

April 2007, Number 151

## A DESCRIPTION OF THE PROPOSED COMPREHENSIVE REVISION OF GEORGIA'S TAX STRUCTURE: HR 900

### Introduction

At the 2007 session of the Georgia Legislature, Speaker Richardson and others filed House Resolution 900, a proposal for a comprehensive revision of Georgia's state and local tax structure. The legislation was introduced with the expectation that it would be studied and possibly refined before the 2008 session of the General Assembly. This Policy Brief provides a description of the changes that HR 900 would bring about. This is the first of several Policy Briefs that the Fiscal Research Center plans to prepare regarding HR 900.

HR 900 calls for a change in the current personal income tax and for the adoption of a value added tax. It would eliminate nearly all other state and local taxes. Much of the legislation changes existing language to accommodate the change in tax structure.

HR 900 is a proposed Constitutional amendment. To be enacted, the legislation requires approval by 2/3rds of the Georgia House of Representatives and of the Georgia Senate, and by a majority of Georgia voters. The Governor would have no legal say regarding the matter. If the proposed Constitutional amendment is adopted, its provisions will bind the General Assembly. As currently proposed, if it is approved by the General

Assembly, the amendment would go to the voters in November 2008, and if approved by the votes, it would become effective January 1, 2009.

### Elimination of Taxes

If HR 900 is adopted, then on January 1, 2009, nearly all state taxes, except the income tax, would be abolished and could not be re-imposed by the General Assembly. To re-impose any of the taxes would require another Constitutional amendment. A new value added tax would be established. In addition, nearly all taxes imposed by local governments would be abolished. Local governments include counties, municipalities, school systems, and special districts.

The following taxes would be eliminated:

- *All property taxes.* This would include property taxes imposed on real property (for example, land and buildings) and on personal property such as inventories and motor vehicles. This would also include the tax imposed on timber when it is harvested. No property taxes could be levied by any governmental body. Since there would be no property tax, HR 900 also eliminates the offices of tax collector and the need for a tax assessor.
- *All sales and use taxes.* This would include the state 4 percent sales tax, local option sales taxes (LOST), special purpose local option sales taxes

(SPLOST), the education special purpose local option sales taxes (EDSPLOST), the homestead exemption sales tax (HOST), the sales tax the City of Atlanta levies to help finance its upgrade of its water and sewer system, the MARTA sales tax, the special sales tax that is imposed in Towns County, and the sales tax imposed in 8 counties and used by 10 school systems for school operations.

- *All state motor fuel taxes.* This would include state fuel taxes currently levied on gasoline, diesel fuel, jet fuel, bio fuels, etc.
- *All unemployment and workers' compensation taxes.* Currently, unemployment insurance, i.e., the payments to workers who are laid off, and worker compensation, i.e., the payments to workers who are injured on the job, are financed by a tax on wages.
- *All gross receipts taxes.* Any tax that is imposed on businesses that uses the gross receipts of the firm as the basis of the tax would be eliminated.
- *All insurance premium taxes.* Currently, insurance companies are taxed based on gross direct premiums. Both the state and local government (counties and some municipalities) impose this tax.
- *The estate tax.* Georgia taxes the value of estates upon the death of the owner. The estate tax is tied to a federal credit that has been phased out so currently Georgia collects no estate tax.
- *All specific, business, and occupation taxes.* Counties and municipalities impose taxes on individuals who practice certain occupations, such as attorneys, architects, and physicians. Counties and municipalities impose excise taxes on the rental of accommodations provided by hotels, motels, lodges, etc., and on the rental of motor vehicles. The state imposes a corporate net worth tax, under which the smallest corporation pays \$10 per year and the largest pays \$5,000 per year.
- *All intangible taxes or other documentation and stock transfer taxes.* The state imposes a tax on the recording of mortgages and on the transfer of real estate property. The revenue from these taxes is split between all of the jurisdictions in which the property is located.
- *All utility taxes.* County and municipal governments impose special taxes on firms that provide telephone services, electricity, natural gas, and cable.

There are several products on which the state and local governments impose excise taxes. These include state taxes on tobacco products and state and local taxes on alcoholic beverages, including wine and beer. HR 900 does not eliminate these taxes.

### **Change in Personal Income Tax**

HR 900 changes the income tax. It proposes a flat rate income tax, which the legislation refers to as the "fair tax."

(HR 900 also refers to the tax on business value added as the fair tax.) This is in contrast to the Fair Tax advocated by Neal Boortz and Representative John Linder, which is a national retail sales tax.<sup>1</sup>

The income tax would apply only to individuals, that is, the statutory income tax on corporations would be eliminated, although that is not explicitly stated. To calculate the personal income tax one would start with "taxable income" and then deduct the following:

- charitable contributions;
- mortgage interest;
- social security benefits, federal unemployment insurance benefits, and other designated tax-exempt benefits;
- rental payments made for primary shelter.

The tax liability would be 5.75 percent of the net amount.

Taxable income currently is defined as the adjusted gross income less personal exemptions and either the value of itemized deductions or the standard deduction. Presumably, the intent of HR 900 is to start with adjusted gross income and thus eliminate personal exemptions, the standard deduction, and itemized deductions such as federal income taxes paid.

The section that defines the personal income tax specifies the tax rate as 5.75 percent, while elsewhere the proposed amendment states that 5.75 percent is the initial rate and that this rate can be increased or decreased.

### **Business Value Added Tax**

HR 900 calls for a new tax, a business value added tax. Each firm, whether incorporated or unincorporated, would be subject to this tax. The firm would start with the total value of sales. From this the firm would subtract purchases from other firms, including purchases of depreciable assets such as machinery and equipment, bad debts, and charitable contributions. Firms could also deduct the depreciation of assets purchased prior to 2009. The firm would not deduct such items as wages and salaries, taxes paid, interest payments made, or rent payment made. The net amount is taxed at the rate of 5.75 percent.

No provision is made for the tax treatment of multi-state firms. Under the existing corporate income tax, the profits of multi-state firms are apportioned to all of the state in which the firm does business. The proposed amendment states that the tax is based on "all sales" of the firm, not just sales made in Georgia. Provision will have to be made for firms that sell in multiple states or countries.

## Revenue for Local Governments

All tax revenue sources used by local governments would be eliminated except for taxes on alcoholic beverages. HR 900 calls for a “local revenue guarantee” that is “to provide that each local taxing jurisdiction should not be impaired financially” from the elimination of local tax revenue sources. It calls for each local taxing jurisdiction to receive “revenue essentially equivalent to the amount of revenue it received in the 2006 tax year” from the taxes that would be eliminated. This local revenue guarantee would be used to pay for debt and for the general operation of the government.

The language that specifies the procedure by which the local revenue guarantee is determined is poorly drafted. Assuming that the intent is to hold each jurisdiction harmless, the procedures would appear to be to be the following. First, the ratio of the jurisdiction’s revenue in 2006 to the total of all revenue (not all tax revenue) collected in 2006 by state and local governments in Georgia is determined. (Note that revenue is more than tax revenue and would include grants, revenue from water-sewer systems, fares collected by transit agencies, etc.) Second, the revenue generated by the two taxes (i.e., the revised personal income tax and the business value added tax) is multiplied by the ratio. (The legislation actually says to multiply the ratio by the 5.75 percent tax rate, so it is not clear whether the actual revenue would be used if the tax rate differed from 5.75 percent.) Third, the resulting product is share that is allocated to the jurisdiction, and is referred to as the local revenue guarantee.

If this interpretation of the procedure is correct, then each year each local jurisdiction would get a transfer of funds from the state government equal to a percentage of the total revenue collected by the state from these two revenue sources. The percentage would be frozen, i.e., it would be the same every year, and would be based on revenue collected in 2006. Whatever is not allocated directly to local governments goes to the state government. Thus, the proposed amendment fixes the allocation of the tax revenue between the state and local governments.

No allowance is made in the amendment for new jurisdictions (which would not have had revenue in 2006) or for growth in the size of a jurisdiction. The amendment does not preclude the General Assembly from providing additional revenue to new or growing jurisdictions. However, the proposed amendment freezes the minimum

share of total revenue that would go to local governments, and thus any revenue allocated to new jurisdictions would have to come from the state’s share of tax revenue.

## Earmarking for Transportation

HR 900 would eliminate the earmarking of revenue to the Department of Transportation. Currently, fuel taxes collected in one year are automatically allocated to the Department of Transportation the following fiscal year. Since fuel taxes would be eliminated, there are no fuel taxes to earmark, and HR 900 does not specify that any of the new tax revenue be earmarked.

## Debt Limitation for Local Governments

Currently, general obligation debt of local governments cannot exceed 10 percent of the jurisdictions property tax base. HR 900 changes that to 10 percent of total revenue receipts. It is unclear whether “revenue receipts” means the “local revenue guarantee” or whether it includes other revenue sources. If HR 900 simply replaced existing tax revenue, then the debt ceiling would be substantially reduced.

## Planned Research Agenda

HR 900 proposes a significant change to Georgia’s state and local tax structure. There are numerous benefits to the simplification of the tax system, but there are also costs associated with the changes. The Fiscal Research Center plans to prepare over the next several months several Policy Briefs that address various aspects of the proposed changes to the tax structure. The first of these Policy Briefs will list the issues and questions that policymakers should want addressed in considering HR 900. Subsequent Policy Briefs will address the revenue implications, incentive effects, debt considerations, equity issues, and administrative aspects of the proposed changes to the tax structure. The purpose of these Policy Briefs is to lay the groundwork for thinking about the underlying issues in the proposal and its implementation.

## Note

1. For a discussion of the Boortz-Linder Fair Tax see *The Fair Tax and Its Effect on Georgia*, Laura Wheeler, Sally Wallace and Lakshmi Pandey, FRC Brief No. 118 (December 2005).

## ABOUT THE AUTHOR

**David L. Sjoquist** is Professor of Economics, holder of the Dan E. Sweat Distinguished Scholar Chair in Educational and Community Policy, and Director of the Fiscal Research Center of the Andrew Young School of Policy Studies at Georgia State University. He has published widely on topics related to state and local public finance and urban economics. He holds a Ph.D from the University of Minnesota.

## ABOUT FRC

The Fiscal Research Center provides nonpartisan research, technical assistance, and education in the evaluation and design of state and local fiscal and economic policy, including both tax and expenditure issues. The Center's mission is to promote development of sound public policy and public understanding of issues of concern to state and local governments.

The Fiscal Research Center (FRC) was established in 1995 in order to provide a stronger research foundation for setting fiscal policy for state and local governments and for better-informed decision making. The FRC, one of several prominent policy research centers and academic departments housed in the School of Policy Studies, has a full-time staff and affiliated faculty from throughout Georgia State University and elsewhere who lead the research efforts in many organized projects.

The FRC maintains a position of neutrality on public policy issues in order to safeguard the academic freedom of authors. Thus, interpretations or conclusions in FRC publications should be understood to be solely those of the author. For more information on the Fiscal Research Center, call 404-651-2782.

## RECENT PUBLICATIONS

*A Description of the Proposed Comprehensive Revision of Georgia's Tax Structure: HR 900.* This brief is a summary of the provisions of the comprehensive revision of Georgia's tax structure contained in HR 900. (April 2007)

*Revenue Structures of States Without An Income Tax.* This report compares Georgia's revenue structure to states without an income tax in order to explore how Georgia's revenue structure would have to change if it were to eliminate its income tax. (April 2007)

*Property Rights Reform: A Fiscal Analysis.* This report analyzes the fiscal effects of a proposed statute revising the legal standard for regulatory takings in Georgia, as well as recent changes in Georgia's eminent domain law. (April 2007)

*Self Sufficiency in Women in Georgia.* In this brief, we use one measure of self sufficiency to estimate the number of female headed households in metro Atlanta that fall below the self sufficiency standard. (March 2007)

*Georgia's Economy: Trends and Outlook.* This report tracks some of the key trends that have shaped and will continue to shape Georgia's economy. These include the decline in manufacturing employment, the aging of Georgia's population, the importance of high tech and tourism industries and globalization. (March 2007)

*Financing Georgia's Future II.* This second release of a biennial report focuses on Georgia's taxes, making cross-state comparisons of their structure and exploring revenue performance over time. (March 2007)

*The Price Effect of Georgia's Temporary Suspension of State Fuel Taxes.* This report explores the effect of the fuel tax suspension on the price of gasoline in Georgia. (February 2007)

*An Analysis of the Financing of Higher Education in Georgia.* This report addresses the issue of the financing of higher education in Georgia by comparing financing in Georgia with other states and examining how financing affects the student population in terms of performance, and retention rates. (February 2007)

*Intergovernmental Fiscal Relations in Georgia.* This report documents the intergovernmental fiscal system in Georgia, with a focus on the expenditure, revenue, and intergovernmental grant system in the state. (February 2007)

*Comparing State Income Tax Preferences for the Elderly in the Southeast.* This brief looks at the current state of these tax preferences in the Southeast for those states that impose a major income tax and estimates the dollar value of these preferences. (February 2007)

*State Tax Incentives for Research and Development Activities: A Review of State Practices.* This report documents state tax incentives offered around the country designed to encourage state level R&D activity. This report also simulates the effect of various credit components in the value of the credit. (January 2007)

*Transportation Funding Alternatives: A Preliminary Analysis.* This report explores issues associated with proposed alternative revenue sources for increasing transportation for funding. (January 2007)

*Geographic Breakdown of Georgia's Interstate Migration Patterns.* This brief looks at the geographic breakdown of Georgia's interstate migration patterns for both the elderly and non-elderly. (December 2006)

*Inventory Taxes.* Policymakers are considering 100 percent inventory tax exemptions as an economic development incentive. This report reviews the potential effectiveness of such exemptions and presents alternative approaches to inventory tax exemptions. (December 2006)

*An Assessment of the State of Georgia's Budget Reserves.* This report assesses the adequacy of Georgia's revenue shortfall reserve. (October 2006)

*Revenue Losses from Exemptions of Goods from the Georgia Sales and Use Tax.* This report provides estimates of the revenue loss from sales tax exemptions. (September 2006)

For a free copy of any of the publications listed, call the Fiscal Research Center at 404/651-4342, or fax us at 404/651-2737. All reports are available on our webpage at: [//frc.aysps.gsu.edu/frc/index.html](http://frc.aysps.gsu.edu/frc/index.html).