September 30, 2009

Dear Mr. Gossett:

As you are aware, Act 81, which became effective July 7, 2009, requires the South Carolina Taxation Realignment Commission (TRAC) to provide the General Assembly with the criteria it will use to assess the effectiveness of the state's current tax system structure within three months of the act's effective date. The legislation provides specific guidance regarding the development of such criteria, stating that it (the criteria) "...be designed with an emphasis on the systemic balance of the state's revenue structure from the standpoint of adequacy, equity, and efficiency and with the goal of maintaining and enhancing the State as an optimum competitor in efforts to attract business and individuals to locate, live, work, and invest in the State."

With the understanding that there is no "one size fits all" formula for evaluating any state's tax structure, please accept the enclosed information as the timely submission of TRAC's required criteria it plans to utilize in its assessment of the effectiveness of the state's current tax system structure.

If you have any questions, do not hesitate to contact me.

Sincerely,

Burnett R. Maybank, III, Chairman
South Carolina Taxation Realignment Commission

Enclosure

Cc: The Honorable Marshall C. Sanford, Jr., Governor of the State of South Carolina
The Honorable Glenn F. McConnell, President Pro Tempore of the State Senate
The Honorable Robert W. Harrell, Jr., Speaker of the House of Representatives
The Honorable Hugh K. Leatherman, Sr., Chairman Senate Finance Committee
The Honorable Daniel T. Cooper, Chairman House Ways and Means Committee
The Honorable Charles F. Reid, Clerk of the House

TRAC STATUTORY OBJECTIVE:
To ensure the State's tax structure enhances "*...the State as an optimum competitor in efforts to attract business and individuals to locate, live, work, and invest in the State*." (Section 1(C)1 of Act 81 of 2009).

As such, TRAC, where possible to objectively measure, will consider the following criteria when examining the "adequacy, equity, and efficiency" of the State's tax structure, and will do so mindful of the statutory objective referenced above:

ADEQUACY:
In short, "adequacy" examines concepts of "reliability" and "balance". Specifically:
1) Does the current tax structure produce revenues that are not highly cyclical relative to the "business cycle", or does the current mix of revenue sources lead to volatility during up and downturns in the economy?
2) Related to the "mix" of revenues, is the state overly reliant on one source of revenue, or is there an appropriate "balance" of sources?
3) Likewise, is the current mix (or balance) stable (as understood by the concept of "elasticity")?
4) Regarding "competition" generally, is the state's tax structure and/or burden (both individual and business) dramatically out of line with other states?
5) Regarding the state's competitive position as it relates to business taxes specifically, understanding that revenue systems are sometimes used as tools of economic development, does the state impose a tax burden far different from that of other states?

EQUITY:
Equity examines the concepts of "fairness" and/or "equal protection" in and/or among various categories or levels of taxpayers. Specifically:
1) How is the tax burden distributed among various categories of taxpayers?
2) Related to individual/household taxpayers specifically, is the current state tax structure "horizontally equitable"? That is, are taxpayers with the same capacity to pay treated equitably? Generally speaking, it is accepted that the "narrower" the tax base, the more inequitable the system. In contrast, the broader the base, the more equitable the system, generally speaking.
3) An additional component to the equity analysis relates to "vertical equity". Specifically, how do tax burdens compare among taxpayers with different levels of incomes and/or abilities to pay?
4) Specifically, does the current tax structure, when examined system wide, minimize "regressivity" as that concept is typically defined?
5) Related to business taxpayers in particular, does the tax structure provide similar treatment for all industries and all firms within a particular industry?
6) Does the tax structure overly favor new business vs. existing business?

EFFICIENCY:
Efficiency examines the tax structure relative to its "neutrality" in impacting or incentivizing taxpayer decision making. Specifically:
1) How efficient is any given state "tax expenditure" (incentive, etc.)? That is, does it accomplish a significant increase in private sector activity with a relatively modest "cost" in terms of lost tax revenue?
2) How does the tax expenditure impact the tax structure relative to the concepts of "adequacy" and "equity"? Does it significantly impact a particular revenue stream that supports a public service(s) and/or does it significantly change the distribution of the tax burden from one class of taxpayer to another?
3) Related, does the tax expenditure incentivize a new or desired activity or does it "reward" existing behavior, or behavior that would have taken place anyway, in the absence of the incentive?

The following sources were used to develop TRAC's "assessment criteria": "Principles of a High-Quality State Revenue System" - a report by the National Conference of State Legislatures; "The Way We Tax - A 50 State Report", Governing Magazine, February 2003; "Selected Issues in South Carolina's Tax and Education System", a report by Donald Boyd and William Fox, April 23, 2008; "Ensuring a Competitive Revenue System for South Carolina - Findings and Conclusions from an Evaluation of the South Carolina Revenue System", Holly Ulbrich, Strom Thurmond Institute of Government and Public Affairs, Clemson University, November 18, 2005.