DOAA
Georgia Department
of Audits & Accounts

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November 29, 2021

Honorable Chuck Efstration
Chairman, House Judiciary
132 State Capitol
Atlanta, GA 30334

SUBJECT: Fiscal Note
House Bill (LC 43 2079)

Dear Chairman Efstration:

The bill would make substantial changes to the state tax code by 1) repealing state income taxes, individual and corporate; 2) broadening the sales and use tax base to include certain currently untaxed services; and 3) increasing the state sales and use tax rate from 4 percent to 7 percent. As a result of the extension of the sales tax to certain services, local sales tax revenues would also be impacted, but the bill provides a mechanism for local governments to roll back millage rates to offset some or all of the sales tax gains (see appendix for a discussion of the problematic mechanics of the roll back as the bill is drafted). The bill would also amend certain statutory limitations on combined state and local sales tax rates to reflect the 4 percent increase in the state rate. All provisions of the bill would be effective on and after January 1, 2024.

## Impact on State Revenue

Georgia State University's Fiscal Research Center (FRC) estimated that the bill would decrease state revenue in fiscal years 2023 and 2024 before a revenue increase in FY 2025, the first fiscal year of the bill's full effect (Table 1). The elimination of income tax revenue would be offset by increasing collections of state sales tax. In FY 2023, income tax revenue would be impacted by the accelerated use of credits that would have no value by tax year 2024. FY 2024 collections would be impacted by this fact, as well as taxpayer shifting of income into later years to avoid income taxes. Finally, the expansion of the sales tax base could result in up to $5.4 billion in new sales tax revenue for local governments in FY 2025, though the bill intends to provide a mechanism for local governments to roll back millage rates to offset the increase. The appendix provides details of the analysis.

**Table 1. Estimated Revenue Effects of LC 43 2079**

| ($ millions) | FY 2023 | FY 2024 | FY 2025 | FY 2026 | FY 2027 |
|---|---|---|---|---|---|
| State Sales Tax Revenue | $0 | $8,600 | $17,571 | $18,058 | $18,558 |
| State Income Tax Revenue | ($359) | ($8,908) | ($16,727) | ($17,180) | ($17,933 |
| Total State Revenue Effect | ($359) | ($308) | $844 | $878 | $625 |
| Local Revenue Effect: | | | | | |
| High | $0 | $2,697 | $5,444 | $5,544 | $5,645 |
| Low | $0 | $2,697 | $5,444 | ($2,747) | $0 |

## Impact on State Expenditures

The Department of Revenue (DOR) would incur additional annual costs of approximately $1.0 million for staffing. It would also have one-time costs of approximately $22,000 for the hiring of the staff. Information system changes would require approximately 12 weeks but would be accomplished with existing resources. Details of the estimate are included in Table 2 and the rationale for the changes are discussed below.

**Table 2. Estimated Short-Term Expenditure Effects**

| | One-Time Costs | Annual Costs* |
|---|---|---|
| Legal Affairs and Tax Policy | | |
| Staff (Manager, attorney or CPA, support staff) | $5,475 | $331,051 |
| Compliance | | |
| Staff (1 supervisor, 8 revenue agents) | $16,625 | $668,974 |
| Total | $22,100 | $1,000,025 |

*Compliance Division costs would begin in FY 2024, but Legal Affairs would need funding in FY 2023 to prepare for the change.

For Legal Affairs and Tax Policy, the expansion of sales tax to a broad array of services will require significant analysis of existing state law and regulations, training of DOR staff, and outreach to the external entities impacted by the law. The Compliance Division would require additional staff because not all income tax personnel would be able to immediately transition to sales tax. Tax year 2023 income tax returns would be filed through FY 2024 and into FY 2025, and amended returns would be allowed for several years. Given the elimination of the income tax system, DOR's staffing needs may begin to decrease in FY 2026 as its income tax responsibilities and workloads are reduced. DOR needs would need to be reassessed during the transition period.

Respectfully,

Greg S. Griffin
State Auditor

Kelly Farr, Director
Office of Planning and Budget

GSG/KF/mt

## Analysis by the Fiscal Research Center

The proposed bill would make the following revenue-impacting changes to the state tax code:

- Section 2 of the bill would modify O.C.G.A.§48-5-32.1, relating to calculation of local property tax roll-back millage rates, defining and requiring Department of Revenue (DOR) reporting of 'Net Fair Tax Act proceeds' distributed to local governments, and then amending the definition of 'roll-back rate' to adjust it by the 'millage equivalent' of such proceeds.

- Section 3 of the bill would repeal the entirety of Chapter 7 of Title 48 of the O.C.G.A. and Section 4 would replace it with the following:

  > "On and after January 1, 2024, no income taxes whatsoever shall be levied or collected by the state or any political subdivision thereof and no income tax returns are required."

- Section 5 would amend the definition of "retail sale' in O.C.G.A.§48-8-2 to include, and subject to tax, the following:

  > "(B.1) The sale of or charges for any personal service, business service, or professional service;" and
  > "(B.2) The sale of or charges for any service to repair, maintain, or improve tangible personal property or real property;"

- Section 6 would repeal two sales tax exemptions in O.C.G.A.§48-8-3 that would conflict with the base expansion in Section 5, specifically paragraphs (22) and (23), which respectively exempt "professional, insurance, or personal service transactions which involve sales as inconsequential elements for which no separate charges are made" and "fees or charges for services rendered by repairmen for which a separate charge is made." Section 6 would also create new exemptions from the base expansion in Section 5 for specific services, including the following:
  - Waste management and remediation services (NAICS code 562),
  - Veterinary services (NAICS code 541940),
  - Investigation and security services (NAICS code 5616),
  - Education services (NAICS code 61), and
  - Health care and social assistance services (NAICS code 62)

- Section 8 would, among other things, set the state sales and use tax rate at 7 percent, up from 4 percent under current law.

### Income Tax

A literal reading of Sections 2 and 3 would suggest that all return filing and collections activity would cease on January 1, 2024, without regard to the tax year (TY) to which such activity pertains. The presumed intent is that state income taxes would be repealed *effective for all taxable years beginning on or after January 1, 2024.* Thus, for example, income tax return filing and collections activity for calendar-year filers for TY 2023 would occur as usual after January 1, 2024, while non-calendar-year filers whose taxable years extend into 2024, but begin before January 1, would be subject to state income tax for their full taxable year.

Personal (PIT) and corporate income tax (CIT) collections data from the Department of Revenue (DOR), showing collections by payment type (e.g., withholding, estimated payments, payments with returns, and refunds), along with current revenue projections provided by the Office of Planning and Budget, were used to estimate continuing collections after January 1, 2024 for tax years beginning before that date. Projected baseline and proforma income tax revenues, and net revenue losses are provided in Table 3.

The bill does not address whether or how Georgia income taxpayers may utilize tax credits earned, but not utilized, prior to repeal of the tax (i.e., credit carryforwards). Some credits may, under current law, be utilized to offset tax liabilities for other than income taxes, including in some cases state insurance premium taxes (IPT) or employee withholding, and a few credits may be sold to be utilized by other Georgia taxpayers. We assume the following with regard to these tax credits:

- Unutilized carryforwards of income tax credits earned prior to the proposed repeal are assumed to expire, to remain unutilized, as there would be no future income tax liability against which to apply them. To the extent taxpayers may be able to accelerate income recognition in order to utilize more of these carryforwards prior to repeal of the tax, state revenue losses would be larger than projected here, but we are unable to estimate this potential behavioral response.

- Similarly, business taxpayers will no longer have state income tax withholding liabilities for employees after repeal of the PIT, so utilization against employee withholding would not provide an avenue for future use of carryforwards of pre-repeal credits earned.

- Those credits that may be used against IPT liabilities are provided for under O.C.G.A. Title 33 and are not repealed by the bill, though the corresponding income tax provisions in Title 48 would be. Thus, the repeal of state income taxes is assumed not to affect utilization of these credits by IPT payers.

- Credits that may be sold and utilized by another Georgia taxpayer include the following:
    - Film credit
    - Post-production and small post-production company credits
    - Qualified interactive entertainment production credits
    - Timber credit
    - Historic rehabilitation credit
    - Railroad track maintenance credit

According to DOR reporting as of July 1, 2021, carryforwards of these credits reported on tax year (TY) 2020 returns totaled approximately $1.46 billion, up from approximately $1.42 billion reported on TY 2019 returns (carryforwards of the last two credits were zero). Assuming continuing growth at the same rate through TY 2023, the total amount of credit carryforwards on these saleable credits is likely to reach nearly $1.6 billion. To the extent the proposed repeal of state income taxes motivates sales and immediate utilization of these credits, state revenues would be reduced by the amount of available carryforwards in the periods between enactment of this bill and effectiveness of the income tax repeal. Though it is not clear why these credit carryforwards have not already been sold and utilized by others, and instead continue to be carried forward, it is assumed that the impending complete loss of value of the credits if not utilized before effectiveness of the income tax repeal will result in sales of at least 90 percent of these credits. It is further assumed that the purchasers of these credits would utilize them against TYs 2022 (25 percent) and 2023 (75 percent) income tax liabilities, reducing state revenues in FYs 2023 and 2024 by approximately $0.36 and $1.08 billion respectively.

Finally, impending effectiveness of the income tax repeal for TYs beginning on or after January 1, 2024, creates a strong incentive for taxpayers – business or individual – to find ways to defer income from TY 2023 to future periods to avoid the tax. Among the mechanisms for individuals to defer otherwise taxable income are delaying capital gains realizations, deferring retirement plan withdrawals, or deferring salary or bonuses (particularly by executives and other high-income taxpayers). Businesses, whether taxed as pass-throughs or C-corporations, may be able to defer recognition of revenues or accelerate recognition of deductible expenses to shift otherwise taxable income to the post-repeal period.

There is extensive economic research into these behavioral responses, intertemporal shifting of income, in response to tax rate changes, including empirical studies that estimate the "elasticity of taxable income" (ETI) for various income types, separate from incentive effects on real economic activity like labor supply or business investment. We use estimates of the ETIs for capital gains income from Dowd et al. (National Tax Journal 2015) and for business taxable income from Patel et al. (SSRN 2017), together with tax return and other data from DOR to estimate the impact of intertemporal shifting of income from pre- to post-repeal periods, as shown in Table 3. Retirement plan withdrawals are assumed to be substantially exempted in Georgia by the retirement income exclusions for those age 62+ or 65+, so no shifting is assumed for this income. Material deferrals of salaries and bonuses are not assumed to occur because businesses would presumably wish to accelerate rather than defer deductible expenses.

**Table 3. Estimated Income Tax Impacts**

| ($ millions) | FY 2023 | FY 2024 | FY 2025 | FY 2026 | FY 2027 |
|---|---|---|---|---|---|
| Current Law* | | | | | |
| PIT Collections | $14,032 | $14,593 | $15,177 | $15,784 | $16,41 |
| CIT Collections** | $1,137 | $1,160 | $1,277 | $1,396 | $1,51 |
| Total Current Law | $15,169 | $15,753 | $16,454 | $17,180 | $17,93 |
| Proposed Law | | | | | |
| PIT Collections | $14,032 | $7,619 | ($326) | $0 | $0 |
| CIT Collections** | $1,137 | $744 | $52 | $0 | $0 |
| Less: Tax Credits Sold | ($359) | ($1,077) | | | |
| Less: Income Shifting | | ($441) | | | |
| Total Proposed Law | $14,810 | $6,844 | ($274) | $0 | $0 |
| Net Change in Collections | ($359) | ($8,908) | ($16,727) | ($17,180) | ($17,933 |

* OPB projections as of July 2021
** Excluding estimated CNWT and FIBOT revenues in OPB projections of CIT

## Sales and Use Tax

The proposed bill would also apply state and local sales taxes to certain personal, professional and business services in Georgia. The bill defines the categories of services to be taxed only by exception, identifying the services that would *not* be subject to tax by creating exemptions for them as noted above. Thus, interpreting personal, professional, and business services broadly and then excluding the exempted services, the following industries (identified by 2-5 digit NAICS codes) were assumed to be made subject to sales tax on their sales of services:

| NAICS | Description |
|---|---|
| 23 | Construction |
| 441 | Motor Vehicle and Parts Dealers |
| 52392–99 | Investment and Financial Advisers |
| 5312–13 | Real Estate Services |
| 54 | Professional, Scientific and Technical Services (excluding 541940, veterinary services) |
| 561 | Administrative and Support Services (excluding 5616, investigation and security) |
| 7113–14 | Promoters of Events; Agents and Managers for Artists, Athletes, etc. |
| 811 | Repair and Maintenance |
| 812 | Personal and Laundry Services |

To project the amount of newly taxable sales within each industry, this analysis uses financial estimates and forecasts from IBISWorld, a leading industry market research firm. For industry subsectors that were not covered by IBISWorld reports, the analysis uses U.S. Census data instead. In 2019, the identified industries generated an estimated $8.23 trillion in revenue nationwide.

Next, to the extent feasible, this analysis excludes estimated sales of tangible goods, which are already subject to tax, or revenues that do not result from provision of services (e.g., donations or investment income). For instance, while auto mechanics provide a repair service, a portion of the revenue they generate comes from sale of repair parts, tangible goods already subject to sales tax in Georgia. These adjustments relied primarily on Economic Census product lines or industry summary data.

For the construction sector (NAICS code 23), Economic Census data was used to exclude construction materials and land costs. For the repair and maintenance industry (811), a Census subject series dataset was used to subtract parts used in repairs. While motor vehicle and parts dealers (441) are not primarily service businesses, a share of industry sales were included in this analysis to capture the repair and maintenance services performed by auto dealerships and similar businesses. Other notable adjustments include temporary staffing and employee leasing revenue, which were excluded from NAICS sectors 54 and 56 because these are essentially payments for wages and related costs of workers who might otherwise be employed directly, and admissions revenue excluded from NAICS sector 711 because admissions charges are generally already taxed in Georgia.

Following these adjustments, ranging from 4 to 93 percent depending on the industry, the national estimate for these industries is reduced from $8.0 to $5.2 trillion for 2019. National estimates of newly taxable sales are then shared down to Georgia based on the state's share of national GDP for the given industry or sector in the fourth quarter of 2019, the most recent period for which data was available prior to the COVID-19 pandemic. Georgia's construction sector, for instance, generated 3.1 percent of the sector's national GDP, while the state's professional, scientific and technical services industries generated 2.6 percent of the national total. After these adjustments, for Georgia's share of newly taxable sales from these industries is estimated to be approximately $149.6 billion in 2019. Table 4 summarizes the adjustments and 2019 estimates.

Each industry's annual revenue was projected forward based on revenue growth forecasts from IBISWorld. For a few subsectors within administrative and support services, no IBISWorld forecasts were available; in these cases, the estimates assume an 11 percent decline in 2020 due to the recession, mirroring the decline in similar subsectors, followed by a resumption of their average growth from 2013 to 2019. Table 5 below shows projected industry services sales within Georgia as well as the average overall growth rate by calendar year (CY) from the effective date through CY 2027.

**Table 4. Industry Estimates Summary for 2019**

| (*$ billions*) | National | | | Georgia | |
|---|---|---|---|---|---|
| Industry | Total Sales | Subtractions | Service Sales | Share | Service Sales |
| Construction | $2,370 | 38% | $1,480 | 3.1% | $45.4 |
| Motor Vehicle & Parts Dealers | $1,305 | 93% | $88 | 2.9% | $2.6 |
| Investment & Financial Advisers | $383 | 15% | $324 | 3.1% | $10.1 |
| Real Estate | $294 | 5% | $278 | 3.0% | $8.2 |
| Professional, Scientific & Technical | $2,274 | 4% | $2,184 | 2.6% | $56.7 |
| Administrative & Support | $963 | 39% | $590 | 3.3% | $19.5 |
| Promoters; Agents & Managers | $51 | 53% | $24 | 1.5% | $0.4 |
| Repair & Maintenance | $205 | 47% | $108 | 2.5% | $2.7 |
| Personal & Laundry | $152 | 10% | $137 | 2.9% | $4.0 |
| Total | $7,996 | | $5,213 | | $149.6 |

**Table 5. Projected Georgia Services Sales by Industry**

| ($ billions) | CY 2024 | CY 2025 | CY 2026 | CY 2027 |
|---|---|---|---|---|
| Construction | $50.6 | $51.4 | $52.2 | $53.0 |
| Motor Vehicle & Parts Dealers | $2.8 | $2.9 | $2.9 | $3.0 |
| Investment & Financial Advisers | $11.4 | $11.7 | $12.0 | $12.2 |
| Real Estate | $7.7 | $7.8 | $7.9 | $8.1 |
| Professional, Scientific & Technical | $62.4 | $63.5 | $64.7 | $65.9 |
| Administrative & Support | $20.3 | $20.8 | $21.3 | $21.7 |
| Promoters; Agents & Managers | $0.3 | $0.3 | $0.3 | $0.4 |
| Repair & Maintenance | $2.8 | $2.8 | $2.9 | $2.9 |
| Personal & Laundry | $3.6 | $3.7 | $3.8 | $3.9 |
| Total | $162.0 | $165.0 | $168.0 | $171.0 |
| Average Growth Rate | 2.0% | 1.9% | 1.8% | 1.8% |

Finally, Table 6 reports the resulting estimates of state sales tax effects of both the added services base and the increased tax rate on the existing tax base. Local effects of the added services base, reported in Table 1, assume an average local rate of 3.33 percent, the population-weighted average as of July 2021, according to the Tax Foundation.

**Table 6. Estimated Sales Tax Impacts**

| ($ millions) | FY 2023 | FY 2024 | FY 2025 | FY 2026 | FY 2027 |
|---|---|---|---|---|---|
| Current Law Revenue* | $7,482 | $7,819 | $8,171 | $8,538 | $8,923 |
| Proposed Law: | | | | | |
| Revenue on Current Base | $7,482 | $10,751 | $14,299 | $14,942 | $15,614 |
| Revenue on Added Services | $0 | $5,668 | $11,443 | $11,654 | $11,866 |
| Proposed Law Total | $7,482 | $16,419 | $25,742 | $26,596 | $27,480 |
| Change in Sales Tax Revenue | $0 | $8,600 | $17,571 | $18,058 | $18,558 |

* OPB projections as of July 2021

## Local Revenue Effects

As a result of the sales tax base expansion, which would apply to the base for local sales taxes as well as state, local governments could be expected to experience outsized revenue gains beginning in CY 2024. To address this, the bill proposes to amend O.C.G.A.§48-5-32.1(a), relating to calculation of local property tax roll-back millage rates. Specifically, the bill defines ‘Net Fair Tax Act proceeds’ (NFTAp) each year as the amounts of sales tax collections for the given jurisdiction that are attributable to enactment of this bill and requires DOR to track and report these proceeds. The bill then modifies the calculation of the ‘roll-back rate’ as defined by subparagraph (9) of this code section, with the apparent intent of reducing the roll-back rate to the level that would offset the NFTAp from the prior year. There are some issues with the language of this bill section, including but not limited to the amendment to subparagraph (9).

Under current law, the roll-back rate is defined as “the previous year’s millage rate minus the millage equivalent of the total net assessed value added by reassessments”, with subparagraph (6) defining the millage equivalent as “the number of mills which would result when the total net assessed value added by reassessments is divided by the certified tax digest and the result is multiplied by the previous year's millage rate." The bill would require that "the millage equivalent" of the NFTAp also be subtracted from the previous year's millage rate. However, the definition in subparagraph (6) does not provide for calculation of a millage equivalent of the NFTAp and should be clarified to make it applicable in the new context.

In mathematical terms, millage equivalent under current law is a simple calculation; it is equal to 1) the change in total assessments for the given year due to reassessments divided by 2) the total assessed value of all property for the same year, with the result multiplied by 3) the millage rate for the prior year. The product of this calculation is a number of mills that are then subtracted from the prior year's millage rate to produce the roll-back rate. The calculation of a similar roll-back adjustment factor, in terms of mills, for the NFTAp should be defined as the ratio of 1) the NFTAp for the prior year over 2) the total assessed value of all property in the current year.

It is also problematic how this roll-back rate modification will apply after the first year it is in effect. Unlike the current-law rollback for gains from reassessment, which gains are measured anew each year versus the prior year, the NFTAp are always calculated as gains from the one-time expansion of the sales tax base, i.e. in comparison to the base under current law. From the estimates above, the aggregate sales tax base would expand by roughly $162 billion in CY 2024, producing around $5.4 billion of NFTAp, requiring an average roll-back rate adjustment of $5.4 billion divided by the aggregate assessed value for 2025. Should the local jurisdiction levy tax at the roll-back rate for 2025, then that rolled-back tax rate becomes the starting point for calculating the roll-back rate for 2026, from which they would subtract not just the millage equivalent of the incremental NFTAp in 2025 over that of 2024, but the entire amount of tax gain from this bill compared to current law. To the extent millage rates are, in fact, rolled back (even partially), the effect would compound, eventually reaching roll-back rates of zero mills.

To understand the magnitude of the problem, note that statewide property tax revenues for local governments were about $13.4 billion for CY 2019, according to DOR, while total assessed value was about $467 billion and the average millage rate statewide was 28.24. Had this law been in effect at the time and produced $5 billion of NFTAp, then the (average) millage equivalent of this NFTAp would be approximately 5/467 or 10.7 mills, and the roll-back rate (ignoring reassessments) would be 17.54. Adopting this roll-back rate would not affect the ratio of NFTAp to total assessments the following year under the bill as written, so assuming adoption of the 17.54 mills roll-back rate and also (for simplicity) flat sales tax collections and total assessments, the same calculation for the next year would push the roll-back rate to 6.84 mills and to zero the year after that.

Further modification of the bill language is needed to correct this, but for purposes of this note, it is assumed that the intent is only to offset the one-time gains from the 2024 base expansion and that the bill will be clarified to reflect this presumed intent.

Finally, it should be noted that roll-back rates are, under current and proposed law, not binding on local governments. The law merely requires the government to follow certain public notice and meeting requirements before adopting a millage rate above the roll-back rate. Thus, for purposes of this note, local revenue effects are given as a range, with the low assuming full rollback in property tax rates in CY2025 to offset the (one-time) base-expansion gains and the high assuming no rollback. The results, adjusting to fiscal years and accounting roughly for timing of sales versus property tax collections, are presented in Table 1.