

SC Taxation Re-Alignment Commission (TRAC)

AGENDA

Thursday, October 28, 2010 at 10:00 AM

Room 105 Gressette

The meeting was called to order at 10:10 AM.

I. Welcome

In attendance:

- Ben Kochenower
- Charlie Way
- Bob Steelman
- Kenneth Cosgrove
- Brian Moody
- Jimmy Addison
- Burney Maybank
- Ken Wingate
- Don Weaver

Not in attendance:

- Jack Shuler
- Ray Stevens

Commissioners will be submitting a written statement regarding TRAC. These written statements will be included in the final report.

II. Adoption of Proposed Agenda

Commissioner Way moved to adopt the proposed agenda. Commissioner Addison seconded the motion. The agenda was adopted without objection.

III. Adoption of Minutes from Previous Meeting

Commissioner Way moved to adopt the proposed minutes. Commissioner Steelman seconded the motion. The minutes were adopted without objection.

IV. Doug Lindholm, Executive Director, Council on State Taxation (COST)

Mr. Lindholm represents almost 600 of the country's largest companies. COST is to promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

COST/E&Y Annual State Business Tax Burden Study (March 2010, for FYE 2009)

This state tax burden study provides estimates of the taxes paid by businesses in each state, which is an important first step in any evaluation of business taxes or tax reform. The study estimates business property taxes, sales and excise taxes paid by businesses on their input purchases, gross receipt taxes, corporate income and franchise taxes, business and corporate license taxes, unemployment insurance taxes, individual income taxes paid by owners of non-corporate (pass-through) businesses and other state and local taxes that are the statutory liability of business taxpayers.

In FY 2009, SC businesses paid nearly \$6 B in state and local taxes. The corporate income tax accounted for 4% of that total (property taxes = 50%) This figure translates to a total effective business tax rate (TEBTR) imposed on business activity in SC of 4.7%. The TEBTR is measured as the ratio of state and local business taxes to private-sector gross state product, the total value of a state's annual production of goods and services by the private sector. The average TEBTR across all states is also 4.7%.

State corporate income taxes seem to garner an inordinate amount of attention from policymakers, commentators, and interest groups – perhaps bc the tax is often perceived by the uninformed to be the primary source of business taxation levied by states. In actuality the Corporate Income Tax contributes relatively small amounts to state coffers.

Sales tax expansion to services – policy issues: Shift from Manufacturing Economy to Service Economy. There were early attempts by FL and Massachusetts. Recent attempts by Maryland and Michigan. Policy arguments: Exempt Business Services, Sourcing Issues, and Disproportionate Impact on Small Businesses.

Tax Administration: In COST's most recent survey of state tax administration systems, SC scored a respectable B grade. The Commission might want to consider the following changes to improve the laws governing tax administration in SC: 1) Require ALJs hearing tax disputes at the ALJ Division to have tax expertise prior to appointment; 2) Eliminate the requirement forcing taxpayers to pay a disputed tax prior to appeal to Circuit Court and Court of Appeals; 3) Equalize the rate of interest applicable to refunds and assessments (currently 2% disparity); 4) Extend the state income tax due date to 30 days beyond the federal return due date; and 5) Define final determination for purposes of reporting federal tax changes to SC.

Recommendations fall well into TRAC's purview.

Commissioner Weaver motions to adopt these five recommendations, Commissioner Steelman seconds the motion. The motion passes without objection. The five recommendations (listed above) are adopted without objection and will be included in the Conformity Report.

V. Rebecca Gunnlaugsson, Director of Research, Department of Commerce

Volatile General Fund growth has been the pattern of recent years.

Property Tax: Counties may increase millage rates year over year to reflect increases up to the CPI plus their resident population. Counties perform general reassessments every 5 years but reappraisals can occur at other times too. Home values do not always follow the CPI. Property taxes are able to increase at levels greater than either housing price index or CPI plus population. 17 states have classified assessment systems. SC has the most categories at 10 and the most rates at 4 (AL and TN also have 4 rates). One of 4 SE states (LA, MS, SC, TN) with different assessment rates for primary residential and other real property. FL, NC, and VA have uniform assessments of 100%. Industrial real and business personal assessed at 2.625 times the rate of primary residential more than all other SE states. Disparate Valuation Methods: Sales price, market value, and taxable values vary considerable. The State Newspaper article "SC's unhappy homeowners" Changes in the market occur more rapidly than changes in appraisals. Exemptions: Foster inequity across municipalities, Have the potential to be subjective and unevenly applied even within the same jurisdiction. Shrink the tax base. Shift the tax burden. Complicate the tax structure. Exemptions: 1) Homestead Exemption began in 1972 with an exemption of 20K for those 65+. The exemption expanded to 50K in 2001. Credit increased from \$45.9 M to \$156.2 M (2000-08). 2) FILOT began in 1987. It allows manufacturing properties a rate of 6% for 30 years with a \$2.5 M investment of 4% for 40 years with \$100 M and 125 jobs. Allows fixed millage rate. This establishes competitive, stable rate for businesses and favors new, large capital investments over existing smaller capital.

Personal Income Tax: High marginal tax rates on low taxable income. Higher tax on labor income discourages human capital investment and entrepreneurial activities. Higher tax rates on higher tax brackets results in greater inefficiencies.

Deadweight Loss: The value of work that would have taken place but doesn't because of tax incidence. In 2008, 41% of individual filers paid no state income tax. This was up from 27% in 2000 and 31.8% in 2007. Explanations for declining tax liability: Using federal taxable income rather than AGI as the starting point for calculating state taxable income; High level of state standard deductions and personal exemptions; Increasing tax credits and targeted deductions; Elimination of the 2.5% tax bracket.

Credits and Deductions: SC allows 36 personal income tax credits. The most substantial include: 1) Non-resident credit (61%), 2) Two wage earner credit (22%) and 3) Child care credit 9%.

Corporate Income Tax: Collections highly variable year-over-year. Totaled \$109.6 M (2.1% of state general revenues) in FY 2010. Sparse data on firms paying corporate tax: SC has one of the lowest corporate income tax rates. Other states impose gross receipts tax (GRT), franchise tax, or additional tax on property, payroll, capital, etc. SC had 20 credits against corporate income tax in FY 2007-08. \$708.9 million in credits claimed. There are 454 filers claiming credits. Investment tax credits: Stimulate new investment, but lower the value of existing capital. SC allows credits to be carried forward up to 15 years. \$645 million carried forward in 07-08. There are 279 filers with carry forward. Increasing use of tax credits and

carry forward's over time. this reduces state corporate revenues. Historically, state corporate tax has been highly variable year-over-year.

Commissioner Steelman: Repeal corporate income tax or reform it? Rebecca explains there are pros and cons to each. Elimination would remove the trouble issues. It is a revenue source though. Most states have some sort of tax on corporations in their states. A reform effort would require some extensive rework. We are taxing few corporations right now.

Sales Tax: Declining sales tax collection since 2004, gross sales have steadily increased (pre-recession) while sales tax collections have declined. 10/1/06 Food tax reduced to 3%. 11/1/07 food tax reduced to 0%. In 2007, gross sales increased 4% while tax collections decreased 5%. BEA estimated \$2.75 B in tax revenues were not collected on items exempt sales tax in FY 2007-08. Consumption patterns have shifted from goods to services in SC. 1965, 54% of consumption was in goods while 46% was services. In 2008, consumption was comprised of 26% goods and 74% services.

Key observations:

Corporate Income Tax: A small number of firms received a large amount of credits. Credits primarily accrue to larger, new firms over smaller and or established firms.

Property Tax: Property value appraisal increases and local spending drive the increase in property tax. Varying assessment rates plus targeted exemptions create an uneven and non-competitive distribution of tax burden.

Personal Income Tax: SC's tax structure is evolving into an effective 2-tier system with rates of 0% and 7%. There is a higher marginal tax rate (on low taxable income), large standard deductions, and highly targeted exemptions.

Sales tax: SC taxes relatively little of its retail sales, requiring higher taxes on a narrower range.

VI. Final Action on Draft Reports

A) Soft Drink Tax Report

Commissioner Cosgrove motions to table the report, Commissioner Weaver seconds the motion. The motion carries with Chairman Maybank being the only opposing vote.

B) Conformity Report

Commissioner Steelman motions to adopt the report, Commissioner Cosgrove seconds the motion. The report is adopted without objection.

C) Fair Tax Report

Commissioner Moody motions to adopt the report, Commissioner Kochenower seconds the motion. The report is adopted without objection.

D) Property Tax Report

Commissioner Steelman moves to adopt the report, Commissioner Kochenower seconds the motion.

Commissioner Steelman suggests a uniform FILOT system. He is willing to reduce the current level to the Department of Commerce recommendation.

Commissioner Way believes that counties need to compete and would like to withdraw that from the report.

Commissioner Addison moves to remove the schedule F requirement. Commissioner Wingate seconds the motion. The motion carries.

Commissioner Addison moves to adopt the report as amended, Commissioner Wingate seconds the motion. The report is adopted without objection.

E) Corporate Income Tax Report

Commissioner Cosgrove moves to adopt the report, Commissioner Moody seconds the motion. The report is adopted without objection.

F) Accommodations and Hospitality Tax Report

Commissioner Weaver moves to strike the accommodations tax on timeshares from the report. Commissioner Kochenower seconds the motion. The motion fails.

Commissioner Moody moves to adopt the report and Commissioner Addison seconds the motion. The report is adopted.

VII. Other Business

Commissioner Cosgrove notes that this is a vast step forward for SC taxation policies and should not be dismissed without serious consideration.

Commissioner Kochenower would like to note that he found this to be a rewarding experience. He believes the Commission accomplished a great deal and should be proud of their work.

Commissioner Weaver thanks all commissioners, especially those from out of town.

Commissioner Addison thanks Ex-Officio Commission Ray Stevens for his invaluable input along the way.

VIII. Adjournment

The meeting adjourned at 12:15 PM.