DEPARTMENT OF AUDITS AND ACCOUNTS

270 Washington St., S.W., Suite 1-156
Atlanta, Georgia 30334-8400

Greg S. Griffin
STATE AUDITOR
(404) 656-2174

September 21, 2016

Honorable Jay Powell
Chairman, House Appropriations Committee
133 State Capitol
Atlanta, Georgia 30334

SUBJECT: Fiscal Note
House Bill 1141 (LC 43 0328ER)

Dear Chairman Powell:

The bill would repeal O.C.G.A. Chapters 7 and 8 of Title 48, relating respectively to income taxes and to state and local sales taxes, and impose a state 5.50 percent "FairTax," a broad-based sales and use tax on final consumption. The tax would apply to the gross payments for taxable property or services used or consumed in the state. The bill also provides for a monthly rebate in the amount equal to the product of the tax rate and the "monthly poverty level" for a given qualified family's size. It should be noted that the bill makes no provision for replacing local sales and use taxes authorized by Chapter 8, resulting in the repeal of a number of local taxes. The bill is assumed to be effective on January 1, 2018.

The bill provides exemptions or credits on property or services purchased for a business purpose in a trade or business, for investment purposes, or for sales or use outside the state. Non-education goods and services purchased by state and local governments, including labor, would be subject to the tax. Georgia purchasers of goods or services from outside the state must remit tax due, if not collected by the seller.

Revenue effects of the bill are summarized in Table 1 on the following page. In the first full year of the bill's impact (2019), the bill is estimated to result in state revenue loss of approximately $4.8 billion. While lost revenue from the repealed taxes are offset by new FairTax revenue, the monthly rebate provision results in the net revenue loss to the state. The net revenue loss is further impacted by the fact that a portion of the FairTax revenue would be paid by the state because the tax is applied to many government expenditures. For local governments, the bill would result in lost revenue of $5.5 billion and additional taxes to the state of more than $1.6 billion. Details of the analysis are provided in the attached appendix.

Table 1. Estimated State Revenue Effects of the Georgia FairTax Act

($ millions)	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**
State Taxes Repealed:				
Personal Income Tax	($5,309)	($11,826)	($12,391)	($12,984)
Corporate Income Tax	(524)	(1,077)	(1,104)	(1,133)
State Sales and Use Tax	(2,969)	(6,177)	(6,425)	(6,682)
Total State Taxes Repealed	($8,801)	($19,080)	($19,921)	($20,799)
State FairTax:				
Revenues	$9,979	$20,743	$21,558	$22,405
Less: Rebates Paid	(2,399)	(4,873)	(5,030)	(5,191)
Less: Tax on State Expenditures	(766)	(1,581)	(1,630)	(1,679)
Net FairTax Proceeds	$6,814	$14,288	$14,899	$15,534
Net Change in State General Funds	**($1,988)**	**($4,791)**	**($5,022)**	**($5,265)**
Local Budgetary Effects:				
Local Sales Taxes Repealed	($2,642)	($5,498)	($5,718)	($5,947)
Tax on Local Expenditures	(784)	(1,632)	(1,697)	(1,765)
Total Local Effect	**($3,427)**	**($7,130)**	**($7,415)**	**($7,712)**

Impact on Expenditures

The bill would result in additional expenditures by the Department of Revenue (DOR) for modifications to IT systems. Based on previous updates to the Integrated Tax System, DOR officials estimated one-time costs of $6.75 million. This would include items such as software, project planning, design requirements, construction, testing, forms, and training. DOR estimated system maintenance and updates of $1.5 million annually.

Sincerely,

Greg S. Griffin

Greg S. Griffin
State Auditor

Teresa A. MacCartney

Teresa A. MacCartney, Director
Office of Planning and Budget

GSG/TAM/mt

Analysis by the Fiscal Research Center

The Georgia FairTax Act, if enacted, would replace Georgia's corporate and personal income taxes, and the state sales and use tax with a new sales and use tax the base of which would include essentially only *final* consumption of goods and services in Georgia by households and governments, and would exclude from taxation all intermediate goods and services purchases of for-profit businesses, purchases for investment purposes, eligible education and training purchases, and purchases for consumption or use outside the state. The bill is assumed to be effective January 1, 2018, though the current text of the bill has a date of January 1, 2017, which given the timing of possible consideration of the bill and the nature of the taxes involved, would not be feasible.

Repeals of Existing State Income and Sales Taxes
Sections 3 and 4 of the subject bill would repeal O.C.G.A. §48-7 and §48-8, respectively, in their entirety, thus eliminating all state income taxes, corporate and personal, and the state sales and use tax. Table 2 shows projections of the affected taxes through FY 2021, based on the most recent available projections from OPB except for the final year, for which the projected growth rates in FY 2020 are assumed to continue. Note that the corporate income tax amounts here do not include the amounts attributable to the corporate net worth tax or the financial institutions business occupations tax, which are not repealed by the bill, but are generally included in corporate income tax revenues for state reporting and forecasting purposes. These taxes are netted out of OPB forecasted revenues based on their shares of the combined revenue in FY 2014-2015.

Table 2. Forecasted State Revenues from Income and Sales Taxes

($ millions)	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**
State Taxes to be Repealed:					
Personal Income Tax	$10,716	$11,295	$11,826	$12,391	$12,984
Corporate Income Tax	959	1,047	1,077	1,104	1,133
State Sales and Use Tax	5,659	5,938	6,177	6,425	6,682
State Taxes to be Repealed	**$17,333**	**$18,280**	**$19,080**	**$19,921**	**$20,799**

Given the assumed effective date of the bill, revenues in FY 2017 would not be affected. For FY 2018, only those revenues applicable to periods after the effective date would be affected. In estimating the revenue loss from these repeals, it is assumed that 50 percent of the forecasted revenues for corporate income and sales taxes for FY 2018 would be eliminated, along with 47 percent of personal income tax revenues, which are collected less evenly over the year.

Regarding corporate income taxes, the bill is not clear as to how the repeal would affect tax liabilities of firms with tax years not corresponding to the calendar year. If the repeal applies only to tax years beginning on or after the effective date, then corporations with tax years beginning from one to 364 days prior to the effective date will continue to accrue tax liability after the effective date of the bill, reducing the FY 2018 revenue loss from the repeal.

Also unclear is the treatment of tax loss and tax credit carryforwards from periods before the effective date. To the extent that either may be applied to reduce other taxes after the repeal, the revenues from those other taxes in future periods may be reduced.

Repeal of Local Sales and Use Taxes
Another consequence of the repeal of O.C.G.A. §48-8 is that this code chapter also authorizes most (but not all) local sales and use taxes in the state, and determines the tax base for all of these local taxes, including those authorized by pre-1983 constitutional amendments and the MARTA Act of 1965. Because the Georgia FairTax Act makes no provision for reauthorizing any of these taxes or to replace the language defining the tax base for them, it must be assumed that revenues from all local sales and use taxes would be eliminated as of the effective date. Table 3 shows projections of each of these taxes, assuming growth from FY 2015 at the same growth rate implied by the OPB forecast of state sales and use tax revenues, and also assuming that the share of total local sales taxes attributed to each category of local taxes remains at FY 2015 levels.

Table 3. Forecasted Local Sales and Use Tax Revenues

($ millions)	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**
LOST*	$1,448	$1,519	$1,580	$1,643	$1,709
SPLOST	1,248	1,310	1,363	1,417	1,474
ESPLOST	1,714	1,798	1,871	1,945	2,023
MARTA	379	398	414	431	448
HOST	130	137	142	148	154
TSPLOST	118	124	129	134	139
Total Local Sales Taxes	**$5,036**	**$5,285**	**$5,498**	**$5,718**	**$5,947**

* Includes Atlanta MOST.

As with the state sales and use tax, passage of the bill would not impact FY 2017 revenues and is assumed to reduce FY 2018 revenues by half.

FairTax Base and Rate
A stated purpose of the proposed Georgia FairTax is "to tax all consumption of goods and services in Georgia once, without exception, but only once" (lines 62-63 of the bill), subject to only limited exceptions. In general, the bill proposes to tax all final goods and services consumption in the state, but not intermediate goods or services. In particular, the proposed bill would apply as follows:

- New goods and services, including but not limited to financial intermediation services, that are produced and consumed in the state **are** taxed.
- New goods and services "imported" from out of state **are** taxed.
- New goods and services that are produced in the state but are "exported" and sold outside of the state **are not** taxed.
- Sales of new homes (net of land value) **are** taxed.
- Used goods and intangible property **are not** taxed.
- Education and training expenses (tuition for primary, secondary, or postsecondary level education, and job-related training courses) **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.
- 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. Purchases by

government for education purposes are assumed to be exempt, though the bill language is not clear on this point.

- Services in the form of labor purchased by i) governments (excluding government enterprises and education) or ii) households employing domestic servants **are** taxed, with the tax payable by such taxable employer on the total compensation paid.

The bill also proposes to tax goods and services, including services in the form of labor, purchased for use in the state by the federal government. However, after discussion with DOR and given the U.S. Supreme Court decision in *McCulloch v. Maryland*, 17 U.S. 316 (1819), specifically that "a tax on the operation of an instrument employed by the government of the Union to carry its powers into execution ... must be unconstitutional", it is assumed that no tax under the Act will be collected on federal government purchases.

It should be noted, also, that the language of the bill in line 229-231 is unclear as to the treatment of used and intangible property. In the South Carolina FairTax Act, from which the bill was apparently drafted, the corresponding section was clear that neither used nor intangible property was to be taxed. However, the numbered and lettered list form of the text of the SC bill was reduced to sentence form in this bill, with punctuation that makes clear interpretation impossible. It has been assumed, therefore, that the intent is as in the SC bill; that is, purchases of both used and intangible property are not taxable.

The tax rate applicable to all taxable purchases under the Act would be 5.50 percent.

Forecasted Revenues

Revenue estimates are based on applying the tax rate under the bill to estimates of the tax base derived 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, used vehicles (see comment in previous section of this note), and imputed rent on owner-occupied housing, together with new fixed investment in owner-occupied homes and state and local government expenditures.

BEA estimates of total PCE also include amounts for the net consumption of nonprofit institutions serving households – that is, the gross output in services to households by nonprofits less any receipts of nonprofits in payment for those services. Purchases by households of services from nonprofits would be taxable, but the net difference, representing services provided without compensation, would not be taxable, so this net amount is deducted from total PCE in estimating the taxable portion.

PCE data at the state level is currently available only through calendar 2014 and does not provide sufficient detail to break out the PCE subcategories that would not be taxed, so national data is used to estimate the non-taxable subcategories and to project the taxable PCE estimate through FY 2016. Taxable PCE is estimated to be approximately 84.2 percent of total Georgia PCE, which in turn is projected from 2014 based on national growth of PCE through the second quarter of 2016 when PCE year-to-date growth was an annualized nominal rate of about 4.0 percent. The same 4.0 percent nominal rate is assumed going forward.

New owner-occupied home investment (including improvements to existing homes) grew nationally at an average annual rate of 3.5 percent from 2008 through 2015, but was volatile, falling by 22 percent in 2009 and rising by double digits and as much as 16 percent in various subsequent years. Georgia investment in new homes and home improvements is estimated based on BEA data on national investment in residential structures through 2015 together with Census estimates of U.S. and Georgia owner-occupied shares of homes by structure type (i.e. single- and multi-family, and manufactured homes). For example, approximately 81 percent of single-family homes in Georgia are owner-occupied, so that figure is multiplied by the total investment in new single-family structures nationally to arrive at the Georgia estimate. A similar calculation is done for multi-family structures and manufactured homes. Improvements and ownership transfer costs are shared down to Georgia based on Georgia's share of all owner-occupied homes. Projections beyond 2015 assume growth equal to the rate of nominal GDP growth, based on the Federal Reserve's median growth forecast of June 2016 for real GDP growth plus inflation, or 3.4 percent in 2016, 3.9 percent in 2017, and 4.0 percent thereafter.

Taxable state government spending, including for labor, is estimated based on total current expenditures and capital outlays, less education spending, from state government funds as reported in the Georgia Comprehensive Annual Financial Report (CAFR) for 2015 (page 30), the latest available. Taxable spending is projected forward through FY 2021 based on projected growth in state expenditures as forecasted in the Governor's Budget Report for FY2017. Local government spending in the state, again net of education spending, is based on FY 2015 estimates from usgovernmentspending.com, which are extrapolated from the latest available Census government finance data (for FY 2013). Local spending projections beyond 2015 assume growth at the same rate as national GDP as described above.

Resulting tax base and tax revenue projections by fiscal year are shown in Table 4. Revenues are net of administrative credits (vendor compensation), estimated for simplicity at ¼ percent of the gross amount of tax. Given the January 1, 2018 effective date of the bill, FY 2018 includes only consumption and revenue for the second half of the fiscal year.

Table 4. Projected Tax Base and Revenues

($ billions)	**FY2018**	**FY2019**	**FY2020**	**FY2021**
Taxable PCE	$159.4	$331.5	$344.7	$358.5
Residential Fixed Investment	8.6	17.8	18.6	19.3
Taxable State Gov't Spending	13.9	28.8	29.6	30.5
Taxable Local Gov't Spending	14.3	29.7	30.9	32.1
Total Taxable Consumption	**$181.9**	**$378.1**	**$392.9**	**$408.4**
Tax Revenue at 5.5%*	**$10.0**	**$20.7**	**$21.6**	**$22.4**

* net of administrative credits estimated @ 1/4% of gross tax amount

FairTax Monthly Rebates

A Family Consumption Allowance or rebate (sometimes referred to as a "prebate") is to be paid to each and every eligible household in the state to offset the tax liability for some base level of spending. Rebate amounts are based on federal poverty level income (PLI) guidelines, published annually by the Department of Health and Human Services (HHS), which income levels vary according to the number of persons in the household. The base for calculation of rebates is generally the PLI for the given household size, but includes an adjustment referred to as the "marriage penalty elimination amount" for married couple households, calculated by adding an amount equal to the difference between the PLI for a one person household and the amount added for each additional person. This base amount is then multiplied by the tax rate, 5.5 percent, to determine the annualized amount of the rebate. The rebates are assumed to be payable to all legal resident households in the state on a monthly basis, for each month of residency.

For purposes of this note, a base year estimate of the total prebate payments is made for calendar year 2016 based on growing 2014 Census estimates of Georgia households, approximately 3.54 million, by the 1.27 percent average annual rate of growth in Georgia's population through 2016 as projected by OPB. The number of married households and the average household size are also from 2014 Census estimates, with married households grown to 2016 at the same rate as total households. PLI figures are from HHS for 2016. CY 2016 rebate estimate calculations are shown in Table 5.

Table 5. Rebate Base Year Estimate

	CY 2016
2016 Poverty Level Income:	
1st Person	$11,880
Each Additional Person	$4,160
Marriage Adjustment	$7,720
2014 GA Average Household Size	2.72
2016 Est'd GA Households	3,631,195
2016 Married GA Households	1,737,465
Avg PLI Base before Marriage Adj.	$19,035
Avg PLI Base with Marriage Adj.	$22,729
Gross Rebate Base ($ mil)	**$82,534**
Rebate Payments ($ mil)	**$4,539**
Avg. Annual Rebate per HH	**$1,250**

Total rebate payments are projected to grow from CY 2016 based on projected inflation, which affects PLI going forward, and population growth. Inflation estimates are based on Federal Reserve projections from March 2016 of PCE inflation (using the midpoint of the projected range) while population growth is again based on OPB projections. The projected total rebate payments on a fiscal year basis through FY 2021 are presented in Table 1, with payments beginning mid-FY 2018.

Finally, it should be noted that the rebate payments are to be made by monthly credits to smartcard (debit card) accounts for each household. The rebate payment language in proposed §48-8-43 includes in lines 483-485 language not in the SC bill that appears to say rebate payments can only be spent to pay the tax portion of any purchase and never, "under any circumstances", to pay for the good or service itself. As written, consumers would apparently have to pay separately for the taxable good or service, and the tax itself. In addition, to the extent any consumer does not pay separately for taxes using their rebate smartcard or does not make enough taxable purchases to use all of the rebate funds on their card, balances would accumulate on the rebate smartcards that potentially may never be spent. The amount that may accumulate, unspent, is not estimated here, but may be significant. It is also unclear what would eventually happen to any unspent funds in individual household smartcard accounts.