliminating all current exemptions and taxing all services. Local governments were promised that they would be held financially whole, but the mechanism for accomplishing this was not specified. Opposition to the new plan on the part of local governments was intense and many editorial writers opposed the plan. At the end of the year a revised plan was presented.

Proposal Three

The third proposal, a revised version of the GREAT Plan, was contained in proposed legislation, a draft of which was made public shortly before the start of the 2008 session of the state legislature. Over the next several weeks the proposal evolved somewhat. At the end of the legislative session, several provisions were jettisoned and others added in an attempt to generate support. In the end, no legislation was passed.

The substantive version of the GREAT Plan contained several proposed changes:

- Eliminate the state's 0.25 mill property tax.
- Impose a $20 fee per motor vehicle used for personal use.
- Eliminate the current sales tax exemption for lottery tickets and food-for-home consumption.
- Provide a refundable income tax credit based on food expense for families with incomes less than 200 percent of poverty.
- Add 174 personal services to the state, but not local, sales and use tax base effective January 1, 2010. Furthermore, taxable services purchased by one taxpayer from one vendor in a given year in excess of $10,000 would be exempt.
- Add a credit for sales taxes paid on multichannel video programming subject to franchise fees.
- Adopt a Constitutional amendment to limit the increase in assessed values of homesteaded property to 1 percent per year until the property was sold.
- Provide a credit against property taxes for school property taxes on homesteaded property and against property taxes paid on motor vehicles used for personal use.

Since 1999, the State of Georgia has provided local property tax relief for homesteaded properties through the Homeowner's Tax Relief Grant program. Presently, the program provides through a direct credit the equivalent of an additional $8,000 homestead exemption against all local taxing jurisdictions. The state reimburses localities through a grant for the credits given. The revised GREAT Plan proposal would have extended this concept to provide as much as a 100 percent credit against local school property taxes. In particular, the legislation proposed to allow a credit equal to the greater of the homeowner's school property taxes or the credit allowed under the current Homeowner Tax Relief Credit. Under the proposed legislation, taxpayers with a homestead would receive a full credit on their property tax bill for the education portion of their property tax liability. It was assumed that only homeowners who pay no school property tax (mainly seniors in school districts that exempt 100 percent of the value of homesteads owned by seniors) would find that the current Homeowner Tax Relief Credit was larger than school property taxes paid. A similar credit program was proposed for the property tax on personal use motor vehicles.

A major addition to the legislation that was made in the final day of the legislative session was a tax levy limitation provision that had been advanced in the Senate. The provision would limit the amount of property tax revenue collected in each local taxing jurisdiction during a taxable year not attributable to new construction to the amount collected in the immediately preceding taxable year plus inflation.

In response to the proposal, the Democrats introduced their own "tax reform" legislation, known as the "Better Economy Through Tax Equity Reform" plan, or the BETTER Plan. Given that the Republicans control the state legislature, this legislation went nowhere.

REVENUE ESTIMATES

The Fiscal Research Center produced several reports analyzing various aspects of the different proposals. These proposals were suppose to be revenue neutral, so the first issue was to develop revenue estimates. The FRC produced revenue estimates for the two iterations of the GREAT Plan (i.e., proposals two and three).

Revenue Estimates of Proposal Two.

The second proposal (i.e., the first iteration of the GREAT Plan) called for the elimination of all property taxes and the expansion of the sales tax base. The first step was to develop an estimate of the amount of revenue that would have to be replaced.[3]

Data on current property tax collections do not exist, so property tax levies were calculated using a database obtained from the Georgia Department of Revenue (DOR) listing the net assessed values and millage rates for all school districts, counties, cities, and special districts in the state. Other revenue associated with property taxes, namely penalty revenue, real estate transfer and recording revenue, intangible property tax revenues, interest earned on received unspent property tax revenue, and property tax collection fees, were estimated to be an additional 12 percent. Including these revenues, the estimated total loss from the elimination of property taxes, at 2006 levels, is $10.8 billion.

Several adjustments of this estimate had to be made:

- The GREAT Plan would allow property taxes to be collected to pay off general obligation bonds, an amount estimated to be $316 million.
- If property taxes are eliminated, then counties can eliminate their tax assessor and tax commissioner offices, an amount estimated to be $193.6 million.
- With no property tax, the Homeowner Tax Relief Grants do not have to be provided. In 2006, this amounted to $412.3 million.
- The elimination of property taxes would reduce deductions for state and federal income tax purposes. This would generate an estimated additional $105.6 million in income tax revenue for the state.

Thus, the net revenue that would have to be replaced by the sales tax revenue would be about $8.6 billion.

The second step was to develop estimates of the potential sales tax revenue from eliminating current exemptions and adding services to the sales tax base.[4] However, there were no details regarding what exemptions would be eliminated and what services would be included. We developed revenue estimates from the elimination of current exemptions under four alternative assumptions:

Alternative 1. For Alternative 1 only the exemptions for purchases by government are retained; all other exemptions are eliminated.

Alternative 2. Alternative 2 adds 3 other exemptions that we believe should not be eliminated. These are:

- Charges for rooms and lodging for stays of more than 90 days. Eliminating this exemption would mean that rent on apartments would be subject to the sales tax.
- Credit allowance for trade-ins on property.
- Sale of raw materials used in manufacturing. To remove this exemption would likely result in a substantial loss of manufacturing in the state.

Alternative 3. In addition to the exemptions retained under Alternative 2, Alternative 3 retains all exemptions that we identify as business-to-business.

Alternative 4. In addition to the exemptions retained under Alternative 3, Alternative 4 assumes that exemptions for health care are retained.

Table 1 contains the revenue estimates for each of the four alternatives. However, there are very

Table 1

Estimated Additional Revenue from the Elimination of Sales Tax Exemptions, 2006 (in millions)

	State Revenue	*Local Revenue*	*Total Revenue*
Alternative 1: retains only the exemption for government purchases	$8,169.4	$5,176.8	13,346.2
Alternative 2: in addition to Alternative 1, retains exemptions for purchase of raw materials, rent, and credit for trade-ins	3,532.4	2,046.9	5,579.3
Alternative 3: in addition to Alternative 2, retains business-to-business exemptions	1,910.4	952.0	2,862.4
Alternative 4: in addition to Alternative 3, retains health care exemptions	1,316.1	550.9	1,857.0

Note: State sales tax rate is 4 percent; we estimate that the average local sales tax rate is 2.7 percent.

important reasons for retaining the exemptions listed in Alternative 2 and thus, these exemptions are likely to remain. There are also strong economic arguments for retaining the exemptions listed in Alternative 3, in particular the argument that a retail sales tax should avoid taxing business-to-business purchases. Finally, it would seem to be politically difficult to eliminate the health care exemptions.

To estimate potential revenue from taxing services, two different databases were used: the Consumer Expenditure Survey and the Economic Census. There are obvious limitations with each data set.

The Consumer Expenditure Survey produces an estimate of the taxation of consumer expenditures on services. Some adjustments to reported expenditure levels had to be made. For example, expenditures on repairs include both parts and labor, but parts are currently included in sales tax base. We did not adjust for noncompliance and evasion, even though it is clear that it would be difficult to collect sales taxes on several of these services including babysitting, lawn services provided by a neighborhood teenager, online dating, and others. Furthermore, imposing a tax on all of these services will cause individuals to purchase some of the services out-of-state, for example, a will can be drawn by an attorney in another state. And, while the individual would be obligated to pay a use tax on the purchase of the will, it is very unlikely that the individual would pay it. Likewise travel services would be hard to tax; for example, the purchase of a ticket for a cruise can easily be made from an out-of-state vendor. Thus, the revenue estimate is an upper bound estimate.

There are services that are unlikely to be taxed, for example, health care services (with a total revenue estimate of $154.3 million) and tuition at private schools (with a total revenue estimate of $89.7 million). If these two services are excluded from the tax base, the revenue estimates for state revenue is $694.8 million and for local revenue is $468.9, for a total of $1,163.6.

The second method relies on information on gross receipts from the latest available Economic Census (U.S. Census Bureau, 2002). The Federation of Tax Administrators (2005), produces a list of services that are taxed by at least one state.[5] We used this list, excluding those services that Georgia already taxes, as the basis for our revenue estimates. These revenue estimates include purchases by businesses as well as households.

For each service we used gross receipts of businesses in each of the industries that provide the identified services. Data are not available for all services; in most of those cases we either used other data to estimate gross receipts or combined services to match the Economic Census categories. As with the Consumer Expenditure Survey data, adjustments have to be made to account for activities such as repairs for which the state currently taxes part of the receipts. The 2002 values of gross receipts were adjusted for population growth and inflation to arrive at 2006 values of gross receipts.

We made two final adjustments to arrive at an estimate of taxable sales:

- We reduced the gross receipts by 19.1 percent to account for sales to government, which was government consumption's share of gross domestic product.
- Some of these sales would have been made to out-of-state buyers and thus not subject to the sales tax. We used reports from New Mexico and South Dakota on which to base a 30 percent and a 60 percent adjustment.

We also estimated revenue if only those services that are taxed in more than 10 other states are added to Georgia's sales tax base.

If we make no adjustment to the value of gross receipts other than to reduce it for estimated government purchases, we estimate that taxing services would produce an estimated additional $2,538.0 million in state revenue and $1,713.1 million in local revenue. Assuming a 30 percent reduction for sales out of state, reduces these to $2,196.5 for the state and $1,482.7 for local governments. If the state is not as aggressive in adding services to the base (i.e., it added only those services currently taxed by more than 10 states), we estimated that the additional state revenue would be $980.2 million and the additional local revenue would be $661.6 million.

Given reasonable assumption regarding what exemptions could be eliminated and what services could be taxed, we estimated that the increase in total sales tax revenue (state plus local) would be between $3.0 billion and $3.7 billion. It is clear that the revenue would not be sufficient to replace all of the property taxes, estimated to be $8.6 billion.

Table 2
Revenue and Cost Estimates (in millions of dollars)

	Revenue Estimate			
Revenue/Cost Category	*FY 2009*	*FY 2010*	*FY 2011*	*FY 2012*
Eliminate State Property Tax	$0	-$95.7	-$102.9	-$110.7
$20 Fee on Personal Vehicles	$67.7	$137.6	$142.0	$146.5
Low-income Tax Credit	$0	-$168.1	-$179.1	-$190.7
Sales Tax on Lottery Tickets	$73.2	$152.3	$164.6	$177.9
Sales Tax on Food-for-Home Consumption	$302.0	$623.6	$664.1	$707.2
Credit for Property Tax on Personal Vehicles	-$326.3	-$659.0	-$672.0	-$685.2
Sales Tax on Personal Services	$0	$336.9	$692.6	$731.4
Credit for Cable Franchise Fee	$0	-$14.9	-$29.9	-$29.9
Credit for School Property Tax on Homesteads	$0	$0	-$1,901.0	-$2,039.8
Partial Elimination of HTRG	$0	$0	$394.7	407.4
Net Change in Revenue	**$116.5**	**$312.5**	**-$826.9**	**-$885.8**

Authors' calculations

Revenue Estimates for Proposal Three

Unlike Proposal Two, details of Proposal Three were specified, in this case in the form of draft legislation. The Fiscal Research Center developed revenue estimates of each component of the proposal (as stated in an earlier section). In this paper, however, we discuss the approach to estimating just the revenue effect on property taxes and the sales tax.

There are no available data on the taxable value of homestead property. The DOR maintains computer-based reports of the property tax bases by property category for all local school systems. Residential is one property category, but it contains an unidentified number of rented residential properties. Since residential category does not include residential property located on farms, we added that to residential property.

To get an estimate of the value of homesteaded property for each school district, the total residential property value in each district was multiplied by a factor that was calculated as follows. The numerator was the number of homesteaded properties (as measured by the number of credits taken under the Homeowner Tax Relief Grant program). The dominator was the sum of the total number of owner occupied housing units, the number of rental units times 0.75, and the number of vacant housing units times 0.75 (units as reported by the Census in the American Community Survey).[6] The resulting factor, 0.654, was applied to the value of residential property in each school district to derive an estimate of the value of homesteaded property in each school district.

For each school district, the reported value of the property tax homestead exemptions were subtracted from the estimated value of homesteaded property. The resulting value was then multiplied by the reported school millage rate to derive an estimate of the property tax levy. Summing across school districts yields an estimated school property tax on homestead exemptions for calendar year 2006 of $1,434.1 million.

The number of owner-occupied housing units reported by the Census exceeds the number of homestead exemptions in the state by 16.5 percent. This suggests that not all home owners currently claim a homestead exemption. If homesteaded properties are granted a credit for all school property taxes, this would provide an additional incentive for a home owner to apply for a homestead exemption. If all of the reported home owners, as reported by the Census, were to take a homestead exemption, the FY 2011 estimated cost of the credit for school property taxes would increase by $313.7 million. This is not included in the revenue estimate.

The revenue estimate for the change in the sales tax base was based on the same report as was used for Proposal Two, but with some notable adjustments. The revenue estimate for Proposal Two did not consider the $10,000 cap on taxable service expenditures. This limitation would most likely be applicable to construction, namely major home renovations and real estate commissions on the sale of homes. The revenue estimate was also adjusted to account for taxes that would not likely be collected, for example, expenditures on lawn services and housekeeping services, and in the informal construction and repair sectors.

Table 2 summarizes the revenue effects of each component of the proposed legislation. Since the provisions would be phased-in or implemented at different times, the legislation would be revenue positive for the first two years, but when fully phased-in in FY 2012, the legislation would cost $885.8 million.

SUMMARY

This paper described three major proposals that were recently advanced in the Georgia state legislature that would have either eliminated or greatly reduced property taxes, with the lost revenue to local governments to be replaced by state grants financed by increased state taxes. While much research was conducted on various aspects of these proposals, estimates of the net revenue played a critical role in the political process. The independent analysis that suggested that there would be a large net revenue reduction was an important issue in the debate over the various proposals.

Notes

[1] See Sjoquist (2007a) for a detailed description of HR 900.

[2] See Sjoquist (2007b) for a discussion of issues raised by Proposal Two.

[3] For details of the property tax revenue estimation methodology see Matthews and Sjoquist (2007).

[4] For details of the revenue estimation techniques, see Matthews, Sjoquist, and Winters (2007). Smith and Walker (2006) had prepared a list of all legislative sales tax exemptions and had estimated the revenue loss associated with each.

[5] Both the Federation of Tax Administrators and the Census Bureau identify service types by NAICS code; relatively good connections can be established between the two data sources.

[6] The 0.75 factor was constructed to reflect the value of homesteaded property relative to the value of residential property. A comparison of housing prices and percent rental housing suggested that rental and vacant housing prices were 75 percent of the value of owner-occupied housing. Thus, the number of rental and vacant housing were multiplied by 0.75 to reflect their lower value.

REFERENCES

Federation of Tax Administrators. Sales Taxation of Services: 2004 Update. Washington, D.C.: Federation of Tax Administrators, 2005. http://www.taxadmin.org/fta/pub/services/services.html

Matthews, John and David Sjoquist. *Replacing All Property Taxes: An Analysis of Revenue Issues.* Atlanta, GA: Fiscal Research Center, Andrew Young School of Policy Studies, Georgia State University, 2007. FRC Policy Brief No. 171.

Matthews, John, David Sjoquist, and John Winters. *Revenue Estimates for Eliminating Sales Tax Exemptions and Adding Services to the Sales Tax Base*. Atlanta, GA: Fiscal Research Center, Andrew Young School of Policy Studies, Georgia State University, 2007. FRC Report 170.

Sjoquist, David L. A Description of the Proposed Comprehensive Revision of Georgia's Tax Structure: HR 900. Atlanta, GA: Fiscal Research Center, Andrew Young School of Policy Studies, Georgia State University, 2007a. FRC Policy Brief 151.

Sjoquist, David L. Issues Associated with Replacing the Property Tax with State Grants. Atlanta, GA: Fiscal Research Center, Andrew Young School of Policy Studies, Georgia State University, 2007b. FRC Policy Brief 157.

Smith, William J. and Mary Beth Walker. Revenue Losses from Exemptions of Goods from the Georgia Sales and Use Tax.. Atlanta, GA: Fiscal Research Center, Andrew Young School of Policy Studies, Georgia State University, 2006. FRC Report 134.

U.S. Census Bureau. Economic Census 2002. Washington, D.C. http://www.census.gov/econ/census