Notes/Sources Page for:

"SC TRAC Sales and Use Tax Exemption Recommendations - Proposal Modifications"

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Slide 1:

Title page.

Slide 2:

Pursuant to Act 81 of 2009, which established TRAC, and according to SC Code Title 12, Chapter 3, Section 10(C)(2)(a), the General Assembly specifically mandated that TRAC provide the General Assembly a "detailed, careful, and comprehensive" recommendation regarding which "sales and use tax exemptions or limitations to be retained, modified, or repealed."

The General Assembly, at least twice during the past decade, has established its own, either joint and/or ad hoc committees, composed of legislators, to undertake a similar review as the one outlined above. However, in neither case did the work of either committee materialize. The committees did not adopt or publish recommendations regarding which sales and use tax exemptions or limitations should be retained, modified, or repealed.

Pursuant to Title 12, Chapter 3, Section 10(C)(2)(b), the General Assembly requires TRAC to, in part, (a) assess state taxes levied that (b) "…fund the operation and responsibilities of state…government".

Comprising 42 percent of total General Fund receipts in the fiscal year just ended (FY2009-10), the Sales and Use Tax is the single largest component of State General Fund revenue. This important component of the State's tax structure is (a) a state levied tax, and (b), the revenue it produces does fund the operation and responsibilities of state government, namely and primarily, K-12 education (pursuant to SC Code 12-36-2620, 12-36-2630 and 59-21-1010).

In FY1996-97, almost 50 percent of "gross retail sales" were subject to sales tax in South Carolina. By FY2008-09, that percentage had fallen to just 38 percent - a number that continues to fall.

More telling is the fact that, during the 10-year period between FY1999-00 and FY2007-08, while "gross" retail sales in South Carolina grew annually at a rate of almost 6 percent, "net" retail sales subject to State sales tax grew at half that annual rate, or just over 3 percent per year. This rate is less than the rate of annual growth in the State's population plus inflation.

It is proper for TRAC to have exhaustively studied the State's sales and use tax history, adaptations (or lack thereof) of (or to) the tax over time, structural issues, and specifically its more than 120 exemptions, exclusions, or maximum sales tax caps, which, as noted above, total an estimated $2.7 Billion annually.

TRAC recognizes that the State's exemptions, exclusions and maximum caps to the sales tax now exceed the amount of General Fund revenue generated from the State's current sales and use tax base not exempt from the tax, thereby making a thorough review of those exemptions of paramount importance when undertaking an overall review and comprehensive analysis of the State's tax structure.

State General Fund revenue derived from the State sales tax, having just completed its third consecutive year of revenue decline, totaled $2.19 Billion during FY2009-10. This is the same level of revenue generated in FY2003-04, or 6 years ago, and, adjusting for inflation, equates to roughly the same level generated in FY1996-97, or 13 years ago.

Slide 3:

Current Proposal

Broaden the Base:
Broaden the State's sales and use "tax base" by repealing, amending, or modifying dozens of the State's sales and use tax exemptions, exclusions, and/or maximum tax caps.

Note: Based on unofficial staff estimates (official BEA estimate pending), the proposal would "broaden" the State's sales and use tax base by an estimated $11.48 Billion, generating an estimated $689 Million in revenue annually.

Lower the Rate:
Utilize 100 percent of the estimated revenue to be generated ($689 Million) for a dollar-for-dollar, commensurate, and permanent reduction in the State's 6% sales and use tax rate, which, at 6%, is currently one of the highest state sales and use tax rates in the country.

Based on initial and unofficial staff estimates, this proposal would lower the State sales and use tax rate from 6% to 4.96%. This is completely revenue neutral.

It is important to note that a rate reduction from 6% to 4.96%, which is almost a 20% reduction, would improve the State's national sales tax ranking by roughly 18 full spots.

It should also be noted that this rate reduction, while substantial, should move lower still, pending TRAC's adoption of the final version of its "Services and Intangibles" recommendations. Like this proposal, TRAC recommends that the General Assembly utilize 100 percent of whatever revenue is estimated to be generated by the services/intangibles recommendations for further dollar-for-dollar rate reduction. Note: While we believe this to be a valid assumption, it nevertheless requires BEA analysis for verification and/or correction.

Modified Proposal

Note: In its effort to recommend long-term and sustainable structural reform, TRAC makes thoughtful decisions by continuing full exemptions on certain items, imposing substantially lower rates on others, and fully exempting certain segments of the population from tax liability out of a desire to achieve the difficult balance between a system that is fairer for all South Carolinians on the whole, while not overly burdening the most vulnerable portions of our populace. As a result, the modified proposal does not expand the base to the degree that the "current proposal" does (see below).

Broaden the Base:
Broaden the State's sales and use "tax base" by repealing, amending, or modifying dozens of the State's sales and use tax exemptions, exclusions, and/or maximum tax caps.

Note: Based on unofficial staff estimates (official BEA estimate pending), the proposal would "broaden" the State's sales and use tax base by an estimated $10.1 Billion, generating an estimated $611 Million in revenue annually.

Lower the Rate:
Utilize 100 percent of the estimated revenue to be generated ($611 Million) for a dollar-for-dollar, commensurate, and permanent reduction in the State's 6% sales and use tax rate, which, at 6%, is currently one of the highest state sales and use tax rates in the country.

Based on initial and unofficial staff estimates, this proposal would lower the State sales and use tax rate from 6% to 5.06%. While slightly revenue negative, TRAC recommends the General Assembly "round down", and as such, set the rate at 5%.

Note: This recommendation assumes the official BEA estimate (still pending) comes in between 5 and 5.06%. If the official estimate comes in below 5%, the recommendation is to adopt the lower (and revenue neutral, not negative) rate.

It is important to note that a rate reduction from 6% to approximately 5%, which is almost a 20% reduction, would improve the State's national sales tax ranking by roughly 18 full spots.

It should also be noted that this rate reduction, while substantial, should move lower still, pending TRAC's adoption of the final version of its "Services and Intangibles" recommendations. Like this proposal, TRAC recommends that the General Assembly utilize 100 percent of whatever revenue is estimated to be generated by the services/intangibles recommendations for further dollar-for-dollar rate reduction. Note: While we believe this to be a valid assumption, it nevertheless requires BEA analysis for verification and/or correction.

Slide 4:

Current Proposal

Tax residential electricity and natural gas, but only at 50% of gross proceeds. At an expected sales tax rate of 4.96%, that's an effective tax rate of just 2.48%.

Georgia and North Carolina impose a sales tax on residential electricity and natural gas at the rates noted on the slide. In total, 23 states currently impose a sales tax on residential electricity and 22 impose it on natural gas. Data source: Federation of Tax Administrators.

Modified Proposal

Reduce the taxable amount of those sales to just 25% of gross proceeds, thereby lowering the sales tax rate to an estimated 1.25%.

"79(92) cents/month" - What does this reference? According to the 2008 Consumer Expenditure Survey compiled by the Bureau of Labor Statistics, the average household (called "consumer unit"), which has 2.5 persons, spent $1,884 on electricity and natural gas combined in 2008. At a sales tax rate of 1.25%, that's a state sales tax liability of $23.55 per household per year, or $9.42/person. That equates to 79 cents per month, per person.

This estimate is similar to data from SCANA. In 2009, the average customer had an annual gas bill of $647. The average electric bill for the latest "test period" was $1,551. Summing the two and multiplying by 1.25% yields a state sales tax liability of $27.48 per customer per year, or $10.99 /person. That equates to 92 cents per month, per person.

Slide 5:

Current Proposal

Tax water sales, but only at 50% of gross proceeds. At an expected sales tax rate of 4.96%, that's an effective tax rate of just 2.48%.

In total, 12 states currently impose a sales tax on water sales at an average sales tax rate of 4.98%. Data source: Federation of Tax Administrators.

Modified Proposal

Reduce the taxable amount of those sales to just 25% of gross proceeds, thereby lowering the sales tax rate to an estimated 1.25%.

"19 cents/month" - What does this reference? According to the 2008 Consumer Expenditure Survey compiled by the Bureau of Labor Statistics, the average household (called "consumer unit"), which has 2.5 persons, spent $446 on "water and other public services" in 2008. At a sales tax rate of 1.25%, that's a state sales tax liability of no more than $5.58 per household per year, or $2.23/person. That equates to 19 cents per month, per person.

Slide 6:

Current Proposal

Prescription medicines. Under current law, prescription medicines purchased at a retail pharmacy are exempt from sales tax liability in South Carolina. TRAC's "current proposal" with regards to retail prescription drug sales would:

RETAIN the full exemption for prescription medicines bought at a retail pharmacy by Medicaid and Medicare beneficiaries.

RETAIN the full exemption for free samples of prescription medicine distributed by its manufacturer.

RETAIN the full exemption for medicine donated by its manufacturer to a public institution of higher education for research or for the treatment of indigent patients.

RETAIN the full exemption for prescription medicine sold to health care clinics and/or charitable hospitals where medical care is given free of charge to all its patients (i.e., "free clinics")

RETAINI a 50 percent exemption on prescription medicines bought at a retail pharmacy by NON Medicaid and Medicare beneficiaries. As such, 50 percent of the gross proceeds of the sale of such prescriptions to non Medicaid/care beneficiaries would be taxable.

That equates to an effective sales tax rate of no more than 2.48%.

Modified Proposal

Prescription medicines. Under current law, prescription medicines purchased at a retail pharmacy are exempt from sales tax liability in South Carolina. TRAC's "modified proposal" with regards to retail prescription drug sales would:

RETAIN the full exemption for prescription medicines bought at a retail pharmacy by Medicaid and Medicare beneficiaries.

RETAIN the full exemption for free samples of prescription medicine distributed by its manufacturer.

RETAIN the full exemption for medicine donated by its manufacturer to a public institution of higher education for research or for the treatment of indigent patients.

RETAIN the full exemption for prescription medicine sold to health care clinics and/or charitable hospitals where medical care is given free of charge to all its patients (i.e., "free clinics")

RETAIN a 75 percent exemption on prescription medicines bought at a retail pharmacy by NON Medicaid and Medicare beneficiaries. As such, 25 percent of the gross proceeds of the sale of such prescriptions to non Medicaid/care beneficiaries would be taxable.

That equates to an effective sales tax rate of no more than 1.25%.

In addition to the sensitivity TRAC has shown to issues of regressivity by maintaining full exemption for Medicaid and Medicare beneficiaries, and by imposing an effective sales tax rate that is 80 percent less than the State's current 6% sales tax rate, TRAC is still concerned about potential excessive sales tax burden on residents with chronic and costly conditions.

That is why TRAC also recommends a MAXIMUM sales tax liability on total prescription drug purchases of $100 ($8.33 month maximum liability) annually.

Residents with annual sales tax liability on prescription drug purchases of more than $100 would be entitled to, and would receive, a full rebate for any sales tax paid over $100.

The rebate would be in the form of a refundable income tax credit and would be available to all residents regardless of income tax liability. Residents with no income tax liability would be able to file for, and receive, their refund for sales taxes paid over $100.

Slide 6:

Behind the Numbers - the Modified Proposal

$70/month - What does that reference? According to a May 2010 publication by the Henry J. Kaiser Family Foundation titled "Prescription Drug Trends", the average retail price of prescription drugs was $71.69 in 2008, but that estimate is before discounts and rebates that in effect lower the cost of prescriptions. In 2009, the average number of retail prescriptions purchased per capita was 12.6 per year.

At $70/month multiplied by a sales tax rate of 1.25% yields an average state sales tax liability of 88 cents per month.

What does the "$1.56/month" reference? For comparative purposes, staff included data from the "State Health Plan" (SHP) - the plan which covers 373,000 state government workers and retirees. In 2009, the plan and its participants paid a total of $575 Million for prescription drug purchases. Based on 373,000 covered lives, that's an average expenditure of approximately $1,500 per year. At 1.25% sales tax, that equates to roughly $1.56 per month in sales tax liability for the average SHP beneficiary.

What does "_" mean? (see below):

373,000 - Number of lives covered by the State Health Plan. The SHP offers a good "proxy" by which to measure the impact of the proposal to cap maximum retail prescription sales tax liability.

$100 cap = $8,000/yr. - The proposal is to cap SC residents sales tax liability at $100 annually. At 1.25%, that means a resident would have to expend $8,001 in retail prescription drug purchases to exceed that cap ($100 divided by 1.25% = $8,000).

227/373,000 = 0.06% (2,700 / 4,500,000) - The question is begged, "How many South Carolinians spend at least $8,001 each year on prescription drugs. While not perfect, the SHP data offers a reasonable proxy, and the result is: "Not many".

Specifically, of the 373,000 lives covered by SHP, only 227 had expenditures that exceed that amount. That equates to roughly just about one half of one percent of all lives covered.

Extrapolated statewide, based on a SC population of 4.5 Million, that equals just 2,700 residents with retail drug expenditures of $8,001 or more.

Medicaid. While not noted on the slide, an analysis of State Medicaid beneficiaries offers further support of the SHP proxy. Of the roughly 624,000 Medicaid beneficiaries that utilized prescription drugs in 2009-10, just 6,000, or just less than 1%, had expenditures that exceeded $8,001.

$47,000/year - Now that we know how many lives covered by the SHP exceeded $8,001 in prescription drug cost, the next question begged is "How much did they spend on average?" The answer is: "A lot". $47,000 on average, to be exact.

@1.25%, $588/year - Multiplying $47,000 by a sales tax rate of 1.25% yields an average sales tax liability for this small group of residents of $588/year. Without a cap, that is the average sales tax liability these consumers would face.

$488 fully refundable credit - That represents the "benefit" of the cap for these consumers. At $588 of sales tax liability, a $100 maximum cap generates a fully refundable income tax refund of $488.

Slide 7:

Current Proposal

Tax prescription prosthetics and insulin, medical supplies and dental prosthetics sales, but only at 50% of gross proceeds. At an expected sales tax rate of 4.96%, that's an effective tax rate of just 2.48%.

Modified Proposal

Reduce the taxable amount of those sales to just 25% of gross proceeds, thereby lowering the sales tax rate to an estimated 1.25%.

Slide 8:

Current Proposal

Under current law, sales of drugs directly to medical providers are fully taxable at 6% unless otherwise specifically exempt by the General Assembly. Under current law, the following drug classes or sales are exempt: certain medicines sold directly to medical providers for treatment of cancer, lymphoma, leukemia (and related diseases), rheumatoid arthritis, respiratory syncytial virus, viscosupplementation therapies, and medicines sold to Nursing Homes for use by Medicare Part A patients.

The current proposal is to remove those specific exemptions, but only tax them at a rate of 50% of gross proceeds which equates to an effective rate of just 2.48%.

Modified Proposal

RETAIN the full exemption for certain medicines sold directly to medical providers for treatment of cancer, lymphoma, leukemia (and related diseases), rheumatoid arthritis, respiratory syncytial virus, viscosupplementation therapies, and medicines sold to Nursing Homes for use by Medicare Part A patients. The General Assembly specifically enumerated these exemptions and in TRAC's final analysis recommends that they be retained.

Slide 9:

Current Proposal

Under current law, sales of drugs directly to medical providers are fully taxable at 6% unless otherwise specifically exempt by the General Assembly. Under current law, the following drug classes or sales are exempt: certain medicines sold directly to medical providers for treatment of cancer, lymphoma, leukemia (and related diseases), rheumatoid arthritis, respiratory syncytial virus, viscosupplementation therapies, and medicines sold to Nursing Homes for use by Medicare Part A patients.

As such, all drug categories and/or classes that do not meet the criteria above or taxed at 6% today.

The current proposal is to provide partial exemption for all the so called "non" drugs by only taxing them at a rate of 50% of gross proceeds which equates to an effective rate of just 2.48%. That's a tax savings of about 60% compared to the current sales and use tax rate of 6%.

Modified Proposal

Medicines sold directly to medical providers but not currently exempt would remain taxable under this proposal but would benefit from an almost 20 percent tax savings compared to current law as the overall sales and use tax rate will drop from 6% to approximately 5%.

Healthcare providers should be made aware of the tax savings they will enjoy based on the TRAC recommendations (modified proposal) as compared to current law.

Slide 10:

Current Proposal

Tax grocery sales, but only at 50% of gross proceeds. At an expected sales tax rate of 4.96%, that's an effective tax rate of just 2.48%.

In total, 14 states currently tax groceries, the average tax rate in those states is 3.79%. Of the 7 states that tax groceries at lower sales tax rates than their state's general rate, the average is 2.6%, making TRAC's proposal very much in line with tax policy in peer states that tax groceries. Data sources: Federation of Tax Administrators and Center on Budget and Policy Priorities.

Modified Proposal

TRAC recommends partial restoration of a "grocery tax", but sensitive to regressivity concerns, especially regarding our State's most needy and/or elderly residents, TRAC recommends RETAINING a 41 percent exemption on grocery sales.

Based on an expected sales tax rate of approximately 5%, that means an effective tax rate on groceries of no more than 2.95%, a rate less than the State formally imposed on groceries in the past.

In addition, out of deference to concerns for the needy, TRAC recommends that groceries purchased with food stamp benefits remain fully exempt as under current (and prior) law.

Note: Of the 14 states that currently tax groceries, the average tax rate in those states is 3.79%. Of the 7 states that tax groceries at lower sales tax rates than their state's general rate, the average is 2.6%, making TRAC's proposal very much in line with tax policy in peer states that tax groceries. Data sources: Federation of Tax Administrators and Center on Budget and Policy Priorities.

Slide 11:

It should also be noted that this rate reduction, while substantial, should move lower still, pending TRAC's adoption of the final version of its "Services and Intangibles" recommendations. Like this proposal, TRAC recommends that the General Assembly utilize 100 percent of whatever revenue is estimated to be generated by the services/intangibles recommendations for further dollar-for-dollar rate reduction. Note: While we believe this to be a valid assumption, it nevertheless requires BEA analysis for verification and/or correction.

What does "Not BEA" refer to? That caveat reminds the reader that all estimates contained herein are unofficial and preliminary draft estimates for informational purposes only, as the TRAC commission awaits official "cost outs" of their various proposals by the Board of Economic Advisors.

What does "Revenue Neutral" refer to? As noted on Slide 3, the "modified proposal" as presented in this power point is slightly revenue negative. That is because mathematically, the broadening of the base contemplated in the modified proposal would reduce the State sales tax rate from 6% to 5.06%. As such, and assuming the calculation and estimates to be correct, the proposal is to "round down" to 5%. When and if the official estimates (including the estimates for services) are provided by the BEA, and if they show the estimate to be below 5%, the recommendation will be to adopt whatever that lower (and revenue neutral) rate is. However, if the BEA advises that the proposal (including services) will lower the rate anywhere between 5% and 5.06%, the recommendation is to "round down" to 5%. If the BEA reports the rate (including services) will be higher than 5.06%, the recommendation will be to adopt whatever that revenue neutral rate happens to be.