DEPARTMENT OF AUDITS AND ACCOUNTS

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July 3, 2017

Honorable Jay Powell
Chairman, House Ways and Means
133 Capitol
Atlanta, Georgia 30334

SUBJECT: Fiscal Note
House Bill 543 (LC 43 0649ER)

Dear Chairman Powell:

The bill would repeal O.C.G.A. Chapter 7 of Title 48, relating to personal and corporate income taxes, and impose a state 6.70 percent "FairTax," a broad-based sales and use tax on final consumption. 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. The bill would be effective on January 1, 2019.

The bill provides exemptions or credits on property or services purchased as an "intermediate article" (including education or training), purchased for a business purpose in a trade or business, purchased for investment purposes, or purchased for sales or use outside the state. Government purchases and purchases by public or private schools, colleges, and universities would be exempt, as would purchases by qualified non-profit organizations. 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. In the first full year of the bill's impact (2020), the bill is estimated to result in state revenue loss of approximately $2.6 billion. The loss would grow slightly in succeeding years. Details of the analysis are in the attached appendix.

Table 1. Estimated State Revenue Effects of the LC 43 0649ER

($ *millions*)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Total State Taxes Repealed*	($9,171)	($19,845)	($20,688)	($21,579)	($22,511)
State FairTax:					
Revenues	$11,330	$23,595	$24,579	$25,648	$26,761
Less: Rebates Paid	(3,048)	(6,310)	(6,536)	(6,772)	(7,014)
Net FairTax Proceeds	$8,283	$17,285	$18,044	$18,876	$19,746
Net Chg in State General Funds	($888)	($2,561)	($2,644)	($2,703)	($2,765)

* Includes state corporate net worth tax

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
State Auditor

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, corporate net worth tax, and 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 would exclude from taxation all intermediate goods and services purchases of for-profit businesses, purchases for investment purposes, eligible education and training purchases, government purchases, and purchases for consumption or use outside the state. The bill is to be effective January 1, 2019.

Repeals of Existing State Income and Sales Taxes
Section 3 of the subject bill would repeal O.C.G.A. §48-7 in its entirety, thus eliminating all state income taxes, corporate and personal. Sections 4 and 5 of the bill would amend, respectively, O.C.G.A. §48-7-30 and §48-7-32 by reducing the state sales and use tax rate from 4 percent to 0 (zero) percent, while leaving all other provisions of Chapter 7 of Title 48 intact. Section 6 of the bill clarifies that, beginning on January 1, 2019, the state sales and use tax shall not be imposed or collected, but that all other (i.e. local) sales and use taxes imposed by Chapter 7 shall continue to be imposed and collected. Section 7 of the bill would repeal Article 4 of O.C.G.A. §48-13, thus eliminating the state corporate net worth tax (CNWT).

Table 2 shows projections of the affected taxes through FY 2023, based on the most recent available projections from OPB except for the final two years, for which the projected growth rates in FY 2021 are assumed to continue. Note that the corporate income tax (CIT) projections from OPB include amounts attributable to the CNWT and the financial institutions business occupations tax (FIBOT), which are generally included in corporate income tax revenues for state reporting and forecasting purposes. The CNWT was amended in the 2017 legislative session to eliminate the CNWT for smaller net worth corporations and would be fully repealed under HB 543, but the FIBOT is not affected and will remain in place. Thus, FIBOT revenues are netted out of OPB forecasted CIT revenues based on that tax's 2.0 percent average share of the combined revenue in FY 2014-2016. Finally, the OPB projections do not reflect tax changes enacted in the 2017 legislative session, so the estimated effects of those changes are netted out.

Table 2. Forecasted State Revenues from Income and Sales Taxes

($ *millions*)	**FY 2019**	**FY 2020**	**FY 2021**	**FY 2022**	**FY 2023**
State Taxes to be Repealed:					
Personal Income Tax	$12,099	$12,736	$13,415	$14,129	$14,882
Corporate Income Tax*	990	990	987	985	982
State Sales and Use Tax	6,017	6,182	6,351	6,525	6,704
Net Effect of 2017 Tax Changes	(38)	(62)	(65)	(60)	(57)
State Taxes to be Repealed	**$19,068****	**$19,845**	**$20,688**	**$21,579**	**$22,511**

* Includes state corporate net worth tax. ** FY 2019 not adjusted for part-year effect of repeal.

Given the effective date of the bill, revenues would first be affected in FY 2019. 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 2019 would be eliminated, along with 47 percent of personal income tax revenues, which are collected less evenly over the year.

Regarding income taxes for taxpayers with tax years not corresponding to the calendar year, income taxes for the tax year in which the effective date of the bill falls will be due only on income attributable to the period prior to the effective date. Finally, all tax loss and tax credit carryforwards from periods before the effective date will be terminated as of the effective date.

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 65-66 of the bill), subject to only limited exceptions. Specifically, 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.
- Sales of new homes (net of land value) **are** taxed.
- Services in the form of labor purchased by households employing domestic servants **are** taxed, with the tax payable by such taxable employer on the total compensation paid.
- New goods and services that are produced in the state but are "exported" and sold outside of the state **are not** 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 the federal government, by state and local governments including school districts, or by qualified non-profit organizations **are not** taxed.
- Goods and services purchased for educational purposes by the University System of Georgia or any of its educational units as well as by eligible private colleges, universities, and elementary and secondary schools **are not** taxed.

The tax rate applicable to all taxable purchases under the Act would be 6.70 percent.

Forecasted FairTax 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, and imputed rent on owner-occupied housing, plus new fixed investment in owner-occupied homes. Unlike in previous versions of this legislation, the base does not include any 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 2015 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. Taxable PCE is estimated to be approximately 84.6 percent of total Georgia PCE, which is projected from 2015 levels to 2023 based on January 2017 Congressional Budget Office (CBO) projections of personal income growth nationally, averaging about 4.2 percent annually over the eight-year period.

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 80.1 percent of single-family homes in Georgia are owner-occupied while Georgia's share of all single-family homes nationally is about 3.0%, so those figures are multiplied by the total investment in new single-family structures nationally to arrive at the Georgia estimate for owner-occupied, single-family home investment. 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 BEA estimate of Georgia nominal GDP growth for 2016 (4.75 percent) and for 2017-23, on CBO projections for nominal GDP growth nationally (averaging 3.85 percent annually).

Finally, the estimated base must be adjusted for tax avoidance or evasion. For example, businesses may underreport their taxable sales and online sales by out-of-state businesses will likely remain difficult to tax, as they are now under the sales and use tax. No estimates of underreporting by dealers with nexus in the state are available for Georgia, but Washington State periodically reports estimates of taxpayer noncompliance for sales and other taxes based on audits of random samples of returns, finding from the most recent study an estimated rate of underreporting for the sales tax of approximately 1.8 percent. This figure does not include untaxed sales by sellers who are not registered as dealers in the state, i.e. those operating in the so-called underground or informal economy, but it is assumed either that this activity is not included in reported PCE figures used to estimate the tax base, as is the case for illegal goods and services according to BEA, or that any amounts included are not material. As for untaxed online sales, estimates made for fiscal notes on various versions of the "economic nexus" bill from the 2017 legislative session suggest another roughly 1.94 percent of taxable sales under the FairTax would remain untaxed, bringing the total noncompliance rate to 3.74 percent.

Resulting tax base and revenue projections by fiscal year are shown in Table 3. Revenues are net of administrative credits (vendor compensation), estimated for simplicity at ¼ percent of the gross amount of tax. Given the January 1, 2019 effective date of the bill, FY 2019 includes only consumption and revenue for the second half of the fiscal year.

NOTE: The tax base under the proposed state FairTax includes sales of new motor vehicles purchased for consumer use, which would also continue to be taxed under the state's Title Ad

Valorem Tax (TAVT) at a rate of 7 percent, bringing the total tax rate on new vehicles to 13.7 percent. Because this seems likely to have been an oversight in drafting, FairTax revenue is also estimated under the assumption that, while the TAVT would remain in place, new vehicles would be carved out of the tax base to avoid double-taxation. The estimated effect on projected revenue from removing all new vehicles from the base is presented in the final line of Table 3. If the bill is so amended, these amounts would add directly to the revenue loss estimates presented in Table 1.

Table 3. Projected Tax Base and Revenues

(*$ billions*)	FY2019	FY2020	FY2021	FY 2022	FY2023
Taxable PCE	$165.9	$345.6	$360.1	$375.9	$392.3
Residential Fixed Investment	10.2	21.2	22.0	22.8	23.7
Total Taxable Consumption	$176.1	$366.8	$382.1	$398.7	$416.0
Taxed Consumption (net of 3.74% noncompliance adjustment)	$169.5	$353.0	$367.8	$383.8	$400.4
Tax Revenue at 6.7%*	$11.3	$23.6	$24.6	$25.6	$26.8
Addendum: Effect of Exempting Consumer-use New Vehicles ($ *millions*)	($288)	($599)	($624)	($652)	($680)

* 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, 6.7 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 2017 based on growing Census estimates of 2015 Georgia households, approximately 3.66 million, by the 1.25 percent average annual rate of growth in Georgia's population through 2017 as projected by OPB. The number of married households and the average household size are also from 2015 Census estimates, with married households grown to 2017 at the same rate as total households. PLI figures are from HHS for 2017. CY 2017 rebate estimate calculations are shown in Table 4.

Table 4. Rebate Base Year Estimate

	CY 2017
2017 Poverty Level Income:	
1st Person	$12,060
Each Additional Person	$4,180
Marriage Adjustment	$7,880
2015 GA Average Household Size	2.72
2017 Est'd GA Households	3,748,421
2017 Married GA Households	1,794,458
Avg PLI Base before Marriage Adj.	$19,250
Avg PLI Base with Marriage Adj.	$2
Gross Rebate Base ($ mil)	**$86,296**
Rebate Payments ($ mil)	**$5,782**
Avg. Annual Rebate per HH	**$1,542**

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 CBO projections from January 2017 of CPI inflation while population growth is again based on OPB projections. Average household size and the married share of households are assumed constant. The projected total rebate payments on a fiscal year basis through FY 2023 are presented in Table 1, with payments beginning mid-FY 2019.