FINAL REPORT OF THE GEORGIA SENATE FAIR TAX STUDY COMMITTEE

Honorable Judson Hill, Chair
Senator, District 32

Honorable Don Balfour
Senator, District 9

Honorable Hardie Davis
Senator, District 22

Honorable Steve Gooch
Senator, District 51

Honorable William Ligon
Senator, District 3

2013

The Georgia Senate
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Prepared by the Senate Research Office

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TABLE OF CONTENTS

I. INTRODUCTION

The Senate Fair Tax Study Committee was created by Senate Resolution 72. The Senate Fair Tax (FT) Study Committee noted that "Georgia is reviewing its taxation structure and the appropriateness of its various forms of taxation," and that "the implementation of the [Fair Tax] at the state level should be considered one of the methods of reforming the current system of taxation in Georgia."

The FT Study Committee was chaired by Senator Judson Hill of Cobb County. The following members served on the committee:

- Senator Don Balfour of Gwinnett County;
- Senator Hardie Davis of Richmond County;
- Senator Steve Gooch of Lumpkin County; and
- Senator William Ligon of Glynn County.

The FT Study Committee convened at the State Capitol on the following dates:

1. Wednesday, July 17, 2013;
2. Friday, September 20, 2013; and
3. Thursday, October 10, 2013.

II. EXECUTIVE SUMMARY

The purpose of the FT Study Committee was to consider whether implementation of Fair Tax-similar policy would benefit the citizen taxpayers of Georgia. This committee asserts that the tax reform of 2012 needs to be on-going, and that this effort sought to continue that success. The ideas and principals which provide the foundation for fair tax reform are not novel, for they are deeply rooted in the fundamental belief that the greater the burden of the tax—the less productive that society will become. This holds true especially to income taxes imposed upon productivity which stymie the entrepreneurial spirit. Georgia is one of 41 states which impose a tax on individual income,[1] and it is the belief of this committee that the top rate of 6 percent could be lowered and potentially eliminated over time.

Georgia's tax structure is archaic. The Georgia economy has simply outgrown this outdated structure of heavy reliance on taxing the income of our residents who comply with the income tax law. The state needs to continue to make Georgia the friendliest environment for businesses to compete in the large, modern free market. Consider, Georgia relies more heavily on income tax revenue than all its neighbors.[2] Georgia's income earners should not bear this heavy burden.

Georgia derives its revenue from corporate and individual income, sales, excise, motor fuel, and—to a very small extent—ad valorem taxes, and fees. Georgia tax revenues fund schools, state universities, highways, public safety, public health, business and professional licensing, court functions, wildlife management, and the state retirement system; moreover, over 75 percent of the state's annual budget is appropriated to education, health care, and criminal justice. These areas are growing faster in actual cost and population served than overall inflation and population growth. Since 1990, the state's Medicaid population has grown 150 percent while the state's prison population has grown 155 percent; this is significant considering the state's overall population growth was only 40 percent. Reserved funds are dedicated sums that are required to be filled before a surplus is considered unreserved; some of these include transportation, lottery, tobacco, and Medicaid funds. Some states, such as Colorado, Arkansas,

[1] Seven states impose no income tax, and two levy it on interest and dividends.
[2] North Carolina passed legislation in 2013 which starts to lower its income tax rate. Virginia is the highest.

Kansas, and Montana have no rainy day funds because they are not required under their state constitutions. Georgia does require and maintain a healthy reserve fund to be utilized when necessary.

Georgia currently enjoys the AAA credit rating, and is one of just a few states to have received the latest highest rating. This is very important, for it affects Georgia's ability to borrow and provide for bonded projects. Georgia maintains a balanced policy of revenue primarily through sales and income tax, and this portfolio is one of the primary reasons Georgia enjoys the AAA credit rating; it is a valued asset. It should be noted though that states that rely upon a single primary source of revenue also enjoy the covered rating.

Taxing less on income applies the basic conservative sense of fairness. Individual earning capacity should not be demonized; administrative and compliance costs should not be burdensome and cost-prohibitive; and productivity and creativity should not be penalized.

A Georgia fair tax policy would promote business development, treat all consumers and retailers fairly, and enhance Georgia's competitive position in the expanding global market; moreover, it would serve as the bold and necessary tax reform expected by Georgia taxpayers.

The concept for taxing personal consumption rather than professional and individual earnings goes all the way back to the Renaissance Period. Thomas Hobbes wrote in *The Leviathan* that "taxing what citizens consume is more just than taxing what they earn." He further noted that "consumption represents what individuals take out of society while taxing earnings demonstrate what is contributed."

During the 1700's, Scottish philosopher David Hume asserted that a principal benefit of consumption taxes is that they are somewhat voluntary because consumers can decide whether to consume the taxed commodity or good. This argument was endorsed by Alexander Hamilton in Federalist Paper No. 51.3.[4]

Georgia is adequately positioned to remain competitive, but more can be accomplished to better Georgia's economic standing both nationally and globally. Policy makers have many options in order to achieve the economic goals, but the primary objective should be to phase down Georgia's income tax. This should be accomplished through streamlining, eliminating, and capping the numerous deductions, credits, and exemptions in addition to at least consideration of implementing a broader sales tax base. The suggestions made by the Tax Reform Council should continue to be considered and implemented. Georgia cannot afford to not act or simply rely upon the status quo to ensure the Peach State's sustained economic growth, strategic competitiveness, and global inclusion.

The FT Study Committee urges Members of the Georgia General Assembly and any interested policy-participants and other parties to take part of this online tax-based game that allows for users to determine how to set tax and revenue policy using variables of tax and spending:

- Tax Reform The Game: www.taxreformthegame.com

[3] As articulated in "America Should Move to a Consumption Tax" by Ted Rueter, Professor of Political Science at DePauw University in Indiana.
[4] See: http://www.constitution.org/fed/federa51.htm

III. TESTIMONY & PERSPECTIVE

"Governments don't reduce deficits by raising taxes on the people; governments reduce deficits by controlling spending and stimulating new wealth."
President Ronald Reagan

1. Wednesday, July 17, 2013

Dr. Christine Ries, Professor of Economics at Georgia Institute of Technology, provided testimony to the FT Study Committee.[5] She opined that there are two primary binds that tie culture together: the economy and the society.

Dr. Ries noted that tax reform is difficult. In the last two years, nearly a quarter of state governors or legislatures have actively pursued pro-growth tax reform proposals; however, in state after state, reform fails under the weight of special-interest political opposition. She said that pro-growth tax reform produces winners and losers, for it sweetened with an overall tax revenue reduction (a tax cut) that balance can be shifted toward the winners; however, in this era of tight state budgets and slow growth, it is difficult to reduce state spending enough to produce a net tax revenue cut. She said that clear and strong economic facts and history work in favor of pro-growth tax reform. Any number of scientific studies over many countries and many time frames show that tax rate reductions produce economic growth. From the political perspective, with more income and wealth to spread around, there can be more winners than losers. She asserted that pro-growth tax reform creates its own net tax cut for investors and income earners.

Additionally, Dr. Ries said that the political challenge has been that these gains, though significant and rapid, are prospective and have not been able to demonstrate to enough voters that they will eventually be winners. No matter how strong the science, voters are persuaded by high-tax, big government proponents and wealth redistribution advocates that they will be hurt by tax reform. Anti-reform advocates use flawed data, biased and misleading analysis, and limited logic to prevent voters from fully appreciating how reform spurs growth, and growth makes them winners.

Dr. Ries stated that a government's job is to create legal and regulatory conditions most favorable to the emergence of the most efficient economy possible. There could be created artificially imposed impediments to citizens' abilities to meet and profit from economic opportunity. She noted that the private sector should be encouraged to produce goods desired by consumers and to buy and sell for a profit; there should be: Life, Liberty and the Pursuit of Profit.

She further suggested that Georgia needs to bring the tax code into line with this overall and essential government responsibility. Reform the tax code to bring it into line with principles of pro-growth taxation which includes: (1) Lower tax rates on production and earning income; (2) Investing; (3) Innovation and risk-taking; and (4) Savings.

She advised to stop penalizing Georgians who produce, save, invest, and earn a profit. Current policy penalizes individuals who hold or create jobs while subsidizing Georgia residents who

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[5] Visit: http://www.econ.gatech.edu/people/faculty/ries. Dr. Ries also served on the Georgia Special Council on Tax Reform and Fairness of 2010. House Bill 1405 created the 2010 Special Council on Tax Reform and Fairness for Georgians and further created the Special Joint Committee on Georgia Revenue Structure which was charged with considering applicable tax reform legislation to recommend to the House and to the Senate.

consume--but do not hold, produce, or create jobs. She stressed that it is important to reform the way taxes are drawn from the economy. Those who produce more win and are incentivized to expand that activity. Those who consume more lose and are incentivized to economize on that activity. Lower rates and broader base shrinks distortions from what the natural workings of the market would produce on its own.

Dr. Ries said government should use the tax system for raising revenue only. Raise revenue and spend to provide conditions for undistorted market operations; moreover, raise revenue at a low cost to support necessary government administration, public institutions, and taxpayers financial well-being. The best policy would secure the broadest possible base with the lowest rates which tax at the end of consumption rather than at several places along that chain; she noted it only gums up the chain. Dr. Ries suggested that there should be simple calculation and simple collection which equal tax treatment for the same economic transactions. There should be no exemptions, deductions, or credits where each special case should be handled by appropriations and subject to legislative management, accountability, and review. She concluded by asserted that if the State of Georgia does not act knowing that there exist interstate and global realities, then this state will fall behind North Carolina, Florida, and Kansas, for example.

Mr. Jim Duffey of Fair Tax-Georgia, provided testimony to the FT Study Committee.[6] He stated that nine states currently have no income tax, and further noted that 62 percent of job growth over the past ten years has occurred in these states:

- Alaska
- Florida
- Nevada
- New Hampshire*
- South Dakota
- Tennessee*
- Texas
- Washington
- Wyoming

(*These states tax only dividend and interest income).

Mr. Duffey suggested that two states with no income tax lead the way in job growth: Florida and Texas. He opined that there should be a simple consumption tax on all goods and services coupled with no exemptions; he further said there would be no losers chosen under a simple system, and asked why simplicity is so difficult to achieve by policy makers? Duffey pointed to Georgia's neighbor to the east, South Carolina, which is considering fair tax legislation; it mirrors the national plan including prebates. It is House Bill 3116,[7]and the purpose is to raise revenue by taxing all new goods and services once and only once, simplify the tax code, to reduce compliance costs, and provide taxpayer rights including the presumptions of compliance and innocence with the state bearing the burden of proof.[8]

Chairman Hill asked Duffey if any other states have actually enacted fair tax legislation; Duffey replied that Georgia could be the first, but South Carolina will likely be the first in the nation.

Senator Balfour asked about North Carolina's new rate of 5.75 percent and whether Georgia's 6 percent was better with available deductions.

[6] Visit: http://www.gafairtax.org/
[7] See: http://www.scstatehouse.gov/sess120_2013-2014/bills/3116.htm
[8] See: http://scfairtax.org/docs/SCFairTaxBillExecutiveSummary10-05-10.pdf

Ms. Virginia Galloway of the Americans for Prosperity Foundation appeared before the committee.[9] She commenced by noting that North Carolina enacted sincere tax reform in 2013 which provides a flat income tax and eliminated the so-called death tax.[10] The legislation moves the state from a tiered personal income tax with a top rate of 7.75 percent, the highest in the South, to a flat 5.75 percent over two years. The plan also reduces the corporate tax from 6.9 percent to 5 percent over two years. If certain revenue targets are met, the corporate rate will fall to as low as 3 percent by 2017.

Highlights of the North Carolina Tax Reform Legislation include:

Individual Income Tax

- Flatten and lower rate to 5.75 percent by 2015;
- Increase standard deduction to $7,500 (for singles);
- Allow full deductibility of charitable contributions;
- Fully exempt Social Security income from state income tax;
- Allow for certain itemized deductions (total of mortgage interest and property taxes paid would be capped at $20k); and
- Retain current child credit of $100 for those earning $40k and increase credit to $125 for those earning under $40k.

Corporate Income Tax

- Reduce rate to 5 percent by 2015; and
- If certain revenue targets are met, rate would decrease to 4 percent in 2016 and 3 percent in 2017.

Other Changes

- Retain full sales tax refund for nonprofits;
- Cap gasoline tax; and
- Fully repeal estate tax.

Ms. Galloway stated that North Carolina will enjoy a 20 percent rank jump in economic competitiveness surveys; moreover, tax reform should be a transparently open process with all information and studied numbers available for public inspection.

Mr. Kelly McCutchen, President of the Georgia Public Policy Foundation,[11] provided testimony to the committee. He noted that Georgia needs structural tax reform; this equals shifting tax liability. Georgia's personal, individual income tax ranks 40th in the nation, and this is bad news for Georgia families. Georgia, Mr. McCutchen said, is primely suited for big economic gains with the help of recent tax reform efforts under House Bill 386 (2012) with the manufacturing and agriculture sales tax exemptions;[12] these reforms were the result of the Georgia Special Council on Tax Reform and Fairness of 2010.

McCutchen said that Georgia should be home to innovation with the state's outstanding research universities. He noted that Georgia has become a major credit processing center, for 65 percent of all the world's credit/debit transactions are processed through Georgia; moreover, Georgia needs to be luring and retaining professionals and capital investment. It is important to

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[9] Visit: http://americansforprosperity.org/georgia/

[10] Visit: http://www.governor.nc.gov/newsroom/press-releases/20130723/governor-mccrory-signs-tax-reform-law

[11] Visit: http://www.georgiapolicy.org/#ff_s=eQqK

[12] See: http://www.legis.ga.gov/Legislation/en-US/display/20112012/HB/386

remember that small businesses pay tax against individual income tax rates as S corporations. McCutchen noted that both New Mexico and Oklahoma are also considering lowering their respective income tax rates. He further stated that only one state has eliminated a major tax in the last 50 years: Alaska. Additionally, he stated that a zero income tax rate would mean about a 10 percent sales tax rate, but he stated that 70 percent of the gross state product is not taxes (housing and healthcare are biggest untaxed services).

Senator Balfour asked about North Carolina's new rate of 5.75 percent and whether Georgia's 6 percent was better with available deductions. McCutchen replied that the state should remain competitive with a 6 percent top rate; however, it turns on Georgia Adjusted Gross Income and how it is achieved. Dr. Ries stated that North Carolina eliminated brackets from 7 percent to 5.75 percent. Georgia should have a goal of a 3 percent top income tax rate.

Senator Davis asked what does it mean to "broaden" the tax base. McCutchen answered that it applies to services such as telecommunications, labor, professionals and even lawn-care.

Senator Davis further inquired whether most new jobs in Georgia are service-related. McCutchen affirmed noting that lower wage, service-sector jobs are being created, but Galloway further asked whether $30,000 annual income jobs are now the middle class. Senator Davis stated that lower wage jobs are not the best goal, and Galloway asserted that the state needs to be better invested in public education to support the demand for high-wage jobs.

Senator Balfour stated that Georgia needs to explore a dynamic tax policy which looks at all deductions and exemptions and how they affect overall revenue. McCutchen suggested that both Oregon and Washington should be reviewed for their dynamic and flexible tax policy, for Oregon levies no sales tax while Washington has no income tax. Duffey opined that successful tax policy is all about trade-off factors that should be made in order to satisfy the lower rates.

Senator Davis asked why Georgia's current tax structure is unfair; McCutchen replied that housing is a prime example. Duffey offered that Georgia's myriad of exemptions, exceptions, deductions, and credits are unfair because they imply that some taxpayers are more important than others; all citizen taxpayers should stand on their own; moreover, there should be no legislated favoritism among and within industries and the population at large.

Senator Ligon asked about the expected state sales tax rate if the income tax was lowered to 3 percent. McCutchen opined that the state sales tax could stand at 6 percent if there were few or no exemptions offered statewide. Senator Ligon further questioned the top threshold for sales tax; McCutchen replied that it depends on the location with applicable local option sales taxes, but a rate of 12 percent would be considered uncompetitive.

2. Friday, September 20, 2013

"We have a system that increasingly taxes work and subsidizes nonwork."
--Milton Friedman

Dr. Robert Buschman, Professor at Georgia State University and Senior Research Associate with the Fiscal Research Center, provided testimony to the FT Study Committee.[13] Dr. Buschman provided a report in contemplation of consumption-based taxation as an alternative to current state income taxes, and he noted that his comments are just one of a range of options that differ in two key structural elements:

[13] Visit: http://aysps.gsu.edu/staff/robert-buschman

- The definition of the consumption tax base; and
- The structure of any "prebate" that might be included to preserve a degree of progressivity in tax burdens.

Key assumptions of this analysis are as follows:

- Any new consumption tax would replace:
  - all current state corporate and personal income taxes, and
  - the current state sales and use tax.
- Existing local sales and use taxes would be unaffected.
- Motor fuels taxes, including the 1 percent sales tax on motor fuels that goes to the general fund, would be unaffected.
- All other state and local taxes and fees, including but not limited to the various excise taxes, property taxes, and the recently implemented motor vehicle title fee would be unaffected.
- The overall revenue effect will be neutral on a static basis.

Dr. Buschman provided two tax base alternatives which represent the bounds of a range from the existing, relatively narrow sales and use tax base to a very broad sales and use tax base intended to include all final goods consumption by Georgia households. The broad base alternative is based on the aforementioned South Carolina Fair Tax Act,[14] which proposes to tax all new goods and services purchased in the state "once and only once," with the exception of goods and services purchased by the federal government. In particular:

- Used goods and intangible property are not taxed.
- Goods and services purchased for resale, or as inputs to, or in the production of, new goods and services are not taxed.
- Education and training expenses (tuition, books, and class-related fees) are not taxed.
- New goods and services that are produced in the state but are "exported" and sold outside of the state are not taxed.
- New goods and services "imported" from out of state are taxed.
- Sales of new homes (net of land value) are taxed.
- Goods and services purchased by state and local government are taxed, except for purchases by "government enterprises" which are government entities that provide or resell goods and services to other government entities for payment.
- Services in the form of labor purchased by (i) governments (excluding government enterprises and the federal government) or (ii) households employing domestic servants are taxed, with the tax payable by such taxable employer on the total compensation paid.

Dr. Buschman noted that the one difference between the broad base alternative analyzed here and the South Carolina model is the exclusion of motor vehicles. It is further assumed that the Title Ad Valorem Tax implemented under House Bill 386 (2012) remains unchanged. The narrow base alternative is based under the current Georgia House Bill 688 which proposes to repeal all state income taxes and offset the revenue loss by raising the state sales and use tax rate, with no change to the current tax base.[15]

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[14] See Footnotes 6 and 7, supra.

[15] See: http://www.legis.ga.gov/Legislation/en-US/display/20132014/HB/688

Further, Dr. Buschman discussed that the theory of the prebate is a payment made by the state to eligible Georgia households to offset the tax liability for some base level of spending; moreover, prebate amounts are based on federal poverty level income guidelines,[16] which vary according to the number of persons in the household. The effect of prebate payments is to make the net tax liability of a household at that base level of income and spending effectively zero, and to preserve some degree of progressivity in state tax burdens. Dr. Bushman opined that a broad-based consumption tax without a prebate is generally considered to be a regressive tax because, on average, comparable households at higher income levels spend a smaller portion of their total income on taxable consumption than do lower income households. Dr. Buschman explained that the proposed Georgia HB 688 does not provide for a prebate of any amount. Two alternatives that provide for prebates are also included, as follows:

- For the narrow base alternative, a prebate paid at the new consumption tax rate on a fixed portion of poverty level income (PLI) for the given household size. The fixed portion is based on the share of spending by poverty level households, on average, for goods and services included in the narrow base definition. Currently taxable consumption by poverty level households is estimated to be approximately 36 percent, based on Consumer Expenditure Survey (CES) data from the Bureau of Labor Statistics.
- For the broad-base alternative, a prebate paid at the new consumption tax rate applied to PLI for the given household size.

As in the proposed South Carolina legislation, the PLI base for calculation of prebates includes an adjustment referred to in SC as the "marriage penalty elimination amount." The PLI base is adjusted for married couple households by adding an amount equal to the difference between the PLI for a one person household and the amount added for each additional person. Prebates under either alternative are assumed to be payable to all legal resident households in the state on a monthly basis, for each month of residency. As the analysis that follows is based on fiscal year 2012 revenues, calendar year 2011 U.S. Census Department estimates of Georgia households and 2011 federal poverty level income guidelines are used in calculating the base for prebate payments. The following table summarizes:

"Prebate" Base Estimate	FY 2012
2011 Poverty Level Income: [1]	
1st Person	$10,890
Each Additional Person	$3,820
Marriage Adjustment [2]	$7,070
2011 GA Average Household Size [3]	2.74
2011 GA Households [3]	3,494,542
2011 Married GA Households	1,667,698
Avg PLI Base before Marriage Adj. [4]	$17,537
Avg PLI Base with Marriage Adj.	$20,911
Gross (Broad) Prebate Base ($ mil) [5]	$73,074
Narrow Base Adjustment [6]	36%
Narrow Prebate Base ($ mil)	$26,307

1. HHS; 2. 1st person amt. less additional person amt.; 3. Census; 4. Poverty level income for a 2.74 person household; 5. Average base times the number of households; 6. Estimated percent of poverty level household consumption that is taxable under the narrow base definition.

[16] Federal poverty level income guidelines are published annually by the Department of Health and Human Services (HHS):

For each tax base and prebate alternative, the tax rate is chosen to generate net revenues, after any prebate payments, just equal to the revenues from the current state income and state sales and use taxes. The analysis is based on actual income and sales tax revenues for fiscal year 2012, as reported by the Georgia Department of Revenue, adjusted on a static basis for the removal of motor vehicle sales from the sales tax base effective this year. Reported revenues and the motor vehicle adjustment are as follows:

Revenue to Replace

($ millions)	FY 2012
State Sales & Use Tax [1]	$5,330
Motor vehicle sales taxes [2]	(421)
Motor fuels 1% sales tax [2]	(191)
Adj. State Sales & Use Tax	4,718
Personal Income Tax [1]	8,143
Corporate Income Tax [1]	590
Total Revenue to Replace	**$13,451**

1. Georgia Department of Revenue, Annual Statistical Report.
2. Fiscal Research Center estimate based on DOR data.

Alternative 1: Narrow (existing) base, no prebate.

Calculations for the first alternative are straightforward, with the tax base estimated from the adjusted FY2012 state sales and use tax revenue (above) and the current state tax rate of 4 percent. The consumption tax rate required for overall revenue neutrality is then simply the amount of revenue to be replaced divided by the implied tax base.

Alt. 1 Tax Base and Rate

($ millions)	FY 2012
Adj. State Sales & Use Tax Rev.	$4,718
Implied Base @ 4% Tax Rate	$117,962
Revenue Neutral Tax Rate[1]	**11.40%**

1. Revenue to replace / implied base.

Alternative 2: Narrow (existing) base with prebate.

The tax base for the second alternative is the same as estimated for the first, but the rate calculation is more complicated because it determines both the gross tax revenues and the prebate payments, and is again set to the level required for revenue neutrality.

Alt. 2 Tax/Prebate Base and Rate

($ millions)	FY 2012
Tax Base (from Alt. 1)	$117,962
Narrow Prebate Base	$26,307
Revenue Neutral Tax Rate	**14.68%**
Gross Tax Revenues	$17,312
Less: Prebate Payments	(3,861)
Net Tax Revenues	$13,451

The average household would receive a monthly prebate payment of about $92 ($1,105 annually), on a Fiscal Year 2012 pro-forma basis.

Alternative 3: Broad base with prebate.

The tax base for the third alternative—the broad base—cannot be estimated from FY2012 revenues as was done for the narrow base. Instead, it is estimated from Bureau of Economic Analysis (BEA) data on Georgia (and national) economic activity. Essentially, the broad base includes all personal consumption expenditures (PCE) except for education, imputed rent on owner-occupied housing,[17] and motor vehicle purchases. In addition, new fixed investments in owner-occupied homes, and total state and local government expenditures are also included.

BEA reports state level gross domestic product (GDP) only on an industry output basis, so PCE for the state is estimated based on national averages of PCE/GDP, or about 69 percent for 2011-2012. Education expenditures for tuition, books, and fees were about 1.6 percent of national GDP over the same period, while imputed rent was about 7.9 percent. Motor vehicle purchases included in national PCE over the period was about 3.0% of GDP. Net of these items, the taxable PCE share is assumed to be about 56.5 percent of Georgia GDP.

Fixed investment in new owner-occupied housing in 2011-2012 is estimated to be about 2.2 percent of GDP nationally.[18] These figures are also not available at subnational levels, so the estimated national GDP share is assumed for Georgia. BEA state-level reporting does include state and local government shares of GDP on an output basis; for Georgia, this accounted for about 8.5 percent of state GDP in 2011, the latest year available. However, state and local governments are only taxed on their goods and services purchases, and their compensation of employees under the South Carolina model of the broad base. Nationally, goods and services inputs and labor accounted for about 90 percent of state and local government output over the last two years, so taxable Georgia government spending is assumed to be about 7.7 percent.

Combined, the taxable portions of PCE, new residential investment, and government spending are assumed to be 66.4 percent of Georgia GDP. To estimate Georgia GDP on an FY2012 basis, the average of calendar years 2011 and 2012 is used, or approximately $425,504 million. The broad base alternative tax base for FY2012 is thus estimated to be $282,534 million. The resulting revenue neutral tax and prebate rate, and revenue estimates are as follows:

Alt. 3 Tax/Prebate Base and Rate

($ millions)	FY 2012
Tax Base	$282,534
Broad Prebate Base	$73,074
Revenue Neutral Tax Rate	**6.42%**
Gross Tax Revenues	$18,144
Less: Prebate Payments	(4,693)
Net Tax Revenues	$13,451

[17] The imputed rental value of owner-occupied housing is included in PCE as a component of housing expenditures, along with actual rent on rental housing.
[18] BEA reports residential fixed investment without distinguishing owner-occupied from rental homes. We assume for simplicity that new single family and manufactured homes, which together account for 87% of new homes in 2011-2012 nationally, are to be owner-occupied. 87% of the values of home improvements and ownership transfer costs, which are also included in BEA figures for residential fixed investment (and not in PCE), are also assumed related to owner-occupied housing.

The average household would receive a monthly prebate payment under this alternative of about $112 ($1,343 annually), on a FY2012 proforma basis.

Dr. Bushman estimated the effects of the three alternatives above on households at or near the poverty level using CES data that is again used to estimate consumption spending patterns for households at that level of income. Estimated tax burdens under current law are then compared to those under each alternative. Four household types are included: single, married with no children, married with two children, and single parent (head of household) with two children.

The income levels used for each are the 2011 poverty level income for that household size, rounded up to the nearest thousand dollars. Those levels, again, are $10,890 for the first person in the household plus $3,820 for each additional eligible person. The taxable consumption base under current law and the first two alternatives is assumed to be 36 percent of income, based on CES data as explained above.

Under the broad base alternative, taxable consumption is assumed to be above gross income. The CES data show that total consumption spending for low income households exceeds gross income, on average, by a considerable margin as many receive transfer payments from government, receive gifts or other assistance from family, or draw down savings. Results are presented in the following table:

Low Income Households' Net Tax Change

		Single		Single Parent, Two Children		Married, No Children		Married, Two Children
Gross Income		**$11,000**		**$19,000**		**$22,000**		**$30,000**
Sales & Use Tax:								
Current Taxable Consumption (% of Inc)	(36%)	3,960	(36%)	6,840	(36%)	7,920	(36%)	10,800
Current State Sales & Use Tax @ 4%		$158		$274		$317		$432
Income Tax:								
Personal and Dependent Exemptions		3,000		8,400		6,000		11,400
Standard Deduction		2,300		2,300		3,000		3,000
Current Law Taxable Income		5,700		8,300		13,000		15,600
Current Law Income Tax, Net of LIC		$159		$242		$523		$679
Total Sales & Use and Income Taxes		**$317**		**$516**		**$840**		**$1,111**
Alt 1 Gross Tax: Current Base, 11.4%		$451		$780		$903		$1,231
Change in Total Tax		**$134**		**$264**		**$63**		**$120**
Alt 2 Gross Tax: Current Base, 14.68%		$581		$1,004		$1,163		$1,585
Prebate		$576		$979		$1,151		$1,555
Net Tax		$6		$25		$12		$31
Change in Total Tax		**-$312**		**-$491**		**-$828**		**-$1,080**
Alt 3 Broad Tax Base (% of Inc):	(140%)	$15,400	(125%)	$23,750	(125%)	$27,500	(125%)	$37,500
Gross Tax @ 6.42%		$989		$1,525		$1,766		$2,408
Prebate		$659		$1,121		$1,318		$1,780
Net Tax		$330		$404		$448		$628
Change in Total Tax		**$12**		**-$112**		**-$392**		**-$483**

As the table shows, under the first alternative—the current sales tax base with no prebate—the result is a tax increase for all four household types, ranging from $63 to $264. With a prebate and the higher necessary tax rate on the current base, the result is a substantial tax cut for all types as the prebate offsets substantially all the consumption taxes paid. The third alternative falls in between, with single person households at the poverty level essentially breaking even compared to current taxes and the other types realizing cuts of between $112 for the single parent household and $483 for the couple with two children.

Dr. Bushman concluded with the following alternatives:

- **Alt. 1:** 11.4 percent with the current base and no prebate;
- **Alt. 2:** 14.7 percent with the current base and a prebate at the same rate on 36 percent of marriage-adjusted poverty level income; and
- **Alt. 3:** 6.4 percent with the broad base and a prebate at the same rate on 100 percent of marriage-adjusted poverty level income.

He stated further that analysis is needed to understand the effects on taxpayers farther above the poverty level of income, but results for those at the poverty level show that only the first alternative negatively impacts those taxpayers. Other considerations for further analysis include the possibility of dynamic effects from a shift to consumption taxation with a broad base and low rates, and the possibility of savings to government and to taxpayers in administration and compliance under a consumption tax. Finally, it is worth noting that many of the same potential benefits of base-broadening and lowering of rates, including benefits from tax simplification, may also be obtainable from revisions to income taxes.

Senator Gooch asked whether Dr. Buschman looked at all the current sales tax exemptions, but he replied that this was not part of this analysis.

Chairman Hill inquired how this could affect local governments; Dr. Buschman answered that broadening a sales tax base could enhance local option sales tax revenue while reducing their uses, moreover, it would assist with stability and efficient administration because local sales tax bases would correctly mirror the state's base. Chairman Hill asked about what would be required under a broad base; Dr. Buschman replied that all cash expenditures would be taxed (except on education and motor vehicles) as end product transactions (which should include new home purchases). The broader base would include most services consumed by households, but not necessarily by businesses. Services generally already have sales taxes built into their prices under respective business plans.

Senator Gooch asked what the sales tax rate would be? Dr. Buschman responded that the 14.7 percent under Alternate 2 would be a high, unattractive sales tax rate that would be necessary to remain revenue neutral with the issuance of prebates.

Chairman Hill inquired to whom prebates would be given; Dr. Buschman replied that it would probably mirror federal proposals which would increase progressivity at lower incomes and be less distortive.

Senator Balfour confirmed that under Alternative 2, there would be no state income tax, and Dr. Buschman agreed. Senator Balfour inquired whether the North Carolina legislation or the Georgia Tax Reform Council's recommendations would be a better model; Dr.

Buschman replied that the Georgia would be better suited to keep the sales tax rate as low as possible while phasing in an income tax rate reduction downward to about 3 or 4 percent.

Chairman Hill suggested that the committee follow up with additional questions including:

> *1. Is there more information on the percentage of consumption subject to the sales tax as it relates to reported adjusted gross income? There is cited a 36% average for poverty level households. To evaluate the impact on all families is there a broader range? Specifically, for every $1,000 of reported adjusted gross income (and perhaps by type of filer), can it be determined a) how much of the reported income is consumption, b) what percentage is currently subject to sales tax, c) what percentage would be subject to a tax on groceries and d) what percentage would be subject to a tax on everything else (as defined by the South Carolina bill). This way, it may accurately predict the extra sales tax paid by all families and compare this to the reduction in income tax.*
>
> *2. On the broad based (based on South Carolina) state and local purchases were included as taxable. This increases the revenue from the sales tax, but also increases costs by an equal amount. Not added back into the model are the extra costs. This approach--although revenue neutral--creates a level playing field where government might otherwise compete with the private sector. Since the federal government cannot be taxed, including Medicare and military spending, perhaps it can be assumed Medicaid would be taxed?*
>
> *3. It would be beneficial to also look at a 3 percent state income tax and a 4.5 percent tax. Under a 3 percent rate with a broader sales tax base coupled with eliminating itemized deductions, the impact of keeping charitable deductions may be determined; moreover, the mortgage deduction cap at $20,000 may be capped annually like North Carolina.*

Dr. Buschman responded that additional information could be provided with the exception of any analysis of items within itemized deductions. The reason is that the data we received from the Georgia Department of Revenue is limited to what is on Georgia tax forms, where only the total of itemized deductions is reported. It might be possible to estimate the total amounts of charitable contributions or mortgage interest deducted from IRS tabulations, but cannot run simulations on actual return data without the details from the federal forms.

Dr. Buschman provided the following answers via correspondence to Chairman Hill's questions with the following analysis of alternative consumption tax structures for Georgia based upon questions presented by the FT Study Committee on September 20, 2013:

1. How do household consumption expenditures that are taxable under each of the following tax base scenarios vary across the income distribution?
   a. Current law sales and use tax base.
   b. Current law plus currently exempt groceries.
   c. Broad household consumption base modeled on South Carolina Fair Tax Act.
2. What would be the implications of taxing state and local government purchases as is done under the proposed South Carolina law? Secondarily, how are Medicaid expenditures treated in that model, where federal government expenditures cannot be taxed?

3. What is the feasibility of combining income tax reductions to, say, a 3% or 4.5% flat rate, and elimination of all itemized deductions except for: (a) charitable contributions, and (b) a maximum of $20,000 annually of mortgage interest?

Taxable consumption by income group—three tax base scenarios.

Using data from the U.S. Census Bureau's Consumer Expenditure Survey (CES), it is possible to estimate taxable consumption patterns by income level, but because of sample size limitations, it is necessary to base the analysis on no smaller than a regional sample, rather than Georgia alone; nevertheless, if the sample is limited to only southeast U.S. states where, for example, regional differences in energy consumption for heating and cooling would not come into play, it is believed that the sample would be representative of consumption patterns in Georgia households of similar incomes. These data have been used in similar analysis by other researchers.

The sample used for the tables below includes the CES samples for Georgia and 15 other states, plus the District of Columbia, in the South census region.[19] The total sample size is 12,045 households, which is divided into income deciles based on estimated federal adjusted gross income.

The broad base alternative is based on taxing all household consumption expenditures for new goods and services except for education expenses, similar to the proposed South Carolina Fair Tax Act, and motor vehicles, which are taxed under the new title fee implemented this year. In addition, spending on motor fuels is excluded from these figures because only the 1 percent sales tax portion of the second motor fuels tax goes to the general fund and, rather than assuming any change to motor fuels taxes, motor fuels were excluded from the broad base alternative in the September 20 presentation estimates.

Finally, because of data limitations, the broad base estimates here do not include new home purchases, which are taxable under the South Carolina proposal. Estimates of the mean taxable consumption by income group, under the three tax base scenarios, are presented in Figure 1 and Table 1 below, with the latter also showing taxable consumption as a percent of total consumption expenditures and of income.[20]

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[19] The Census Bureau's South region includes Alabama, Arkansas, Delaware, District of Columbia, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia, and West Virginia.

[20] In lower income groups, consumption exceeds gross income, on average, because spending may be funded by transfer payments, savings, or other sources not included in reported income. Note also that these estimates are based on household expenditure types that are not necessarily readily classifiable into taxable or non-taxable categories, particularly under the broad base scenario, so these figures should be viewed as only rough approximations of taxable consumption.

Figure 1: Taxable Consumption
Three Alternatives, by Income Group (2012)

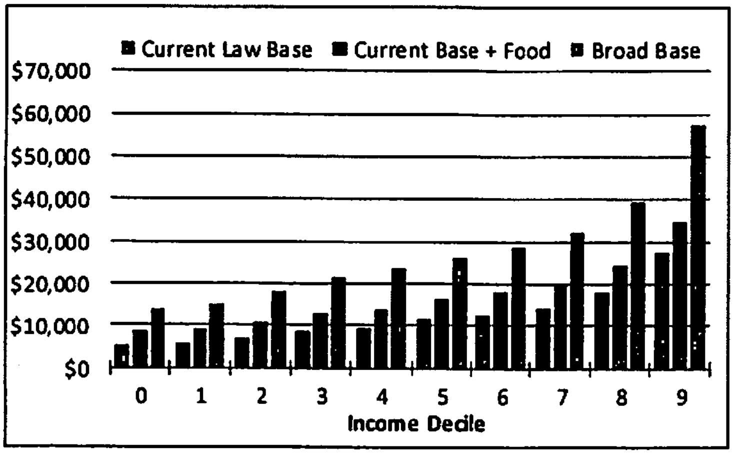

Table 1: Taxable Consumption
Three Alternatives, by Income Group (2012)
*Source: Consumer Expenditure Survey data and FRC calculations.

Inc Decile	Min Income	Mean Income	Current Law Base	*% ttl expend*	*% income*	Current + Food	*% ttl expend*	*% income*	Broad Base	*% ttl expend*	*% income*
0	<$0	<$0	$5,209	26.0%	nmf	$8,661	43.2%	nmf	$13,926	69.4%	nmf
1	$0	$3,057	$5,637	25.1%	184.4%	$8,968	40.0%	293.4%	$15,252	68.0%	499.0%
2	$7,553	$12,108	$6,960	28.3%	57.5%	$10,760	43.7%	88.9%	$18,090	73.5%	149.4%
3	$17,355	$22,143	$8,519	29.2%	38.5%	$12,893	44.2%	58.2%	$21,513	73.7%	97.2%
4	$26,402	$31,839	$9,435	26.8%	29.6%	$14,018	39.8%	44.0%	$23,560	66.9%	74.0%
5	$36,821	$43,102	$11,524	27.7%	26.7%	$16,411	39.5%	38.1%	$26,400	63.5%	61.2%
6	$49,921	$57,263	$12,702	25.4%	22.2%	$17,920	35.8%	31.3%	$28,892	57.7%	50.5%
7	$65,400	$75,420	$14,231	25.3%	18.9%	$20,028	35.7%	26.6%	$32,400	57.7%	43.0%
8	$87,000	$102,777	$18,313	25.6%	17.8%	$24,709	34.6%	24.0%	$39,521	55.3%	38.5%
9	$122,400	$204,646	$27,384	24.9%	13.4%	$34,620	31.5%	16.9%	$57,472	52.3%	28.1%
All		$55,093	$11,987	26.0%	21.8%	$16,894	36.7%	30.7%	$27,694	60.2%	50.3%

Source: Consumer Expenditure Survey data and FRC calculations.

Taxing state and local government purchases.

Both the proposed national Fair Tax and the proposed South Carolina Fair Tax provide for taxing government purchases of goods and services, including labor, unless the purchases are made by a government enterprise that provides goods or services for payment and that collects the tax on its sales. The South Carolina legislation would not tax federal government purchases in the state due to constitutional issues, but it would tax state and local governments.

The rationale for taxing government spending, even though the state government would be paying itself, is to "level the playing field" between the public and the private sector in terms of costs of providing services and thus limit market distortions.

On the surface, it might seem that government costs would rise by the amount of the taxes paid on goods, services, and labor purchased by governments, but this is not so clear. Government workers, contractors, and vendors would no longer be subject to individual or corporate state income taxes, nor would contractors and vendors be subject to sales taxes on their business purchases under existing Fair Tax proposals. As a result, these currently existing taxes would no longer be embedded in the wages or prices paid by government purchasers and pretax prices should decline. In fact, this effect should apply regardless of whether the purchaser is in the private or the public sector. On this basis, the estimated breakeven tax rate for the broad base alternative in the September 20 presentation assumed that the price effect of eliminating embedded taxes from government purchases would be to roughly offset the gross consumption taxes paid on those purchases; however, it is not clear that such pretax wages and prices would necessarily fall immediately or even quickly.

For instance, many workers have annual contracts that stipulate their salary level and it is highly unlikely that these would be automatically renegotiated to account for changes in the gross cost of labor. In addition, the increased cost of consumption from the additional sales tax associated with a broader base (or higher rate) will lead to concerns about price levels. If the sales tax is not adequately netted out of the production chain, there is additional potential of price cascading. For these reasons, an additional breakeven broad consumption tax rate has been estimated that assumes no reduction in pretax prices of goods and services, or labor. That is, it is assumed for this estimate that pretax prices are unchanged, so government spending would increase by exactly the amount of tax paid on government purchases. Adjusting for this is mathematically equivalent to removing government spending from the tax base and results in a breakeven consumption tax rate of 7.61 percent, compared to 6.42 percent under the original assumption. Further study of this question is needed and though the original assumption should hold in the long term, it may be prudent in drafting any potential proposal for Georgia to consider an initial tax rate that is conservative (7.61 percent) so that state revenues would be held harmless at a minimum. The rate could potentially be adjusted downward if revenues remained at acceptable levels.

Limiting itemized deductions to lower income tax rates.
To estimate the effect of limiting itemized deductions to only charitable contributions and mortgage interest, with the latter capped at $20,000 per year, it is necessary to rely on IRS Statistics of Income program summary data rather than microsimulations using actual return data. Though simulations with return data would be preferable, Georgia income tax data made available by the Department of Revenue do not include a breakdown of the components of itemized deductions, providing instead only the level of total itemized deductions for each return; however, comparing 2011 IRS figures for total itemized deductions by income group for Georgia residents to the Georgia returns data, the numbers of returns itemizing and the total deductions by income group and overall are similar, so the effect of this hypothetical tax change can be approximated roughly.

The IRS figures for total itemized deductions, and the mortgage interest and charitable contribution claims for tax year 2011, by income group, are provided in table 2 below.

Table 2: Select Itemized Deduction Data for Georgia (2011)
*Source: IRS Statistics of Income TaxStats.

SOI Group	FAGI	Total fed. itemized deductions: # Rtrns	Sum (,000)	Mean	Mortgage interest: # Rtrns	Sum (,000)	Mean	Charitable contributions: # Rtrns	Sum (,000)	Mean
1	<$1	-	-	-	-	-	-	-	-	-
2	<$25,000	214,673	2,396,454	11,163	97,373	689,401	7,080	123,350	253,380	2,054
3	<$50,000	353,029	5,434,437	15,394	245,381	1,665,572	6,788	275,031	826,755	3,006
4	<$75,000	313,761	5,666,292	18,059	255,767	1,935,931	7,569	264,109	923,971	3,498
5	<$100,000	236,340	5,672,152	24,000	204,556	1,745,418	8,533	207,072	819,312	3,957
6	<$200,000	351,233	9,402,788	26,771	307,394	3,252,264	10,580	321,610	1,651,630	5,136
7	<$500,000	96,512	4,584,649	47,503	80,910	1,323,761	16,361	91,209	864,661	9,480
8	<$1,000,000	14,711	1,468,106	99,796	11,440	273,070	23,870	14,159	367,073	25,925
9	>=$1,000,000	6,318	2,199,597	348,148	4,193	112,924	26,932	6,123	868,880	141,904
All		1,586,577	36,824,475	23,210	1,207,014	10,998,342	9,112	1,302,663	6,575,664	5,048

Source: IRS Statistics of Income *TaxStats*.

An important qualification to using these data is that, because the IRS provides only the numbers of returns claiming mortgage interest deductions and the total of those deductions, it is not possible to determine precisely how much of such deductions would be disallowed due to the hypothetical $20,000 cap; however, based on the mean mortgage interest deductions, we can see that the top two income groups exceed the cap, on average, by $3,870 and $6,932. These amounts, multiplied by the number of filers claiming this deduction in those income groups, provide a minimum estimate of the amount of disallowed mortgage interest—about $73.3 million for tax year 2011.

Assuming the remainder of mortgage interest would qualify for deduction under this hypothetical, along with all of the charitable contributions claimed, the total disallowed itemized deductions would be about $19 billion, distributed across the income groups as shown in Table 3.

Applying the average effective tax rates for all itemizers in each group, estimated from the actual returns data and shown in the table as well, we can estimate the additional revenue generated by the hypothetical change, before any reduction in tax rates, at about $884 million. The tax change is also calculated at lower, hypothetical top tax rates of 4.5 percent and 3.0 percent (or the groups AETR, if lower) for comparison.[21] These alternative assumptions suggest the revenue impact is between $550 and $884 million. If we had access to the IRS data on itemized deductions, we could be more precise in these estimates.

[21] One note of caution about itemized deduction limitations of these sorts is that some taxpayers may find it more advantageous to take the standard deduction instead, causing the revenue gains to be smaller. However, it is assumed that the choice to itemize is dominated by federal tax considerations and that few taxpayers, if any, would gain enough savings on their Georgia taxes from a switch to the standard deduction to offset the cost of such a switch on their federal return.

Table 3: Estimate Disallowed Deductions and Tax Change

SOI Group	FAGI	Disallowed deductions*	# filers affected	AETR	Tax chg.* @AETR	Tax chg.* @ AETR or 4.50%	3.00%
1	<$1	-	-	-	-	-	-
2	<$25,000	1,453,673	214,673	0.956%	13,897	13,897	13,897
3	<$50,000	2,942,110	353,029	3.521%	103,592	132,395	88,263
4	<$75,000	2,806,390	313,761	4.550%	127,691	126,288	84,192
5	<$100,000	3,107,422	236,340	4.992%	155,123	139,834	93,223
6	<$200,000	4,498,894	351,233	5.391%	242,535	202,450	134,967
7	<$500,000	2,396,227	96,512	5.593%	134,021	107,830	71,887
8	<$1,000,000	872,233	14,711	5.335%	46,534	39,250	26,167
9	>=$1,000,000	1,246,857	6,318	4.843%	60,385	56,109	37,406
All		$19,323,803	########		$883,777	$818,053	$550,001

* Dollar amounts in thousands.

The estimated tax liability effects of limited itemized deductions can then be compared to simulated effects of reductions in top tax rates to the same levels, 4.5 and 3.0 percent, with no other changes, to get a rough estimate of the overall net tax change. For a reduction in the two top marginal rates to 4.5 percent (from 6 percent and 5 percent), leaving other brackets unchanged, the total change in tax liability for all filers would be a reduction of more than $1.7 billion.[22] Similarly, a reduction in the three top rates to 3 percent with the lower three brackets unchanged would reduce overall tax liabilities by more than $3.5 billion. A similar analysis with a top marginal rate of 5 percent would result in about a $300 million gap between the revenue loss from the rate cut and the gain from the itemized deduction limits. Clearly, the hypothetical limitations on itemized deductions would not come close to offsetting the revenue loss from rate cuts of these magnitudes. Though, again, these are rough estimates because of data limitations, it is likely that the largest rate cut that could be offset by these hypothetical itemized deduction limitations would be about three-fourths percent off of the top rate--bringing it to 5.25 percent.

Mr. Wesley Tharpe with the Georgia Budget and Policy Institute appeared before the committee.[23]

Mr. Tharpe started by warning that shifting from a balanced tax system that includes income taxes to one that relies wholly or mostly on sales taxes would not be in the best interests of Georgia. Tharpe explained that there are two overarching reasons Georgia should avoid proposals that seek to swap the state's income taxes for an expanded sales tax:

- One, the supposed economic benefits that some contend would result from deep income tax cuts are highly unlikely to materialize; and
- Two, enacting such sweeping tax changes would have a number of unintended consequences, such as pushing the cost of government down the income ladder onto families that are less able to pay.

[22] Simulation using all filer records produces a reduction of $1.7 billion, but because we cannot confirm that all 2011 returns are included in the file, the actual reduction could be somewhat larger.

[23] Mr. Tharpe is the tax and economic policy analyst for the Georgia Budget and Policy Institute. Visit: http://gbpi.org/

Tharpe referred to the "economic boon myth" – the contention that slashing income taxes is a proven recipe for boosting a state's economy. The reality is that despite their popularity and intuitive appeal, such claims are not supported by the vast majority of academic research or by the experience of other states. The assertion that economic evidence overwhelming supports the no-income-tax model rests on only a small handful of flawed studies whose findings have been somewhat cherry picked.

Tharpe then provided examples: Some have said that the nine states without income taxes had much stronger economies over the past decade than income-taxing states.[24] This claim overly relies on only a couple of measures that make no-income-tax states look superior, while ignoring a wide variety of other economic indicators where income-tax states perform just as well, if not better, than their no-income-tax peers. Income taxing states over the past decade had on average slightly stronger economic growth per person, smaller declines in household income, and the same average unemployment rate as states without income taxes. The comparison holds true even if you look only at the nine highest income tax states, which as of 2012, also have better wages, fewer residents without health insurance, and more Fortune 500 companies on average than the nine no-income-tax states.

These findings are consistent with the consensus of mainstream economics that lower state and local taxes are not reliably linked to stronger state economies. A recent comprehensive review of this question by the Center on Budget and Policy Priorities in Washington, D.C., determined that of 25 relevant academic studies and peer-reviewed articles published since 2000, only four found that state tax cuts consistently boost the economy. The other 21 found the impact of state and local taxes on economic growth to be either negligible, nonexistent or, in some cases, inconsistent – for example, where a particular tax might have an impact over one time span but not another, or where one tax might appear to matter in one state but matter not in another. These findings are also consistent with the common sense reality that competitive tax levels are only one piece of the puzzle for state success. A state has a strong economy that creates jobs when its total package of attributes makes it an attractive place to start a business or raise a family. That means world-class schools and universities to educate workers and entrepreneurs; well-maintained roads and ports for businesses to get their goods to market; and high-quality communities with parks, libraries and other amenities. Sufficient tax revenue helps achieve these other attributes.

Tharpe then explained that three of the nine states – Alaska, Texas and Wyoming – enjoy enormous economic and revenue benefits from their abundant supplies of natural resources; about 80 percent of state revenue in Alaska, for example, comes from levies on oil and gas. Two of the nine – Florida and Nevada – have unique tourism markets that are heavily taxed to help replace their lack of income tax revenue. The other four – New Hampshire, South Dakota, Tennessee and Washington – are like Georgia, in that they lack these resources. They get by through heavy use of sales and property taxes and, in the case of Tennessee, by drastically underinvesting in key state priorities such as education and roads.

Tharpe suggested that put another way, even if the economic boon myth was true, Georgia cannot drill Texas' oil, can't borrow Florida's beaches, and does not want to be Tennessee. The Lone Star state today ranks 49th in high school graduation, 10th highest on the share of its residents in poverty, dead last in the share of its residents with health insurance, and tied

[24] As previously discussed: Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington and Wyoming.

for last with Mississippi for the percentage of its workers making at or below minimum wage. The second major problem with a drastic shift from income to sales taxes is that such a move would have a number of specific drawbacks, which are well-documented from the experience of other states.

Tharpe then stated that most noteworthy is that a major tax swap would shift the cost government down the income ladder onto those least able to pay – lower and middle income families. In GBPI's recent report, it made some estimates of how extreme that shift might be, depending on how details of a final plan are filled in. It was determined that any plan capable of being revenue neutral would likely raise taxes on a majority of Georgia households, while giving those at the very top of the income scale a significant tax break.

What is important to understand, Tharpe stressed, is that the technicalities of how state taxes work make crafting such a plan extremely hard. That is why other states exploring a tax swap have not been able to crack the code of how not to raise taxes on most families. Recently passed legislation in North Carolina, for instance, is scheduled to raise taxes on an estimated 80 percent of North Carolinians, or most households making less than $84,000 per year. In all, the top 5 percent of North Carolina taxpayers will receive 90 percent of the benefit from that final plan.

Tharpe asserted that North Carolina is not alone. A failed plan pushed by Gov. Bobby Jindal in Louisiana would have spiked taxes, on average, for 60 percent of that state's taxpayers, while also increasing the annual tax bill for Louisiana businesses by $500 million due to new taxes proposed on business to business services. Several states in the Midwest and Great Plains have flirted with the idea as well, such as Nebraska, where a proposal from that state's governor would have increased taxes by more than $700 a year for those making from $37-$60K a year, while dropping them by nearly $5,000 for taxpayers earning more than $91K a year.

Georgians making less than $15,000 per year pay less than 1 percent of their annual earnings in personal income taxes, but an estimated 7 percent of annual income in sales taxes. Georgians making from $162,000-$393,000, meanwhile, pay an estimated 4 percent of their yearly earnings in income taxes, but less than 2 percent in sales taxes. This means if you shift even further toward sales taxes, many Georgia families would see only meager gains from income tax cuts, which for many would be cancelled out by drastically higher sales taxes.

Tharpe explained that this discussion did not turn on actual legislation, but rather general theory.

Chairman Hill inquired about the three scenarios presented, and pointed out that the first shows an extreme deficit. Tharpe replied that there are various options with various inclusions, but a deficit would evolve to a point where a possible 14 percent sale tax rate would be politically unachievable; moreover, general theories would attempt to find a way to pay for an income tax reduction, but it is important to note that these scenarios do not contemplate so-called prebates as contained in the federal legislation. Chairman Hill then asked about the North Carolina analysis from the Georgia Budget and Policy Institute; Tharpe answered that the Institute for Tax and Economic Policy in Washington, D.C. is in step with the Congressional Budget Office, and this is where the North Carolina figures originated.[25] Chairman Hill then inquired as to what suggestions there are for improving Georgia's competitiveness and ultimately the Gross Domestic Product for the state; Tharpe answered that policymakers should look to an overall package of what is offered to all groups and how Georgia can compete globally rather than just looking at other southern states; moreover, Georgia needs to enact more than only tax reform. The state needs to address education, transportation, and infrastructure needs. Tharpe said he would suggest raising more revenue per capita; Georgia is currently ranked 49th nationally.[26]

Chairman Hill asked whether it would require tax increases in order for Georgia to reach a 40th national ranking; Tharpe responded that the Tax Reform Council was very close to the best package including the widest mixed bag of proposals. For example, no one was completely satisfied with their recommendations on broad proposals, but it did contain a tax cut on 40 percent of all Georgians.

Senator Balfour suggested the $1 billion revenue increase under the Georgia Budget and Policy Institute scenarios under an $18 billion state revenue budget was difficult to contemplate. Tharpe offered that House Bill 688 was introduced late in the 2013 legislation sessions so it has not been properly analyzed. Senator Balfour stressed that it could be fair to assume that an effective tax reform plan would mimic what passed the Georgia House passed in 2011 (House Bill 388).[27] Senator Balfour further stated that 50 percent tax increases are unacceptable, but the 5-10 percent variable increase under that legislation that maybe included a 9-10 percent sales tax rate is easier to digest, and questioned what real tax reform would visualize. Tharpe replied that a modern tax system would be fair across the board. Senator Balfour then discussed the recent Transportation Special Option Sales Tax (TSPLOST) vote failure in most of the state's regions, and that the population may not have an appetite for tax increases;[28] moreover, the motor vehicle tax is very static and difficult to alter. Tharpe responded that some taxes should be tied to inflation to grow with the economy.

Senator Gooch asked about transportation in general; Tharpe responded that Georgia seems to be competitive overall on how the state collects revenue.

The discussion then turned on the importance of a skilled workforce and strong schools.

Chairman Hill then asked how the highest income tax states out-perform low income tax states; Tharpe replied that there is a distortion on economic strength based upon states and cities. He noted that recent economic recovery and strength among cities include Houston and Dallas in no-income tax state Texas--plus San Francisco and Boston in high-income tax states of California and Massachusetts.

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[25] Visit: http://www.itep.org/

[26] Some reports have Georgia at 50th nationally: http://www.taxadmin.org/fta/rate/11taxbur.html and 49th: http://www.taxpolicycenter.org/taxfacts/Content/PDF/state_local_pc.pdf.

[27] See: http://www.legis.ga.gov/Legislation/en-US/display/20112012/HB/388

[28] TSPLOST would have allowed various regions across Georgia to levy a penny sales tax for infrastructure and transportation improvements. The Transportation Investment Act (TIA) allowed each of the state's 13 specially designed regions to decide whether to implement an additional penny sales tax for transportation, which was commonly referred to as T-SPLOST. Only three regions voted in favor: the Heart of Georgia, which is south of Macon, the River Valley, which includes Columbus, and the Central Savannah River Area, which includes Augusta.

3. **Wednesday, October 10, 2013**

"The hardest thing to understand in the world is the income tax." –Albert Einstein

John Nothdurft of the Heartland Institute appeared before the final hearing by the FT Study Committee.[29] He commenced by stating that there needs to be a true commitment to enact real tax reform. Georgia can look to several states for leadership on this issue: Louisiana, Nebraska, Kansas, Michigan, Oklahoma, and North Carolina are enacting or considering substantive tax reform.

Mr. Nothdurft explained that North Carolina recently passed legislation which lowers and flattens its income tax while limiting and capping exemptions so as to not undermine the reform itself. Nothdurft then pointed to the Tax Foundation 2014 Business Climate Index;[30] it ranks Georgia as 32nd nationally. The Index enables business leaders, government policymakers, and taxpayers to gauge how their states' tax systems compare.

The 10 best states in this year's Index are:

1. Wyoming
2. South Dakota
3. Nevada
4. Alaska
5. Florida
6. Washington
7. Montana
8. New Hampshire
9. Utah
10. Indiana

Nothdurft cited to the Index, noting that the absence of a major tax is a dominant factor in vaulting many of these ten states to the top of the rankings. Property taxes and unemployment insurance taxes are levied in every state, but there are several states that do without one or more of the major taxes: the corporate tax, the individual income tax, or the sales tax. Wyoming, Nevada, and South Dakota have no corporate or individual income tax; Alaska has no individual income or state-level sales tax; Florida has no individual income tax; and New Hampshire and Montana have no sales tax; however, it is important to point out that this does not mean that a state cannot rank in the top ten while still levying all the major taxes. Indiana, which ousted Texas from the top ten this year, and Utah have all the major tax types, but levy them with low rates on broad bases.

Further, Nothdurft explained that sound tax policy should generate jobs and encourage economic growth; however, burdensome income taxes destroy productivity and risk-taking by entrepreneurs. Generally, he opined that taxes on capital are more damaging than taxes on consumption. Nothdurft pointed to the Georgia Senate's efforts to pass Tax Expenditure Limitations during the past few legislation sessions (2011).[31] He explained that these

[29] Mr. Nothdurft is Director of Government Relations for the Heartland Institute. Visit: http://heartland.org/

[30] See: http://taxfoundation.org/article/2014-state-business-tax-climate-index

[31] See: http://www.legis.ga.gov/legislation/en-US/display/32067. Senate Resolution 20 would have restricted the state from spending any money in excess of the previous year budget adjusted for inflation and population. Any additional revenue beyond the spending limitations would be required to go into the

constitutional constrictions limit corporate welfare by capping spending growth and maintaining lower income tax rates. Nothdurft opined that it would take ten years to potentially eliminate income taxes naturally via savings through spending cuts. He further cited to Ten Principals of State Fiscal Policy published by the Heartland Institute.[32] The list shows:

1. Above all else: Keep taxes low;
2. Do not penalize earnings and investment;
3. Avoid "sin" taxes;
4. Create a transparent and accountable budget;
5. Privatize public services;
6. Avoid corporate welfare;
7. Cap taxes and expenditures;
8. Fund students, not schools;
9. Reform Medicaid programs; and
10. Protect state employees from politics.

Nothdurft stated that Georgia is well-positioned to effectively reduce its income tax with a sustainable path to actually eliminate it and complete globally for growth and entrepreneurship.

Chairman Hill asked how best to address spending limitations with growing education needs and adjustments. Nothdurft replied that the tax reform is strong policy only if spending is controlled. The state could allow for instances where exceeding the capped spending limits are allowed by a necessary vote.

Mr. Jonathan Williams of the American Legislative Exchange Council (ALEC) presented testimony to the committee.[33] Mr. Williams cited to an ALEC publication, "Rich States, Poor States" which shows Georgia is ranked 31st in economic performance.[34] It additionally compares the economic performance of the aforementioned nine states without an individual income tax versus the nine states with the highest individual income taxes over the past decade . Williams noted that the population in states with no income tax has grown 149 percent faster than their high tax counterparts; however, states with high income tax rates have lost jobs while no income tax states have seen a 5.4 percent growth in jobs. Further, even state revenue has grown 82 percent faster in no income tax states versus their high tax counterparts. Williams conceded that there are other factors, too: right-to-work status, regulatory environment, and makeup of state economies clearly affects these statistics; but these general trends have been reflected decade after decade for the past 50 years.

Mr. Williams asserted that the goal of American tax policy should be to raise revenue for functions of government in a way that minimizes distortions, so as to grow the overall

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Rainy Day fund until it reaches a point of 15% of the previous year spending. Once the rainy day fund is at 15%, additional revenue would be used to slowly phase-out the state income tax. There was a 2006 Senate Study Committee on this topic; the report from that committee: http://www.senate.ga.gov/sro/Documents/StudyCommRpts/06LimitedTaxationRpt.pdf

[32] See: http://heartland.org/sites/all/modules/custom/heartland_migration/files/pdfs/19354.pdf

[33] Mr. Williams is the Director of the Tax and Fiscal Policy Task Force at the American Legislative Exchange Council. Visit: http://www.alec.org/

[34] See: http://www.alec.org/wp-content/uploads/GA.pdf

economy and facilitate commerce. The fundamental principles presented here provide guidance for a neutral and effective tax system; one that raises needed revenue for core functions of government, while minimizing the burden on citizens.

- *Simplicity:* The tax code should be easy for the average citizen to understand, and it should minimize the cost of complying with the tax laws. Tax complexity adds cost to the taxpayer, but does not increase public revenue. For governments, the tax system should be easy to administer, and should help promote efficient, low-cost administration.
- *Transparent:* Tax systems should be accountable to citizens. Taxes and tax policy should be visible and not hidden from taxpayers. Changes in tax policy should be highly publicized and open to public debate.
- *Economic Neutrality:* The purpose of the tax system is to raise needed revenue for core functions of government, not control the lives of citizens or micromanage the economy. The tax system should exert minimal impact on the spending and decisions of individuals and businesses. An effective tax system should be broad-based, utilize a low overall tax rate with few loopholes, and avoid multiple layers of taxation through tax pyramiding.
- *Equity and Fairness:* The government should not use the tax system to pick winners and losers in society, or unfairly shift the tax burden onto one class of citizens. The tax system should not be used to punish success or to "soak the rich," engage in discriminatory or duplicative taxation, nor should it be used to bestow special favors on any particular group of taxpayers.
- *Complementary:* The tax code should help maintain a healthy relationship between the state and local governments. The state should always be mindful of how its tax decisions affect local governments so that they are not working against each other – with the taxpayer caught in the middle.
- *Competitiveness:* A low tax burden can be a tool for a state's private sector economic development by retaining and attracting productive business activity. A high-quality revenue system will be responsive to competition from other states. Effective competitiveness is best achieved through economically neutral tax policies.
- *Reliability:* A high-quality tax system should be stable, providing certainty in taxation and in revenue flows. It should provide certainty of financial planning for individuals and businesses.

Williams stated that since taxes lower the economic welfare of citizens, policymakers should try to minimize the economic and social problems that taxation imposes. Citizens then directly gain the benefits of a low tax burden. These benefits are summarized below:

1. Greater economic growth allows citizens to keep more of what they earn while spurring increased work, saving, and investment. A low-state tax burden would mean a competitive advantage over states with high-rate, overly progressive tax systems.

2. Greater wealth creation significantly boosts the value of all income-producing assets and help citizens maximize their fullest economic potential, thereby broadening the tax base.

3. Minimize micromanagement and political favoritism which creates a complex, high-rate tax system that favors interests who are able to exert influence in the

> State Capitol, and who can negotiate narrow exemptions and tax benefits that help only limited taxpayers and not the general economy. "A fair field and no favors" is a good motto for a strong tax system.

He stated that 43 million Americans are moving to new states which generally offer lower overall state tax burdens; these relocations represent a $2 trillion transfer of wealth from some states to other states. It is important to remember that states do compete with each other for human and economic capital; moreover, North Carolina is aggressively seeking to secure its position with over $600 million in tax cuts. These cuts result from a new flat individual income tax rate of 5.75 percent by 2015 and a lower corporate income tax rate of 3 percent if certain income triggers are satisfied. Conversely, California asked voters to approve a higher 13 percent state income tax rate in 2012, and it was approved.[35] Proposition 30 also raised the state sales tax rate to 7.5 percent. It was suggested that a 1 percent increase in tax rates decreases GDP by 2.5 percent. He also discussed the State of Washington which enjoys no income tax liability; about 65 percent of voters recently rejected a new state income tax in that liberal-leaning state.[36]

Williams further noted that North Carolina cut income taxes without increasing sales tax rates; moreover, Oklahoma has shown a strong record of lowering income tax rates incrementally over the past decade through bipartisan efforts. Consider, under the leadership of Governor Pete DuPont during the 1980s, Delaware lowered its income tax rate from 18 percent down to 10 percent while reforming and deregulating its corporate laws which made Delaware the proverbial home to the nation's largest corporations and banks.

Williams urged the FT Study Committee to set reasonable expectations with no more than three to five years of adjustment; he opined that too much time would allow for reversal of policy. Further, he noted that state and local governments grew 90 percent faster than the private sector since the 1990s, and there needs to be institutional controls to limit excessive growth and spending by governments. He expects South Carolina to act soon to mirror what North Carolina has done to reform its tax policy; however, Nebraska is also a likely candidate to enact substantial tax reform, and Texas may eliminate most, if not all, of its business taxes.

Nationally, Williams stated, 25 to 30 states are exploring whether to lower their tax rates, but 15 to 20 states are looking to raise taxes. He pointed to Illinois' recent actions to rate their state income tax by 50 percent, but Chicago is experiencing a hemorrhage of population, losing over 1 million residents since 2003. Additionally, Williams opined that progressive income tax rates generally do not work with the states because of open state borders which provide for easy transfers of capital and wealth.

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[35] See: http://www.forbes.com/sites/ashleaebeling/2012/11/08/california-voters-sock-it-to-the-rich-and-the-fate-of-other-state-tax-ballot-measures/

[36] See: http://blogs.wsj.com/wealth/2010/11/03/why-washingtons-tax-on-the-rich-failed/ and http://www.reuters.com/article/2010/11/03/us-usa-elections-washingtontax-idUSTRE6A21CJ20101103

IV. CONCLUSION AND RECOMMENDATIONS

The FT Study Committee found the hearings, testimony, and presentations to be informative and helpful; the committee is very thankful for all who participated and contributed to this important policy-making process. The FT Study Committee finds that tax reform should be an ongoing process, and this process in Georgia should not have concluded with the enactment of House Bill 386; moreover, it should serve as a catalyst for continued reform of substantive changes to state tax policy.

Specifically, the FT Study Committee recommends the following actions be enacted through legislation:

- Phase down of the state corporate and personal income tax from 6 percent to 5 percent or lower. This should be done in conjunction with the elimination and capping of specific credits and deductions taken against state income tax.
- Maintain the state sales and use tax at 4 percent with the elimination of targeted exemptions.
- Review all existing credits, deductions, and exemptions available under Georgia law to ascertain their need and usefulness for the public at large and further discuss how these credits, deductions, and exemptions stymie the ability to bring down respective income and sales tax rates which apply to all Georgia residents.
- Enact a Supermajority Requirement of the Georgia General Assembly in order to raise tax rates from where they currently are set by policy.

The FT Study Committee asserts that consumption-based taxes will prove to be more stable over time. Income taxes are too reactionary to national and global economic recessions, and such fluctuation undermines the ability for states to rely upon consistent revenue streams. There is no evidence that shows the lack of income tax as a primary source of state revenue as a reason for instability or maintenance of the highest credit ratings by the applicable reporting agencies.

Georgia stands at a great position to lead the south and the nation in economic development and tax code reforms to make it competitive for both business and human capital. Embracing the status quo at this time would be a failure to act, and this would be a disservice to the taxpayers of Georgia and to the future of this state's economic competitiveness and stability.

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Information discussed and used herein has been provided in part by the Fiscal Research Center at the Andrew Young School of Policy Studies, GBPI, Georgia Department of Revenue, GPPF, NCSL, ALEC, Heartland Institute, and the Tax Foundation.