

Is our State Broke? *...Or is our System Broken?*

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HOW WILL S.C. SURVIVE CURRENT
ECONOMIC CONDITIONS, WHILE LAYING
THE GROUNDWORK FOR FUTURE
ECONOMIC DEVELOPMENT?

*AN ANALYSIS IN SUPPORT OF
COMPREHENSIVE TAX REFORM*

Two Things We Hear in South Carolina:

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Economic Development efforts will *never* be effective in S.C., because...

“...the state of South Carolina has no money”

“Our Taxes, Here in South Carolina, Are Just Too High!”

True or False?

“But the State of South Carolina Has No Money?”

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**With budget cut after budget cut...
and the state and country in the midst
of a recession, these words are often
uttered.**

**But South Carolina has real needs...
and citizens continue to expect basic
services such as education, safety, and
healthcare.**

But the State of S.C. Has No Money?

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- Since 1953, SC experienced negative revenue growth twice!
- *But we are in our third year of negative revenue growth ('09-10)...& revenue is down \$660 mill entering into '10-11*
- In 2010-11, S.C. could be an *additional* \$1.5 billion short!
- The S.C. Board of Economic Advisors (BEA) has *cut revenue estimates 7 times in the last two years!*
 - Education has suffered 9 rounds of cuts in 18 months (*\$700+ million*)
 - Last year, K-12 has had its low 2009-10 budget cut \$317 (*1997 level*)
 - 2010-11: the General Assembly budgeted K-12 @ *1994-95 levels!!!*
- Just this last year, the **state of S.C. has lost over \$1.3 billion** in revenue... *leading to multiple budget cuts!*

What Has Happened to SC Revenue? *If taxes high?*

BEA to the TRAC, Dr. Bill Gillespie, September 30, 2009

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- Since 2006, SC has cut at least $\frac{1}{4}$ out of state budget (~25%)
- SC now relies on the Sales (47%) and Personal Income (40%) Taxes for a total of 87% of State Revenue (narrow tax base)
- S.C. Sales Tax Revenue has decreased (even though we've increased the tax twice since 1984) due to:
 - Increased numbers of Sales Tax Exemptions
 - S.C. economy shifts from products to “services” (*few are taxed*)
 - Shift of sales to Internet (*little-to-no S.C. taxation*)
- Personal Income Tax Collections *now at 2001-2002 Levels!!!*
- All Remaining (*non-Sales/Personal Income*): only 13-15%

“Our Tax Rates here in South Carolina *are just too high!*”

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SC’s Overall State/Local Tax Burden:

37th highest nationally

*Estimated at 8.8% of income
(below the national average of 9.7%)*

Are South Carolina Tax Rates Too High?

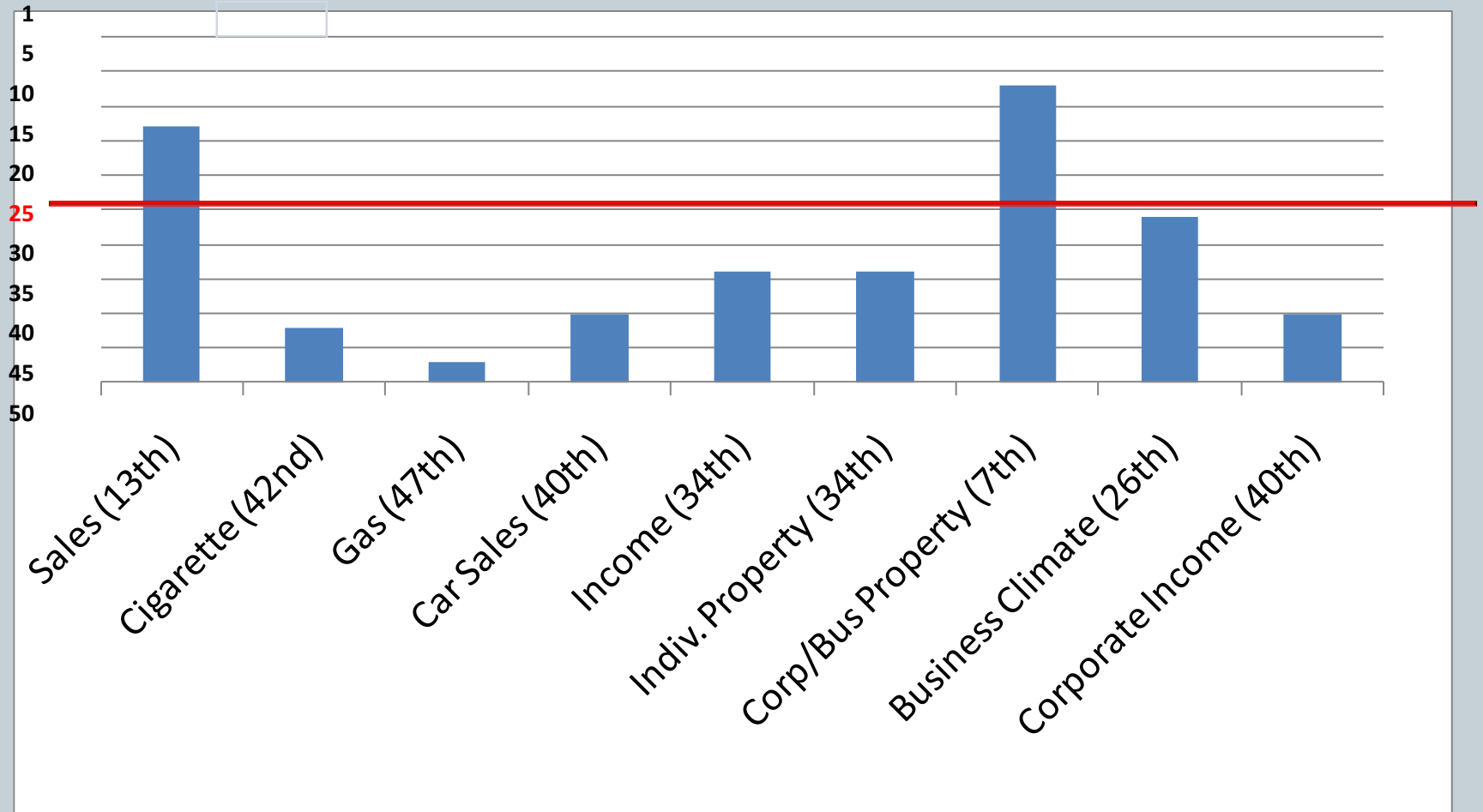
The Tax Foundation, non-profit 501-c-3 since 1937: www.taxfoundation.org

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- Sales Tax (6%): **13th** (*the most common rate; 26 states w/ lower rates*)
- Cigarette Tax (57¢): **42nd**
 - Last yr, NC raised 10¢...to 45¢
 - NC/Ga. Debating a \$1 increase
 - National Average: \$1.42 -pack
- Gas Tax: **47th** (*1987 last increase*)
- Car Sales Tax: **40th**
- Income Tax
 - Top Rate: **13th** (7%)
 - Overall: **34th** Effective Rate
- Indiv. Property Tax: **34th**
- Industrial/commercial/bus. Property Taxes: **7th**
 - (Due to Act 388 tax swap)
- Business Climate Tax: **26th**
 - Compares 5 areas:
corporate taxes; sales taxes;
unemployment insurance
taxes; indiv. income taxes;
& taxes on property
- Corporate Income Tax: **40th**

South Carolina Tax Rates *Versus* the Nation

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S.C. is Collecting ~24% Less (*\$1.57 billion*) in G.F. Revenue than in '06-07.

Why?

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Permanent Tax Cuts have Eroded Revenue Stream

(size of reduced state revenue since 2005)

- Homeowner Property Tax Break (sales swap): **\$585 mil ('08-09)**
 - *PLUS, Additional cost to state to reimburse schools ⇒ \$125.5 million ('10-11)*
- Total Elimination of the State's Grocery Tax: **\$430 million**
- Elimination of Soft Drink Tax (mid-1990's): **\$~34 million**
- Elimination of S.C.'s bottom income tax bracket: **\$86 million**
- Reduction of tax on small businesses (7% to 5%): **\$129 million**

* Source: *State Budget Outlook* presentation by SC Sen. Finance (*Mike Shealy & Craig Parks*)

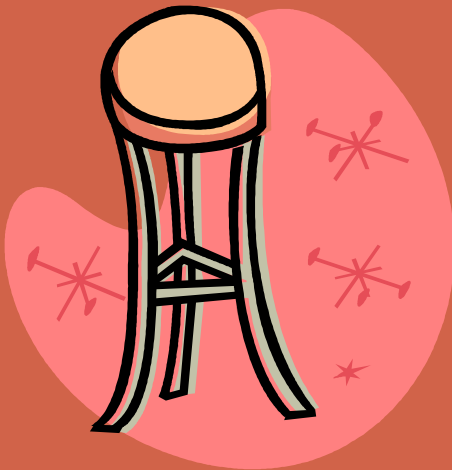
The state's not broke... *Our revenue system is!*

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- Permanent tax cuts in strong years (*no revenue in lean!*)
- Several tax rates are some of lowest in the country (*i.e. cigarettes, gas, cars*)
- ***Property Taxes ... & Act 388***
- ***Sales Taxes ... & Exemptions***
- We collect little in the way of “***Internet Sales Taxes***”
- Random ***tax incentives*** for New Businesses (*does SC do enough for existing...?*)
- We exempt more “***Services***” from taxes than most states
- In a deep hole & won't stop digging! (***19 new bills!!***)

The Three Legged Stool

South Carolina's Tax Structure prior to 2007



What Do We Tax in South Carolina?

In 2006, S.C. passed Act 388 which eliminated owner-occupied property taxes (for schools) in exchange for a 1-cent state sales tax increase.

Prior to this, our state's tax structure was praised by economists because it was balanced with three major sources of revenue: Sales, Income, and Property taxes. **This three legged stool had served our state well for decades.**

Today, S.C. relies mostly on Income & Sales Taxes to Fund most of its state budget... largely a *two-legged stool!*

What Did Act 388 do to S.C.'s Tax System?

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- Act 388 shifted tax burden from a *stable* revenue source (owner-occupied property) to a *less reliable & more volatile* source (sales)
 - *With sales down 8-10% in the current recession, so is state sales tax revenue*
- Since General Assembly promised to make up lost 388 tax swap (sales tax) revenue, the *G.A. has been forced to budget to reimburse school districts—*
 - *\$50 million ('08-09)*
 - *\$108 million ('09-10)*
 - *\$120 million (est. '10-11)*
- Act 388 has cost the state \$585 million since 2006 (*Anderson Independent*)

The Effects of Act 388 on Property Taxes

Dr. Robert Cline, Ernest & Young, LLP, "Broadening the Tax Base"

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- Act 388 immediately disproportionately **shifted \$250 million** *onto the backs of SC businesses.*
- SC business now pay 48% of the total S.C. property tax collections (*U.S. average is only 33%*)
 - Large Industrial: SC is 5th highest (74% above US av.)
 - Large Commercial: SC is 20th highest (9% above US av.)
 - Homeowner: SC is 37-39th (34% **below** the US av.)
 - Property tax share of business taxes in SC is 36% higher than US
- 388 created a tax incentive for people from NC to move to SC, work & pay NC taxes, & bring children to schools

The Effects of Act 388 on Property Taxes

Rudolph Bell, Greenville News, December 23, 2009” and Ellen Saltzman, Clemson University’s Strom Thurmond Institute, December 2009

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Disparity in tax bills b/w owner-occupied & 2^d/Rental homes much wider in SC than in Ga, NC, TN & Va

- Prior to Act 388, the difference was 50%. *Now...*
 - 141% higher in Beaufort Co.; 138% in Greenville; 133% in Clemson
- *Greenville Example:*
 - For \$1 million home, \$7,756 tax bill if “primary” home and \$18,486 if a “second” home
 - For \$100,000 home, \$776 if “primary” and \$1,849 if “secondary”
- *Statewide:* Differences can range from 119 – 165%
- *Consequence?* HUGE increase in % of homes classified as “primary” residence – *Beaufort increased from 25% to 40%*

Income Taxes: SC is taxing the *heck* out of its' Work Force

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**OF THE ~2.1 MILLION STATE
INCOME TAX RETURNS FILED,
41% HAVE ZERO TAX LIABILITY!**

**SC RANKS 6TH IN # OF TAXPAYERS
WHO PAY NO INCOME TAX!!**

RESULT? 59% LEFT, PAY MORE!!!

S.C. (Income) Taxing its' Workers!!!

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65-yr. old couple: \$76,580, yr.

Couple w/ 2 kids: \$26,000

65 yr exemption/2: \$30,000

Standard Deduction: \$11,400

Enhanced St. Ded.: \$ 13,600

Personal Exempt/4: \$14,600

Personal Exempt/2: \$7,300

Social Security Excl: \$25,680

Result? 1st \$76,580 Tax Free
(Don't pay taxes unless over
\$77,000)

Result? 1st \$26,000 Tax Free
*Most of SC's hard working
families make \$25-65,000
– working harder &
paying more in taxes!*

What DO We Tax in South Carolina?

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State **Sales Tax** = 6% (raises \$2.5 billion annually)

However, by allowing 80+ sales tax exemptions, we *exempt more (\$2.7 billion) annually than actually collected (\$2.5 billion)*

S.C. could eliminate 95% of exemptions, cut the sales tax in 1/2 (6 to 3-cents), and collect the exact same revenue (\$2.5 billion)

S.C. taxpayers (w/ no deductions) are subsidizing those who enjoy exemptions!

So, ... what do we actually tax?

{Cost of exemption in parenthesis.}

*Source: South Carolina Board of Economic Advisors “Sales & Use Tax Exemptions: Fiscal Year 2008-09” (<http://www.bcb.sc.gov/BCB/bea/exemptions.pdf>). Note: The examples below are just some of the 80+ exemptions to the South Carolina state sales tax. See link for more info.

What DO We Tax in South Carolina?

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Vehicle Tax Exemption = \$300 sales tax cap

- We collect \$300 on sale of used 2006 - \$5,000 Hyundai. We collect \$300 on a \$385,000 - 2009 Lamborghini Roadster – \$22,800 exemption. *{\$152 mill}*
- We collect \$300 on a \$36,000 BMW.
 - *N.C. collects \$1,080 & Georgia collects \$2,520 on same vehicle!*
- We collect \$300 on the sale of a \$5,000 - 15 foot Sylvan Smokercraft Fishing Boat. We collect \$300 on a used 1982 – 126 foot \$6.5 million Feadship Yacht – a \$389,700 exemption. *{\$5 million}*

What DO We Tax in South Carolina?

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- We collect 90¢ (6%) sales tax on a \$15 model airplane, but we cap the tax on a million dollar Lear jet at \$300 - a \$59,700 tax exemption. *{\$1.2 million}*
- We collect \$300 on the sale of a 1989 - \$5,000 Chieftain Winnebago. We collect \$300 on a 2007 - \$130,000 Coach House Platinum Recreational Vehicle – a \$7,500 exemption. *{\$7.9 million}*
- We collect \$300 on the sale of a 1973 - \$5,000 Singlewide (2 BR/1Ba/480 sq ft) Manufactured Home. We collect \$300 on a 2001 - \$139,500 Doublewide Commander Manufactured Home (4 BR/2Ba/2432 sq ft) which meets certain energy efficiency standards – a \$8,070 exemption. *{\$26.6 million}*

What DO We Tax in South Carolina?



We <u>DO</u> Collect Sales Tax	We do <u>NOT</u> collect Sales Taxes on...	Cost to SC
½ of Modular Home	the other half of the home	\$1.9 mil
\$4.14 on Panasonic Phone	Phone/cord from Phone Co.	\$22.8 m
\$18 on Lionel Train Set	\$300,000 EMD GP-9 Train	\$352k
18-cents on string for kite	Twine used - deliver papers	\$600k
6-cent, college rule paper	Paper sold to Newspapers	\$5 mil
42-c, Football Prev. Mag.	Sale: <i>The State</i> Newspaper	\$7 mil
Supplies for Laundromats	Supplies for Dry Cleaners	\$3.3 mil

What DO We Tax in South Carolina?



We <u>DO</u> Collect Sales Tax	We do <u>NOT</u> collect Sales Taxes on...	Cost to SC
14¢, dry clean shirt	Dry Cleaning for Ships	\$1.5 mil
glove to clean chicken cage	Automatic clean-out system	
\$35 on a 9ft. G-3 Jon Boat	\$15 mil. New Hopper Barge	\$170k
Sale of FM Radio Station	Sale of AM Radio Station	
Dinner cruise in Charleston	timeshare weekend, Battery	\$5.3 mil
\$60: <i>asphalting driveway</i>	Asphalt taken out of state	\$614k
State Fair concession items	<i>Pig on Ridge Concessions</i>	\$475k
Chassis for rebldg. Chevy	Chassis for Internt.Shipping	\$550k

What DO We Tax in South Carolina?

- We collect \$12 in taxes on the sale of a carburetor for the engine of a Chevrolet Nova. We collect no taxes on the sale of parts/supplies used in repairing commercial air carriers. *{\$562,000}*
- We collect taxes on the sales of Carolina and Clemson football tickets. We collect no taxes on lottery tickets. *{\$47.6 million}*
- We collect taxes on 30% of the gross proceeds of the rental of a portable toilet. We collect no taxes on the other 70% of the toilet. *{\$332,976}*
- We collect taxes on wicker items (baskets, furniture, etc.) sold at the town's local hardware store. We collect no taxes on the sale of sweet grass baskets. *{\$30,000}*

{These are just 25 of the over 80 sales tax exemptions! For examples of all 80 exemptions, go to What Do We Tax in SC? S.C. Sales Tax Exemptions @ www.oldeenglishconsortium.org }

...And in S.C., We Give You Two
“Shotgun Wedding”
Tax Free Weekends!

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2009: SC ADDED A *TAX FREE*
WEEKEND FOR GUN PURCHASES
AND
OUR *BACK TO SCHOOL* HOLIDAY
ALLOWS BRIDES TO PURCHASE
WEDDING DRESSES & LAW
FIRMS TO BUY THE YR'S *PAPER*

S.C. Loses Revenue on Internet Sales

2010 University of Tennessee Study

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- S.C. lost \$94 million last year in uncollected Internet sales taxes. This year, S.C. is expected to lose \$110 million
- From 2007 to 2012, S.C. is projected to lose \$569 million!
- Most S.C. citizens are unaware that they are required to pay sales taxes on all Internet purchases, by either:
 - Pay the sales taxes on line 26 of the S.C. Income Tax Return
 - Bring in receipt to DOR each time you make purchase & pay

Other states have adopted procedures to collect internet tax!
NC law: increase internet sales tax collections by \$500 mil
(*w/o internet collections, SC businesses competition disadv.*)

“Do We Tax “Services” in South Carolina?”

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2/3 of all S.C. purchases are “*services*”

BUT...

S.C. exempts 133 (*out of 168*) services!

Significantly more exemptions than other states

New “growth” items: *not taxed!!*

*Example: SC does not tax internet/computer-related items
– i.e. data processing & music/video/books downloading*

SC Exempts 133 Services (\$955 mil. ea. yr.)

Dr. Holley H. Ulbrich, Strom Thurmond Institute, February 19, 2010

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- In S.C. the **service sector** accounts for *over 1/2 of state GDP*
- From 1947 to 2007, “services” have grown from 39 to 66% of household consumption; *however, during the same time, the traditional “tangible sales” tax base – as a share of household consumption – dropped from 61 to 34%.*
- Yet, as SC moved from an *Industrial* to a *Service* economy, *our state has not adjusted* its revenue structure accordingly.
- If SC changed its system hence, it would expand the coverage of services (*broaden the base*) – allowing SC to lower tax rates for all citizens **&** generate sufficient revenue

SC & the Tax Exemption of 133 Services

Jim Eads, Executive Director, Federation of Tax Administrators, January 6, 2010

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- Nebraska recently found itself in a recession... and has increased from 55 to 74 services taxed (*to balance revenue*)
- What are other states doing? (*to spread & lower tax burden*)
 - Florida: taxes 64 services
 - Tennessee: taxes 67 services
 - West Virginia: taxes 110 services
 - ***Why broaden tax base by decreasing service exemptions?***
 - S.C. could lower the tax rate for all AND generate more revenue;
 - S.C. could distribute (a lower) tax burden to all businesses *fairly*;
 - S.C. could treat consumers more equally (& at a lower rate of taxation).
 - If S.C. taxed all *feasibly taxable* services, we could raise \$955 million in revenue (*or decrease all accordingly*)

What Services DO We Tax in South Carolina?

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S.C. Taxes “**Services**” at 6% Rate

However, by allowing 133 “service” tax exemptions, the state exempts almost \$1 billion per year (~\$955 million)!!!

80% of SC services are exempt; while only 20% are taxed...
...at a high rate of 6%!!!

S.C. could eliminate just 1/2 of the remaining (133) exemptions, cut the tax rate in 1/2 (6% to 3%), and collect the exact same revenue!

So, ... what do we actually tax? What do we exempt?

**Source: Federation of Tax Administrators, 2007 Survey of Service Taxation*

SC Exempts 133 Services (\$955 mil. ea. yr.)

Below are only *one-third* of the 168 “services” from the *Federation of Tax Administrators, 2007 survey of Service Taxation*



Services Taxed in South Carolina	Services <u>NOT</u> Taxed in S.C.
Cell Phone & Phone Answering Services	Dating, Tennis Lessons, & Massages
Diaper Service	Pet Grooming & Horse Boarding/Trng.
Funeral Services	Loan Brokering, Bail Bond, Debt Couns.
Commercial Art & Graphic Design	Interior Design/Decorating & Janitorial
Commercial Linen Supply	Storage of Household Goods or Furs
Credit Information	Lobbying, Public Relations/Mgt. Cons.
Photocopying & Printing	Telemarketing, Taxidermy, Tire Repair
Cable & Direct Satellite TV	Fishing & Hunting Guide Services
Car Rentals	Limousine & Travel Agent Services
Aircraft Rentals	Chartered Flight & Parking Lots/Garage
Hotel/Motel Lodging	Lawn Mowing/Landscaping/Extermin.
Trailer Park Overnight-Stays	Shoe Repair, Haircutting, Carpet Clean

Tax Incentives for New S.C. Businesses

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Is SC following its Strategic Plan (tax incentives)? What is our comprehensive job-creation, pro-business strategy?

Annually, special tax incentives range from \$32-\$254 mill

Once these tax incentives are “in,” they are “in.” Often, there is no “clock” for when all tax incentives expire.

How are existing businesses supported? *Do they end up paying for these incentives for out-of-state breaks?*

Just this past yr., the GA carved out a tax exemption for a natural disaster company that announced project 1½ yrs ago

What does this do to the overall tax burden/revenue?

The state's not broke... *Our revenue system is!*

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Cigarette, Gas, & Car Taxes

(ranked between #40-46):

- *\$300-800 million per year*

Property Taxes (& Act 388):

- *\$150+ million exempted per yr.*

Sales Tax Exemptions

- *\$2.7 billion per year*

Internet Taxes Not Collected:

- *\$110 million per year*

Service Exemptions:

- *\$955 million per year*

Random Annual Tax Incentives:

- *\$32 – 254 million per year*

Bottom Line

Uncollected *Exempted* Revenue

- **Approx. \$4-5 billion annually**

Could SC drastically lower tax rates for all South Carolinians?

Could SC “plug the hole in the leaky ship?”

Could SC stabilize its economy – creating jobs across S.C.?

Could we do it ALL?

*“So... How Did We Get in
This Mess?”*

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Our State is not Broken...

Our current system of
taxation is!

Why Do We Need Tax Reform?

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Our current system of taxation is a *hodgepodge* – evolving from tax cuts and tax shifts over the past 20 years *that has left the state with unstable/unreliable revenue sources.*

- We have cut tax sources during the good years leaving us with insufficient resources during the down cycles.
- We've responded to the pressure of special interest groups
- Our system does not support infrastructure development needed for the successful future operation of our state. It only supports the state's needs during the boom years.

Why Do We Need Tax Reform?

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- We tax some goods & not others without any apparent reason!
- ***And it doesn't stop!*** Our elders taught us that, when you look up & find yourself deep in a hole... the first thing you've got to do... ***is to stop digging!*** (at least until you analyze how you got there... and come up with the best solution to get out of the hole!)
- Just this session, the General Assembly introduced 19 new bills – giving new tax breaks to everything from *animal husbandry* to *geothermal heat pumps* exemptions!

*“So... What Can We Do to Change
our System & Get Out of This Mess?”*

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**What are the
Fundamental Criteria
of a
Sound Tax Structure?**

Fundamental Criteria of Tax Structure

Saltzman & Ulbrich, Strom Thurmond Institute

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1. It must be **competitive**. It cannot be viewed as one that discourages industries and people from coming to our state, living in our state, expanding business in our state, and investing in our state.
2. It must be **adequate**. It must support improvement of SC's economic foundations:
 - ✦ *Educational and workforce quality systems*
 - ✦ *Infrastructure*
 - ✦ *Vibrant and growing communities*
 - ✦ *Overall quality of life*
3. It must be **equitable** *both horizontally and vertically*. It must be perceived as fair. No one segment should have advantage at the expense of others. (*Palmetto Institute*)

The best approach is to have a *broad tax base with the lowest possible tax rates*. This is not the way we are currently headed.

“So... What is Our General Assembly Doing to Fix It?”

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On June 24, 2009, the leaders of the
General Assembly passed S.12
creating the

**“South Carolina Tax Realignment
Commission,”**

also known as **TRAC.**

What IS this “TRAC” Commission?

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- TRAC is a temporary & independent commission comprised of non-legislators. It is created to assess the effectiveness of the current tax structure and make recommended changes to the General Assembly by November, 2010 (dissolve Jan. 1, 2011).
- Members include:
 - Ken Wingate (CPA, JD – Gov. Sanford) * Jack Shuler (Speaker Harrell)
 - Brian Moody (CPA – Gov. Sanford) * Bob Steelman (Chairman Cooper)
 - Don Weaver (Sen. McConnell) * Kenneth Cosgrove (Chair Cooper)
 - Burnet Maybank, (JD - Sen. Leatherman)* Ray N. Stevens (DOR Director)
 - Ben Kochenower (CPA – Sen. Peeler)
 - Charles S. Way, Jr. (Sen. Land)
 - Jimmy Addison (Speaker Harrell)

“So... What Should I do about it? How Can I Make A Difference?”

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1. Support the goal of Tax Reform & the work of TRAC. *This should be our state’s top priority. Economic Dev!!*
2. Call your local legislators NOW... thanking them for passing S.12 (TRAC working on this for 1 yr.). *Are they just as committed to passing TRAC recommendations?*
3. Begin sharing (holding meetings and/or sharing at existing meetings)... *sharing the need for tax reform in South Carolina & the structure for fundamental change*
4. Make your voice heard (*letter to editor, call/email, etc*)
5. Ask candidates for office *how they plan to vote re: TRAC*

Who can I contact for more information?

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Olde English Consortium

- www.oldeenglishconsortium.org (hand-outs, revised regularly)
- 803-385-5143 or FanningOEC@gmail.com

Western Piedmont Consortium

- www.sc-wpec.org (hand-outs revised regularly)
- 864-223-9127 or RWILSON@SC-WPEC.ORG

Please feel free to contact Dr. Mike Fanning (OEC) and/or Dr. Ray Wilson (WPEC) if you would like further information or if you would like for someone to come and speak re: Tax Reform with a group in your region.

Please use this information in any way you see fit. They are yours to copy, adapt, & use on your own. Help us get the word out. We want our communities, legislators, and candidates to hear from as many people as possible about this important issue: Comprehensive Tax Reform.