# DEPARTMENT OF AUDITS AND ACCOUNTS

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March 27, 2017

Honorable Chuck Hufstetler
Chairman, Senate Finance
121-C Capitol
Atlanta, Georgia 30334

SUBJECT: Fiscal Note
House Bill 329 (LC 43 0701ERS)

Dear Chairman Hufstetler:

The bill would change state income tax provisions and expand the definition of a dealer that must collect sales tax or report taxable sales to the Department of Revenue.

- *Income Tax Provisions* – Part I of the bill would lower the top marginal tax rate to 5.65 percent, eliminate the state itemized deduction for Georgia income taxes paid, and increase personal exemptions. The effective date of these changes is January 1, 2018. Effective January 1, 2019 adjustments for inflation would be made to the income tax bracket thresholds, personal and dependent exemption amounts, and standard deduction amounts. <u>Note that these effective dates are not as specified in the bill but are the stated intent of the committee chairman. Corrections to the bill are assumed to be forthcoming</u>.
- *Sales Tax Provisions* – Part 2 of the bill would extend the definition of dealer to any person who sells at retail more than $250,000 in total, or any amount in 200 or more transactions, of tangible personal property, for physical or electronic delivery into the state for use, consumption, distribution, or storage within the state, in the previous calendar year. This change thus proposes to impose, collect, and remit obligations on sellers who do not have nexus in the state under current law based on the economic magnitude of their sales into Georgia. Firms that reach these thresholds and do not collect and remit sales taxes would be required to notify purchasers in Georgia of their obligations to file and pay use tax on their purchases, and to mail annual sales and use tax statements to purchasers and the Department of Revenue.

  Part 2 effectively expands the concept of nexus for purposes of the state sales and use tax from a physical presence standard to one of substantial economic presence or "economic nexus", imposing both a duty to collect and remit the tax, and notification duties. Thus any revenue gains from such expansion would depend on the law surviving potential constitutional challenges under the precedent of the U.S. Supreme Court ruling in *Quill Corp. v. North Dakota* (1992).

Georgia State University's Fiscal Research Center (FRC) estimated that Part 1 of the bill would result in a loss of $292 million in FY 2019, the first year of the part's full effect (Table 1). The loss would grow to $526 million in FY 2022. Regarding Part 2, FRC noted that there is significant uncertainty about the amount of currently untaxed online sales into Georgia as well as the amounts of currently untaxed sales by firms that would reach the proposed thresholds to be taxed. Given this uncertainty, FRC believes that these estimates should be considered what is not collected on online sales because of lack of physical nexus of sellers, not what is likely to be collected. FRC estimated foregone state revenue of $274 million in FY 2019, growing to $355 million in FY 2022. Local sales tax revenue not collected is estimated at $206 million in FY 2019 and $266 million in FY 2022. Details of FRC's analysis are provided in the attached appendix.

**Table 1. HB 329 LC 43 0701ERS Estimates Summary**

| ($ *millions*) | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 |
|---|---|---|---|---|---|
| Part I: Income Tax Changes | | | | | |
| Revenue Effects* | ($116) | ($292) | ($364) | ($442) | ($526) |
| Part II: Economic Nexus | | | | | |
| Implied Foregone Revenue on Untaxed Online Sales | | | | | |
| State | $126 | $274 | $299 | $326 | $355 |
| Local | $94 | $206 | $224 | $244 | $266 |

* Net of state sales tax revenue gains from consumption from increased disposable income; assumes changes to rates, deductions, and exemptions occur January 1, 2018, with indexing beginning in tax year 2019.

Sincerely,

Greg S. Griffin
State Auditor

Teresa A. MacCartney, Director
Office of Planning and Budget

GSG/TAM/mt

## Analysis by the Fiscal Research Center

*Part I: Income Tax Changes*
To estimate the state revenue effects of the bill, the proposed changes to the tax rate structure and itemized deductions were simulated using tax year 2014 personal income tax data from the Department of Revenue. Because these data do not include details of itemized deductions, the reported itemized deductions for filers who itemized are reduced by the taxpayers reported Georgia tax liability as a proxy for the taxes paid deduction. The net effect of the proposed changes that would take effect initially, simulated on TY 2014 return data, would be to reduce aggregate tax liabilities by approximately 2.24 percent. This figure represents the estimated revenue gain from TY 2018 returns, affecting withholding and estimated tax payments in FY 2018 as well as these and final payments or refunds in FY 2019.

The initial inflation adjustments for TY 2019 would impact collections in FY 2019 and FY 2020, with TY 2020 and subsequent years' adjustments having similar effects split across fiscal years. For all periods, an inflation rate of 2 percent is assumed. The effects of these adjustments were also estimated by simulation. Note that the effects of inflation adjustments compound as inflation at the assumed 2 percent rate continues.

The combined effects of the changes, in terms of the simulated aggregate impact on tax liabilities, are applied to projected personal income tax revenues as shown in Table 2, which are assumed to grow from budgeted FY 2018 levels by the rates shown, to estimate the effects of the changes over these periods. Each period is adjusted to reflect, in FY 2018, a partial fiscal year effect given the effective date of the initial changes, and for the overlapping fiscal year effect of the inflation adjustments.

Finally, because the income tax changes would result in material increases in disposable incomes of Georgians, it is assumed that a portion of the income tax savings would be spent on goods and services subject to the sales tax. The sales tax effects assume a 5 percent average savings rate, with the balance spent on consumption, of which approximately 31% is assumed to be taxable. Estimated income tax and state sales tax effects are presented in Table 2, with the combined effect as shown in Table 1.

**Table 2. Baseline Personal Income Tax Revenue Projections**

| ($ *millions*) | **FY 2018** | **FY 2019** | **FY 2020** | **FY 2021** | **FY 2022** |
|---|---|---|---|---|---|
| Baseline PIT Revenues | $11,455 | $12,015 | $12,572 | $13,124 | $13,667 |
| *Change from prior year* | *5.14%* | *4.89%* | *4.64%* | *4.39%* | *4.14%* |
| Income Tax Net Effects | ($118) | ($295) | ($368) | ($447) | ($532) |
| State Sales Tax Effects | $1 | $3 | $4 | $5 | $6 |

*Part II: Economic Nexus*
The potential revenue gains regarding economic nexus would arise from imposing either 1) collect and remit or 2) reporting requirements on out-of-state sellers who, due to current nexus rules, are not required to collect Georgia sales taxes, thus potentially enabling the state to capture sales or use taxes on currently untaxed online and mail-order sales. National estimates of online sales are available and these can be shared down to Georgia, but it is not possible to know what portion of these sales are currently taxed or not taxed in the state. Many online retailers also operate from

physical stores and are thus likely to already have nexus in the state. Others that do not operate physical stores may have nexus in the state arising from distribution centers located here, affiliates with a physical presence, or other nexus triggers. The following summarizes the data and assumptions used in arriving at the estimates of foregone revenues from untaxed online sales.

- The U.S. Census Bureau's Annual Retail Trade Survey estimates U.S. e-commerce retail sales for 2014 at approximately $299 billion. Of that amount, approximately $255 billion or 85.3 percent is estimated to be attributable to "nonstore retailers", specifically electronic shopping and mail order houses.
- More recent estimates are not broken out by type of retailer, but the Census estimate of aggregate e-commerce retail sales for the four quarters corresponding to state fiscal year 2016 is approximately $367.4 billion. Assuming the same 85.3 percent share attributable to nonstore retailers, sales for this subset are estimated to have been about $313.4 billion.
- This amount is shared down to Georgia based on Georgia's share of U.S. households with internet access, about 3.15% as of 2012 according to Census data, resulting in an estimated $9.9 billion of nonstore retailers' sales in Georgia.
- The Georgia Department of Revenue (DOR) reports that, for FY 2016, the state collected approximately $190.6 million in state sales tax from NAICS code 4541, electronic shopping and mail order retailers. This revenue represents a 13 percent increase over FY 2015, which itself was 20 percent higher than collections in FY 2014.
- FY 2016 collections correspond to approximately $4.8 billion of taxable sales, leaving $5.1 billion of estimated untaxed sales by nonstore retailers into Georgia. If fully taxed, these sales would have produced $204 million of additional state revenues and $153 million for local governments (assuming an average local tax rate of 3 percent).
- These sales estimates for FY 2016 represent the pool of currently untaxed online sales, but actual gains if the proposed law is upheld are likely significantly smaller than implied by this estimate sales volume due to several mitigating factors.
    - Many out-of-state online sellers will likely not reach the in-state sales thresholds of the proposed bill and thus will remain untaxed.
    - Some portion of online retail sales are of goods delivered electronically—e.g. digital downloads of music, books, videos, etc., and thus not currently subject to tax regardless of nexus or reporting requirements—or are sales that are exempt from sales tax under other provisions of the code.

  Unfortunately, no information is available from which to estimate these mitigating factors.
- The $204 million estimate above for FY 2016 represents about an 18 percent increase over the comparable estimate for FY 2015. However, Census estimates of nonstore e-commerce sales show growth of about 15 percent per year over the two years ending June 2016. Finally, Forrester Research (cited by trade news website internetretailer.com, Jan. 29, 2016) forecasts online sales growth through 2020 to average 9.3 percent annually. Thus the projections assume a growth rate of 12 percent for FY 2017, roughly midway between recent Census-reported growth and Forrester's forecast, 10 percent for FY 2018, and 9 percent thereafter.