

SC Taxation Re-Alignment Commission (TRAC)

MINUTES

Friday, September 10, 2010 at 10:00 AM

Room 105 Gressette

The meeting was called to order at 10:05

I. Welcome

In attendance:

- Ray Stevens
- Ken Wingate
- Ben Kochenower
- Burnie Maybank
- Bob Steelman
- Kenneth Cosgrove
- Jack Shuler

Not in attendance:

- Brian Moody
- Don Weaver
- Jimmy Addison
- Charlie Way

Chairman Maybank explains documents that are passed out to Commissioners. It is a property tax comparison produced by Dr. Ulbrich that he believes to be neutral which is hard to find among property tax comparisons.

II. Adoption of Proposed Agenda

Commissioner Shuler moved to adopt the agenda, Commissioner Wingate seconded the motion. The agenda was adopted via voice vote

III. Adoption of Minutes from Previous Meeting

Commissioner Shuler moved to adopt the minutes, Commissioner Steelman seconded the motion. The minutes was adopted via voice vote

IV. Other Funds Presentation by Mike Shealy, Budget Director, Senate Finance

General Fund collections are \$5.75 B, Federal Funds total \$7.37 B, Other Funds \$7.44 B. SC personal income is \$145 B therefore total collections are about 15% of SC's economy.

FY 10-11 brought a proviso that creates the Joint Other Funds Oversight Committee to review other funds in the state and recommend the appropriate policy for the receipt, appropriation, expenditure, and reporting of other funds. Fund sources are interrelated. General Fund downturns force agencies and interest groups to seek fees. Federal program expansions produce pressure to create match funding. Other fund availability changes strategies of agencies (& interest groups) in seeking General Funds. General Funds have the least strings attached for their use. They are underwritten by the state's income tax (individual & corporate), the general sales (4%) tax and citizens pay and all receive some type of benefit.

Federal funds are usually categorical programs by the Federal Government requiring a funding match by state government. These are generally regulations on the use of these funds, and non-compliance can mean penalties. Major programs include Medicaid, Transportation and Research.

Many presidential administrations have used a Keynesian approach to macroeconomic policy (example: ARRA of 2009). SC's portion of stimulus funds: Total \$7.86 B of which \$2.86 B in tax cuts and total spending in SC \$5 B. Of the \$5 B \$3.4 B will be received by state agencies through the state budget. Distribution requirements: 82% must be allocated to K -12 and higher education and 18% may be allocated for other government purposes. Federal Debt held by public is \$14 Trillion. In comparison to other countries of debt as % GDP the US falls on the high middle.

Other funds can be defined as "earmarked" or "restricted." Earmarked fund means that the interest from the fund accrues to the General Fund. Restricted means that the interest on the fund accrues to that specific fund. In SC's accounting system, when an appropriation cannot be classified as General or Federal, it is other funds. In theory, there is a relationship between the cost borne by the individual and the benefit accrued by the individual using the government services. Externalities are produced that benefit the state as a whole. The role of the GA: 1)How revenues are collected and deposited. 2) How much is spent 3) What funds are spent on. 4)Transfers of funds. 5) Lapse and carry-forward of funds. The role of the executive branch: Implementation to cause an action based on the parameters set by the Legislative Branch. In SC great attention is given to General Funds at the margin with numerous budget laws (statutes & provisos). They have a passive stance to Federal Funds, depending on trade groups for favorable treatment and Executive Branch for interpretation. Spotty attention is paid to other funds, dependent on circumstances.

Top 10 'Other Funds:'

Earmarked or Restricted: University Fees, Sales Tax – EIA, Medicare and Medicaid Reimbursements , Gas Tax, Auxillary Enterprises – Sales and Services, Lottery Proceeds, Contributions Hospitals/Medicaid ospital MIAA, Motor Vehicle Licenses, Special Fuel Tax

Federal Funds: DHHSs Medicaid Assitance Payments, DSS Food Stamp Coupons, DOT Federal Grants, DHHA disproportionate Share, SCE school food services, SDE low income, SDE Title VI Part B Handicapped, DHHS Medicaid asst payments, DSS Temporary assistance to needy families, MUSC Health services research and development grants.

A detailed budget submitted by state agencies to the Office on State Budget serves as the basis for the Appropriation Bill deliberation. There has been a trend in spending from General Funds to Other Funds. Conditions may accelerate this trend for the foreseeable future.

Commissioner Kochenower asks if there are any suggestions for how TRAC should address the lack of concern regarding Federal and Other Funds. Mr. Shealy believes the Commission should endorse the process that is set up in proviso and make recommendations as they deem appropriate within the scope of this proviso.

Commissioner Steelman inquires whether it would it be appropriate for TRAC to make standards in the recommendations regarding review and approval of these Other and Federal Funds. Mike believes that if TRAC recommendations included a framework and structure for evaluating other funds, that would be within their scope.

V. Presentation by Michael W. Fanning, Ph.D.

How will SC survive current economic conditions, while laying the groundwork for future economic development? Since 1953, SC experienced negative revenue growth twice. This is the third year of negative revenue growth and revenue is down \$660 M entering in FY 10-11. In FY 11-12, SC could be an additional \$1.5 B short. The South Carolina Board of Economic Advisors 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 M (1997 level). In Fy10-11 the General Assembly budgeted K-12 @ 1994-95 levels. This past year, the state of SC has lost over \$1.3 B in revenue leading to multiple budget cuts. Since 2006, SC has cut at least ¼ of the state budget. SC now relies on sales tax and personal income for 87% of state revenue. Sales tax has decreased due to increased numbers of sales tax exemptions. Personal income tax collections are now at 2001-02 levels. SC has the 37th highest tax burden nationally.

SC is collecting 24% less (\$1.57 B) than in 06-07. Permanent Tax cuts have eroded the revenue stream. Several tax rates are some of the lowest in the country. In 2006, SC 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. 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 revenues. Since the General Assembly promised to make up lost A388 tax swap (sales tax) revenue, the GA has been forced to budget to reimburse school districts. Act 388 has cost the state \$585 M since 2006. Act 388 disproportionately shifted \$250 M onto the backs of SC businesses. SC business now pay 48% of the total SC property tax collections. Act 388 created a tax incentive for people from NC to move to SC work and pay NC taxes and bring children to SC schools. It also created a disparity in the tax bill between owner-occupied & 2nd/ Rental homes as it is now much wider in SC than in Ga, NC, TN, and VA. Prior to Act 388 the difference was 50% but is now 141% higher in Beaufort County.

Income taxes: Of the 2.1 M state income tax returns filed, 41% have zero tax liability. This has SC ranked 6th in the number of taxpayers who pay no income tax.

State sales tax = 6% (raises \$2.5 B annually). However, by allowing 80+ sales tax exemptions we exempt more annually than actually collected. SC could eliminate 95% of exemptions, cut the sales tax in ½ (6-3 cents) and collect the exact same revenue (\$2.5 B).

SC loses revenue on internet sales. SC lost \$94 million last year in uncollected internet sales taxes. This year, SC is expected to lose \$110. From 2007 to 2012, SC is projected to lose \$569 million. Most SC citizens are unaware that they are required to pay sales taxes on all internet purchases by either: A) Pay the sales taxes on line 26 of the SC income tax return. B) Send in receipt to DOR each time you make an internet purchase and pay. Other states have adopted procedures to collect internet tax. NC law increase internet sales tax collections by \$500 mil.

SC has significantly more exemptions than other states. In SC the service sector accounts for over ½ 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 consumptions – 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 taxes services at 6%. However, by allowing 133 service tax exemptions, the state exempts almost \$1 B per year.

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. 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.

Commissioner Kochenower: How would you score our work product so far? Mr. Fanning would score it a solid A. The goal of broadening the base to lower the rate. As a non-profit, he whole heartedly supports that non-profits should pay taxes on taxable goods. Very appreciative of the work TRAC has accomplished thus far, and be as innovative as the commissioner has been thus far.

VI. Receipt of Subcommittee Proposal

The Commission received the Individual Income Tax Subcommittee Report.

Chairman Maybank: Local A&H is next Friday in Charleston. Meeting will be in Charleston and will be casual. Corporate Income Tax Subcommittee has not been scheduled and will be much narrower.

Rebecca Gunnlaugson from Department of Commerce will present at a future meeting

VII. Other Business

The next TRAC meetings will be Tuesday, September 21 (property tax being the primary focus), and the 30th of September.

VIII. Adjournment

Meeting adjourned 11:32 AM.