



Making Good Tax Policy

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Keeping Taxes Up to Date

- TRAC made a good start on updating our tax system
- Many states have tax commissions that regularly review various aspects of the tax system and proposed policy changes
- SC has had lots of studies and committees and tax law changes but has not done tax REOFRM

What's the difference between tax changes and tax reform?

- Tax changes are piecemeal responses to specific situations or interest groups
- Reform means cleaning house, the accumulated exemptions, deductions, exclusions, etc. that clutter our tax system and tweaking it to reflect changes in the economy
- Reform also means keeping an eye on what other states, especially our neighbors, are doing and deciding how to respond

Annualization is still with us!

- Without a tax commission or other form of systemic review, we suffer from tax annualization
- What is annualization? Making a commitment in one budget that is carried over and grows in future budgets
- General Assembly has brought spending annualizations under control in the last decade
- No provision for reviewing tax annualizations
- Can address problem with sunset laws or rolling reviews

What qualities do we want in a tax system?

- Efficiency
- Equity
- Adequacy

Efficiency

- Tennessee and the sales tax
- Chicago and the property tax
- Act 388 and property conversions
- Local merchants and the sales/use tax on internet sales

What is efficiency?

- Efficiency effects are a result of a tax change that either reduces revenue or discourages economic activity or both
- Income taxes can influence location of households and firms
- Sales taxes can affect where people shop and where businesses locate
- The higher the tax rate, the greater the decision-changing effect of the tax

What is efficiency (contd)

- Efficiency also means keeping an eye on the competition and what they are doing in rates, sales tax base, business incentives, etc.
- Finally, efficiency also means keeping taxes simple so we don't waste a lot of resources on the cost of tax compliance and collection

Efficiency and location incentives

- It's a competitive game to attract and retain job-creating firms
- Offering location incentives is a poker game that can result in a winner's curse
- States are disadvantaged in having to be transparent
- Good work on amazon in getting a better deal!
- Taxes are pretty far down the list of location factors
- Need to make sure that what we get (jobs, investment) is worth what we give away
- Accountability—did they keep their promises?

Equity

- Is it fair that an elderly household in SC pays 80% less tax than a younger household?
- Is it fair to pay the same sales tax on a 10 year old car as you pay for a brand new BMW?
- Is it fair to tax dog food but not dog grooming?
- Is it fair to tax rental property at a rate that is more than twice as high as owner-occupied?

What is equity?

- Equity means a fair distribution of the responsibility to pay taxes. Fairness is a basic American value.
- Rich/poor is one dimension of fairness (regressive and progressive taxes), but so are differences in age groups, business v. households, kinds of firms, etc.
- Perceived fairness makes people more willing to pay their fair share, so less money had to go into collecting taxes.

Adequacy

- Layoffs of state employees is the largest source of job losses in 2011.
- States are shortening school years and cutting programs to reduce costs.
- Infrastructure maintenance (roads, state buildings) is a casualty of inadequate funds.

What is adequacy?

- Enough revenue to fund basic public services
- Too much revenue means wasteful spending. Too little revenue means that households and businesses do not have important services that make firms more productive and improve quality of life for residents.
- Quality of public services is an important factor in attracting and retaining retirees and business firms.

Benchmarking adequacy

- Between 1997 and 2009, states collected taxes amounting to 9.4% to 10.2% of personal income; in 2009, they collected 9.8%
- SC collected 8.1% and ranked 43rd
- GA 9.1%, 32nd; NC 9.8%, 16th
- Per capita taxes (resources to fund public services)—SC ranked dead last at \$1,845

Some General Tax Rules

- Broad base, low rate is better than narrow base, high rate (efficiency, equity)
- Multiple bases creates a more stable and equitable revenue system than fewer bases (adequacy, equity)
- We should look at the equity of the revenue system as a whole, not the particular tax (equity)
- Tax preferences/tax expenditures need to be reviewed as regularly as expenditures (efficiency, adequacy, equity)
- Earmarking reduces budget flexibility in hard times (adequacy)

Window of Opportunity #1: Internet Sales

- Work with the Multistate Tax Commission and the SC Congressional delegation to persuade Congress to lift restrictions on requiring internet sellers to collect state sales/use taxes
- Efficiency—ban encourages shopping on line rather than with out Main St/Mall retailers
- Equity—higher income people are better able to shop on line, avoid tax
- Equity—favors out of state over in-state sellers
- Adequacy—a large and growing loss of sales tax revenue: Congress could replace lost federal aid to states without making any more expenditures

Window of Opportunity #2: Broader Coverage of Services

- Recommended by TRAC, being considered by many other states
- SC taxes only 36 out of a possible 160+ services taxed in other states
- Services are the growth sector of the economy, so taxing services would adapt to changes in the economy

Sales Tax on Services: Efficiency and Equity

- Efficiency—can collect more revenue at a lower rate; stop distorting choice between spending on goods and spending on services
- Equity—low income households groom their own pets, paint their own nails, mow their own lawns, cut their own hair; taxing services makes sales tax less regressive

Sales Tax on Services: Adequacy

- States that tax many services raise as much as 35% more revenue after controlling for tax rate, population and income
- More revenue from the 6th penny (Act 388) would take pressure off the General Fund to make up revenue shortfalls in the Property Tax Relief Fund

Window of Opportunity #3: Local Sales Tax

Sixteen counties do not have a 1% local sales tax. Extending the sales tax to those sixteen would

- Make it easier for internet/catalog vendors to comply with SC sales tax
- Help counties make up lost revenue from cuts in state aid to subdivisions with no corresponding cuts in county responsibilities (adequacy)
- Stabilize city and county revenue during downturns (adequacy)
- Ensure similar property tax relief from local sales tax regardless of county (equity)

Window of Opportunity #4: Index Excise Taxes for Inflation

- Many excise taxes are so many cents per gallon, case, pack, etc. The value of the tax declines each year with inflation (e.g., the 16 cent gasoline tax would be 32 cents if adjusted for inflation). Indexing would make sure that the value of the revenue remains constant.
- If these taxes were efficient, equitable and adequate when the rates were established, indexing will restore them to that state.

Window of Opportunity #5

Admissions/Amusement Tax

- These taxes were at the same rate as the sales tax before Act 388 but were not adjusted when the sales tax rate went to 6%.
- These services are consumed more by higher income households and would make the tax system less regressive (equity); raise more revenue (adequacy); and would not influence people to choose recreation over other kinds of spending because of a lower tax rate (efficiency).

Window of Opportunity #6: Sunset Provisions

Existing credits (53) on the income tax and many exemptions on the sales tax could be sunsetted (scheduled to expire unless renewed) at some defined future date, forcing re-consideration.

Window of Opportunity #7: Restore Inheritance Tax

Now that the federal estate tax is back with a generous threshold exemption, SC could again take advantage of the credit for state against federal taxes as a source of revenue with little cost to the heirs.

If not now, when?

It's never a good time for tax reform. And it's always a good time for tax reform. SC needs and deserves a tax system that is fair, adequate, and efficient, and that changes with changes in the economy and the population. Each of these seven opportunities we have offered would move the state in that direction.

Contact Us!

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