BACKGROUND

In its 2010 legislative session, the Georgia General Assembly created the 11-member Special Council on Tax Reform and Fairness for Georgians and charged it with conducting a thorough study of the state’s tax structure. (Full disclosure: the author was a member of the Council.) The legislation also created the Special Joint Committee on Georgia Revenue Structure, which was charged with converting the Council’s recommendations into legislation “without significant changes.” The legislation was to be voted up or down, with no amendments allowed. This paper describes the work of the Council, its recommendations, and the fate of its recommendations.

The Council’s first meeting was held on July 28, 2010; its deadline for reporting its findings and recommendations was January 10, 2011, giving the Council essentially five months to conduct its business. Given the short time frame, the Council relied heavily on available research and background materials and on presentations by various organizations, including tax policy institutions, from both within and outside of Georgia, and business groups. The Council also held 11 public fact-finding sessions throughout the state to give citizens and interested parties an opportunity to be heard and offer input.

The Council’s work was conducted while a state-wide campaign was being waged for all state elected officials, including the Governor. Since Governor Purdue could not run for another term, there were many candidates in the hunt. This posed a significant political problem for the Council. If it made public any possible recommendations, the candidates would have likely been forced to take a position on them. At the same time, the Council was subject to the open meeting law. While the Council had public meetings, most of the discussions of tax options were conducted through a series of meetings and conference calls, each involving a few Council members, thereby avoiding having to announce an official public meeting. While this avoided having possible recommendations being subject to a premature debate among the candidates, it made it impossible for the Council to have full discussions of the options among all members.

CURRENT TAX AND REVENUE ENVIRONMENT

As with other tax reform efforts in other states, the Council reviewed Georgia’s economy, its tax system, and its economic competitiveness, drawing largely on reports and material prepared by Georgia State University’s Fiscal Research Center. Georgia is a low taxing state, ranking 49th in state taxes per capita, and relies heavily on the personal income tax and the sales tax. Georgia’s tax system ranks 19th most regressive (Institute on Taxation and Economic Policy, 2009). Georgia is reported to have a strong business tax climate; it is ranked 10th by COST. While Georgia continues to attract population, employment growth has slowed. Real earnings per worker have actually declined over the 15 years, consistent with the observation that good paying jobs have been replaced with lower paying jobs (Turner, 2009; Matthews, 2009).

GUIDING PRINCIPLES

The Council developed a set of guiding principles that mimic the standard list of tax principles adopted by tax reform efforts in other states. Beyond that, the Council was guided by the charge from elected state leadership to create a tax structure that incentivizes job growth and investment. There was also a desire to shift from taxing income to taxing consumption, to expand tax bases and lower tax rates in order to reduce economic distortions, and to avoid taxing business inputs in order to reduce tax pyramiding.
ANALYSIS AND RECOMMENDATIONS

The final report of the Council contains a description and analysis of each tax. In this paper, we highlight the main issues with each tax and summarize the Council’s recommendations. The Council did not make recommendations for specific changes to the property tax.

Personal Income Tax

The income tax is based on the federal income tax, but a significant exclusion from Federal Adjusted Gross Income (FAGI) is for retirement income, including Social Security. Georgia law provides for an exclusion of non-social security retirement income (defined as non labor income) of up to $35,000; the exclusion is scheduled to increase to a 100 percent of retirement income by 2016. The personal income tax has six tax brackets, but the maximum rate of 6 percent is reached at very low taxable income, namely $7,000 and $10,000 for a single and joint return, respectively. Thus, the tax essentially has a flat rate, but it is modestly progressive. Georgia has 10 personal income tax credits, only one of which depends on income.

The Council’s income tax recommendations were extensive. Many of the adjustments to Federal AGI were recommended for elimination, including the exclusion of retirement income and contributions to college saving plans. All of the deductions (standard and itemized) and non-dependent personal exemptions were proposed for elimination; the dependent exemption was to be reduced from $3,000 to $2,000. The Council recommended replacing the current rate structure with a flat rate of 4 percent, to be phased in over three years. In addition, the Council proposed to eliminate all but three of the tax credits.

Since these changes would increase the tax liability for low-income tax filers a new tax credit was proposed which was designed so that any filer using a standard deduction would be held harmless. In essence, a filer would determine the tax paid under the new flat tax and under the current system taking the standard deduction, and would pay the lesser of the two taxes.

Corporate Income Tax

Georgia is regarded as having a business friendly corporate income tax structure based on the relatively low rate of 6 percent and the use of a single sales factor apportionment formula. The Council’s recommendations focused on the 30 plus business tax credits, 12 of which are designed to promote economic development and job growth.

With the exception of certain large projects, there is essentially no information available to determine if these credits are worthwhile. The Council heard evidence that the existing credits are complicated to apply for and to monitor; that generally they do not have much value to small and new firms; that the rules and regulations, which were adopted to control the cost of the credits, restrict the usefulness of the credits; that many of the credits are not used or used by a very small number of firms; and that some of the credits were designed for specific firms.

Many members of the Council believed that the tax credits fail on most of the principles adopted by the Council. Nevertheless, some Council members believed there may be reasons to provide tax credits, or other economic development financial incentives; in particular, they saw a need for credits in order to remain competitive with incentives offered by other states.

The Council recommended that all of the current 12 economic development tax credits be replaced with a discretionary system of two simple incentives – a credit for job creation and a credit for capital investment. The legislature would authorize annual revenues to be set aside to fund these credits; the Department of Economic Development would be charged with allotting these funds to entice both new and existing businesses to create jobs and/or invest in Georgia, but with the allocation subject to approval by an independent body that includes the governor. Furthermore, the Council recommended that the use of these incentives be measured and tracked in order to determine if they yield a positive net return for the state. The Council proposed that all other tax credits be eliminated.

The Council also proposed that the corporate income tax rate be set equal to the personal income tax rate if that tax rate was lowered.

Sales and Use Tax

As in other states, the current sales tax base has not kept pace with changes in the Georgia economy, in particular, the growing importance of services and remote sales. In addition, the state has adopted numerous sales tax exemptions that have eroded the tax base. The objectives of the Council’s recommendations were to: expand the tax base to match the changes in Georgia’s economy; reduce
distortions; increase long-run growth and stability of revenues; and improve tax compliance. The proposed changes included the following:

- The Council recommended putting food-for-home consumption back into the base.
- Georgia is the only state in the Southeast that taxes energy used in manufacturing. The Council concluded that a new exemption for energy used in manufacturing and an expanded exemption for energy used in agriculture are necessary to retain energy intensive industries such as carpeting. The Council thus recommended a new sales tax exemption for energy.
- In place of the current myriad of sales tax exemptions for purchases by agricultural businesses the Council proposed combining these exemptions into one exemption. The Council heard numerous stories about abuse regarding the use of the agricultural exemptions, and thus recommended that the state issue exemption certificates that would assure that the purchase was being made by a qualified agricultural producer.
- Georgia has offered sales tax holidays on school items, apparel, and energy efficient products; because of declining tax revenues, the Legislature has not authorized a sales tax holiday for the past two years. Empirical evidence presented to the Council found that sales tax holidays have no effect on total consumption other than to change the timing of purchases and to shift the mix of items purchased to those that are exempt. The Council recommended that the Legislature not re-enact sales tax holiday legislation.
- There are over 110 sales tax exemptions in Georgia’s tax code. The Council recommended that exemptions for government and business inputs be retained. The Council did not have the time to determine which of the other exemptions should be retained and which should be eliminated. Each of these exemptions was put into one of four categories: Healthcare, Education, Non Profit, and Miscellaneous. The Council recommended that the General Assembly consider, over a four year period, whether to eliminate or retain the exemptions in each of these four categories.
- Georgia does not levy sales and use tax on casual sales of titled personal property. The Council concluded that this creates a distortion in the marketplace as it creates an unfair disadvantage to licensed dealers who must collect sales tax. The Council recommended that the sales tax be applied to casual sales of titled personal property, including motor vehicles, watercraft, and aircraft.
- Georgia’s sales tax currently applies primarily to the purchase and rental of tangible personal property. In order to extend the sales tax to this increasing share of the economy, the Council recommended that certain personal services be added to the sales tax base.
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- During the 2010 legislative session, Georgia passed legislation bringing the state into substantial compliance with the Streamlined Sales and Use Tax Agreement. The Council recommended that Georgia be brought into full compliance with the Agreement. The Council considered recommending an “Amazon law,” but because these laws have led Amazon to cancel arrangements with affiliates and have generally ended up in litigation, the Council did not recommend adoption of such a law.

**Tobacco Excise Tax**

Georgia has one of the lowest taxes on cigarettes in the nation, currently $0.37/pack, compared to the national average of $1.45/pack. The Council
recommended increasing the tax to the average of the surrounding states, which is $0.62/pack, and to index it for inflation.

**Motor Fuel Tax**

Georgia has two fuel taxes, a 7.5 cent per gallon tax and a 3 percent tax on fuel. Every six months the 3 percent tax is converted to a pennies-per-gallon tax based on retail gas prices. Combined, Georgia’s total fuel tax is 16.8 cents per gallon. The Council considered recommending increasing the fuel tax to the national average over a period of years, but did not. The Council did recommend fixing the total fuel tax at the current combined level and indexing the rate with the highway construction cost index.

**Insurance Premium Tax**

Georgia is one of the few states with both a local and state insurance premium tax, and the combined rate makes the total rate one of the highest in the country. Because a Georgia-based insurance firm that writes policies in other states pays the higher of the Georgia rate or the tax rate of the state in which the policy is sold, there is a strong disincentive for locating an insurance company in Georgia. The Council recommended that the total insurance premium tax rate be reduced to 1.75 percent. The Council left it to the Legislature to determine how the revenues would be divided between the state and local governments.

**Communications Services Tax**

Georgia’s current taxes and fees on communications results in preferential treatment to some providers based solely on the type of infrastructure they use to deliver the product (Tresh, 2010). Several other states have modernized their communications services taxes so that such taxes and fees apply uniformly to all communications service providers. North Carolina is reported to have done a particularly good job of reforming its communications taxes. The Council recommended that Georgia reform its taxation of the communications industry along the lines of the North Carolina reform. Under the proposal, the current state and local sales tax on local telephone service and the current local franchise and public, education and government access (PEG) fees would be replaced by a uniform statewide 7 percent tax on all communications services, with the revenue split evenly between the state and local governments.

**COMMENTS ON COUNCIL’S RECOMMENDATIONS**

From an economic efficiency perspective, the Council’s recommendations make a lot of sense. The proposals broadened the base for most taxes, reduced taxation of business inputs, and reduced the various incentives of the existing deductions and credits. However, from an equity perspective the combined proposal is very regressive.

Of particular concern was the proposal for the personal income tax. The personal income tax recommendation was developed at the very end of the Council’s deliberation, and thus no analysis of it was conducted prior to the issuance of the final report. The Council believed that the personal income tax proposal was likely to lead to reduced revenue, which is why it proposed a phase in of the 4 percent tax rate. In fact, when a revenue estimate was prepared just prior to the release of the Council’s final report showing a substantial increase in revenue, it was greeted with some skepticism and not included in the report.

The Fiscal Research Center conducted an analysis of the income proposal soon after the Council made its recommendations public. The analysis of the effect on the distribution of tax burden showed that the proposal would increase the average effective tax rate for filers with income below about $110,000 of FAGI, and substantially reduce the average effective tax rate for filers about that. This raised concerns among elected officials, and led to efforts on the part of the legislature to significantly change the income tax proposal.

The substantial estimated revenue increase from the changes to the personal income tax, along with the expansion of the sales tax base, made the entire tax reform package a tax increase. That was a major concern to legislators, particularly those who had signed the no tax increase pledge, and led Grover Norquist to initially oppose the Council’s recommendations.

The recommendations of the Council did not fare well in the public arena. While opposition developed around nearly all of the recommendations, substantial and vocal opposition developed for most of the proposed changes to the sales tax. There was strong opposition to putting food-for-home consumption back into the sales tax base and to taxing services. As noted above, the Council did not have the time to analyze all 110 or so exemptions, and thus recommended that the state legislature reconsider over a 4-year period the existing sales
tax exemption for non-profits, hospitals, etc. These exemptions include such publically popular exemptions as Girl Scout cookies, Boy Scout fundraising, etc. The Council’s recommendation was taken as proposing the elimination of the exemptions, rather than “just” consideration of their elimination, and this brought out the opposition. In part this result was due to a lack of an opportunity on the part of the Council to explain its recommendations, perhaps to poor phasing of the recommendations, and possibly to political naivety on the part of the Council (the only elected official on the Council was the outgoing governor, who was not an active participant).

LEGISLATIVE ACTION

As required, the Special Joint Committee crafted legislation containing the Council’s recommendations. However, this 127-page bill was never voted on. As a result of the public outcry over many of the Council’s recommendations, the leadership in the Legislature developed a bill containing a modified set of tax reform provisions. Some of the provisions followed the recommendations of the Council, including those for the communication tax, the agricultural sales tax exemption, and the energy sales tax exemption. Other Council recommendations were dropped, including the changes to the insurance premium tax, the motor fuel tax, and the tax on cigarettes, and the elimination of income tax credits. Major changes were proposed to the Council’s recommendations regarding the income tax and the sales tax.

Members of the Council thought they did what the Legislature requested, namely study the entire state tax system and make recommendations without regards to political consequences. Several members of the Council were thus somewhat dismayed when the leadership of the Legislature rejected much of what the Council had recommended.

The legislation did propose major changes to the personal income tax, including the following:

1. The only subtraction from (FAGI) to be eliminated would be the deduction of dependent’s unearned income included in FAGI of parent’s return.

2. The allowable retirement income that can be excluded from taxation would be frozen at the 2011 level.

3. The standard deduction and non-dependent exemptions would be eliminated.

4. Itemized deductions would be capped and could only be taken by taxpayers with Georgia Adjusted Gross Income (GAGI) below a certain amount. Those filing Married Filing Jointly and Head of Households would be allowed up to $30,000 of itemized deduction if their incomes were $75,000 or less, and up to $17,000 if their incomes were between $75,000 and $160,000. The allowable itemized deduction would phase out dollar-for-dollar above the threshold income of $160,000. The allowable itemized deductions and income limits for those filing as Married Filing Separately or Single would be half that for Married Filing Jointly.

5. Taxpayers would be allowed to claim the deduction for some amount of unreimbursed business expenses allowed under the Federal income tax, namely the amount of the federal deduction in excess of $2,500 up to a net deduction of $8,000.

6. The current dependent exemption would be replaced with a new dependent exemption. For taxpayers with GAGI of $60,000 or less the exemption would be $5,300. For taxpayers with GAGI between $60,001 and $70,000 the exemption would be $3,640. For taxpayers with GAGI between $70,001 and $200,000 the exemption would be $2,000. There would be no dependent exemption for taxpayers with GAGI greater than $200,000.

7. The current rate structure would be replaced with one tax rate: 4.6 percent for tax year 2012 and 4.55 percent for tax year 2013 and subsequent tax years.

8. A new tax credit was proposed, which was a modification of the tax credit proposed by the Council in order to hold harmless low-income taxpayers. The proposed credit amount differs by filing status but not, as the Council had proposed, by the number of dependents. This credit for tax year 2012 (2013 and beyond) would be equal to the difference between 4.6 (4.55) percent of GAGI and the tax liability under the existing tax structure for a taxpayer who took a standard deduction and claimed no dependents.
The changes to the income tax were projected to reduce tax revenue, as compared to the projected increase from the Council’s recommendations.

Regarding the sales tax, the proposed legislation rejected the Council’s recommendations of adding food-for-home consumption back into the base and imposing sunsets on most of the current exemptions. While the Council recommended adding several services to the base, the legislation included only maintenance, repairs, and installation services for personal use motor vehicles. Since parts are currently included, the proposed change would add only the labor charge for these services.

The stumbling block in getting the proposed legislation passed was the personal income tax. As noted above, the Council’s proposal would have resulted in a very large tax increase and a substantial shift in income taxes from high income taxpayers to lower and middle income taxpayers. The drafters of the legislation addressed these two issues. To reduce the increase in revenue the drafters drop the elimination of the income exclusions such as for retirement income and contributions to education savings plans, and the elimination of the tax credits.

The new tax credit was designed to hold harmless those filers who used the standard deduction and it essentially did that. So, the attention was put on the distribution of tax burdens of itemizers. In order to have sufficient revenue to lower the income tax rate, non-dependent personal exemptions and some of the itemized deductions had to be eliminated. But this led to a tradeoff: reducing the tax rate in combination with the new tax credit would reduce taxes for nearly all filers, while reducing personal exemptions and allowable deductions would increase taxes, particularly for those with large itemized deductions. The legislature considered more than two dozen iterations of changes to the tax rate, personal exemptions, and allowable deductions in its effort to find an option under which few taxpayers would have a tax increase while the tax rate could be significantly reduced.

However, given the differences across itemizers in the magnitude of itemized deductions, the drafters of the legislation could not come up with a method that would ensure that only a small number of filers would have a tax increase, while at the same time allowing a substantial reduction in the income tax rate. The “solution” was to allow some dependent exemption and some amount of itemized deductions, but to phase out both of them as income increases. The last version of the bill would have increased taxes for a substantial number of itemizers, particularly for middle income taxpayers.

On the morning that the House was to consider the bill, the House Minority Leader presented information on how the proposal tax package would affect the distribution of the tax burden. In particular, she showed that a substantial number of taxpayers would have a tax increase. At that point the Speaker pulled the bill. Billy Hamilton (2011) has a wonderful summary of these events.

CONCLUDING COMMENTS

There are several lessons that I took away from this experience.

1. Avoid undertaking a tax reform effort during a political campaign.
2. Avoid undertaking a tax reform when a new governor will come into office just as the final report is delivered. Since the new Georgia governor was not party to the proposal to conduct a tax reform, he was not obligated to support the recommendations.
3. Five months is too short a time to do a tax reform study. The Council did a substantial amount of work and developed a very significant set of recommendations. But this in part was due to the research that the Fiscal Research Center had done over the past few years in anticipation that a tax reform commission would be established. However, the short timeframe and the political environment made it impossible to have a conversation with either elected officials or the public regarding the recommendations. It would have been highly likely that the Council’s income tax proposal would have been changed if there had been time to do an analysis of the effect on revenue and the distribution of the tax burden.
4. While a principal purpose of the reform was to ensure that the tax code was business friendly, having a council that included no elected officials led to recommendations that were not politically acceptable or that were politically naive. On the other hand, the absence of most political interference did allow the Council to recommend dramatic and wide sweeping changes to the tax code.
Note


References


