ESTIMATED CHANGE IN TAX LIABILITY
OF TAX REFORM COUNCIL’S PROPOSALS

The brief presents our best estimates of the change in tax liability for the tax changes proposed by the Tax Reform Council under the assumption that the recommendations are fully implemented as proposed in the Final Report of the Tax Reform Council (2011). The estimates are for FY 2012 other than for the income tax, which are for CY 2012. The estimates are presented in Table 1; the estimate reflects corrections made on March 8, 2011. Explanations for the estimates follow the table.

These are not revenue estimates since revenue by fiscal year will depend on how the recommendations are phased in. In addition, the timing of the flow of revenue to the state does not match the tax liability. For example, sales taxes are paid in one month, but the state does not receive that revenue until the following month, and the income tax is paid through withholding throughout the year but with adjustments in the following year when tax returns are filed.

Estimates for the sales tax are for state revenue only; local sales tax liability would be about 70 percent of state revenue.

The Insurance Premium Tax proposal calls for the General Assembly to determine how the revenue from the new rate is divided between state and local governments. Three alternative allocations are presented and are described in the footnote to the Table 1.

These estimates are preliminary and may change as certain assumptions are refined. All of the estimates were prepared by staff of the Fiscal Research Center unless otherwise noted.

Table 1 includes a range, expressed as a percentage, for each estimate that indicates how confident we are in the estimates. The ranges are not always uniform around the estimate since there are reasons to believe that an estimate is, for example, more likely to be on the low side than the high side. The confidence level, which is obviously subjective, depends on the quality of the underlying data, the nature of the assumptions that had to be made, and the number of imputations necessary to develop the estimate.

Explanations for How the Tax Liabilities Estimates Were Determined

Personal Income Tax

The income tax estimate reported in the Final Report applies to the adoption of a 5 percent flat income tax rate but with none of the other changes contained in the Tax Reform Council’s personal income tax recommendation.
TABLE 1. ESTIMATED CHANGES IN TAX LIABILITY FOR THE TAX REFORM COUNCIL’S PROPOSALS

<table>
<thead>
<tr>
<th>Recommendations</th>
<th>Alternative 1</th>
<th>Alternative 2</th>
<th>Alternative 3</th>
<th>Confidence Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>4% Flat Rate Personal Income Tax</td>
<td>$223</td>
<td>$233</td>
<td>$233</td>
<td>+20%/−20%</td>
</tr>
<tr>
<td>4% Corporate Income Tax Rate</td>
<td>−$224</td>
<td>−$224</td>
<td>−$224</td>
<td>+5%/−5%</td>
</tr>
<tr>
<td>Eliminate Business Tax Credit</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Eliminate Exemption for Food-for-Home</td>
<td>$463</td>
<td>$463</td>
<td>$463</td>
<td>+10%/−5%</td>
</tr>
<tr>
<td>Consumption</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax Casual Sales</td>
<td>$151</td>
<td>$151</td>
<td>$151</td>
<td>+10%/−5%</td>
</tr>
<tr>
<td>Revamp Agriculture exemptions</td>
<td>−$4</td>
<td>−$4</td>
<td>−$4</td>
<td>+5%/−5%</td>
</tr>
<tr>
<td>Add an Energy Exemption</td>
<td>−$248</td>
<td>−$248</td>
<td>−$248</td>
<td>+25%/−25%</td>
</tr>
<tr>
<td>Tax Services per List in Final Report</td>
<td>$298</td>
<td>$298</td>
<td>$298</td>
<td>+15%/−5%</td>
</tr>
<tr>
<td>Increase Cigarettes Tax to 68 cents per pack</td>
<td>$114</td>
<td>$114</td>
<td>$114</td>
<td>+5%/−5%</td>
</tr>
<tr>
<td>Index Motor Fuel</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Reduce Insurance Premium Tax to 1.75%</td>
<td>−$6</td>
<td>−$248</td>
<td>−$495</td>
<td>+5%/−5%</td>
</tr>
<tr>
<td>4% Communication Tax</td>
<td>$195</td>
<td>$195</td>
<td>$195</td>
<td>+5%/−5%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$971</td>
<td>$729</td>
<td>$482</td>
<td></td>
</tr>
</tbody>
</table>

Notes: Alternative 1 assumes that local governments get no revenue from the reduced Insurance Premium Tax rate; Alternative 2 assumes that the state and local governments share the reduced revenue equally; Alternative 3 assumes that the state revenue is reduced by the entire reduction in total revenue.

Personal income tax estimates were derived using the FRC tax simulation model using 2005 tax returns. It is assumed that the current tax rates are replaced by a flat 4 percent tax rate. The retirement income exclusion is assumed to be completely phased out and the credits are assumed to be eliminated. Adjustments were made for the elimination of three other income exclusions (high deductible health care, education saving account, expenses for organ donation). No information could be found to estimate the effect of eliminating the exclusion for the deduction for payments to minority subcontractors and dependent’s unearned income included in federal AGI of parent’s return; it is believed that these are very minor adjustments.

The estimates are based on current retirement exclusion amount and do not reflect the increase in allowable retirement income exclusion that is part of current law.

The proposal calls for the elimination of the current personal exemptions, the standard deduction and itemized deductions. A new $2,000 personal exemption for dependents and the proposed new tax credit are assumed to be in place.

The changes that were estimated for 2005 were applied to the 2012 personal income tax forecast to estimate the 2012 effect of the proposed income tax changes. The estimate reported in Table 1 is a revision of the original estimate issued in February 2011.

**Corporate Income Tax Rate Reduction**

We started with the forecasted revenue for the corporate income tax for FY 2012. We assumed that the revenue would decrease by the same percentage as the reduction in the tax rate from the current 6 percent to the proposed 4 percent. We do not believe that reducing the corporate tax rate will result in a large change in economic activity, particularly in the short-run, given that Georgia uses a 100 percent sales tax factor to apportion the profits of multi-state businesses.

**Business Tax Credits**

An estimate of the revenue effect of this recommendation was not included in the Final Report. Eliminating the current economic development credit program will not likely affect revenue in the near term because of the large volume of credits.
that have been awarded to taxpayers but not used. It is expected that these credits, given the expected increase in corporate profits, will be used at about the same rate as the rate of credits actually taken.

The establishment of a new credit program will depend on the value of credits provided by the legislature. We cannot forecast that decision.

**Food-for-Home Consumption**

We started with the estimate in the Final Report of $472 million for FY 2012 but later realized that the estimate did not properly account for food purchased by WIC coupons. So, the estimate was reduced to account for food purchased with WIC coupons.

No adjustment has been made for a behavioral response to the increase in the tax on food from 2.8 percent (the average local tax rate) to 6.8 percent. Assuming a price elasticity of -0.098 (which was obtained from the Economic Research Service), the effect of increasing the tax on food would result in a decrease in the quantity of food purchased of 0.4 percent. Despite the decrease in the quantity of food purchased, the total expenditures (including the sales tax) on food will increase. Assuming incomes remain constant, this means that purchase of other goods and services or savings will decrease. This could result in some reduction in tax revenue.

**Casual Sales**

The initial FRC revenue estimate contained in the Final Report equaled $151 million, which is for FY 2012. (The revenue estimate provided by the industry is for state and local revenue for taxing casual sales, although they assume an average local rate of 2.5 percent, while the average local rate is 2.8 percent.)

The FRC estimate and projections come from an extensive fiscal analysis of proposed legislation that was considered in the 2009 and 2010 session of the General Assembly. Wheeler (2010) provides the details of the revenue estimate.

**Agriculture Exemption**

The extension of Agriculture Exemption is not in the Final Report as a formal recommendation of the Tax Reform Council, i.e., it is not one of the highlighted recommendations. The revenue estimate is based on revenue estimate for 2010 provided by Dr. McKissick of UGA. An annual growth rate of 1 percent was assumed. No adjustment was made of the potential savings from requiring a certificate to obtain agriculture exemption or restricting exemption to farmers with at least $2,500 in annual sales.

**Sales Tax Exemption for Energy Used in Electricity Generation, Manufacturing, Mining, and Agriculture**

No revenue estimate was included in the Final Report. We started with the $152 million estimate for 2010 that the FRC previously provided for this exemption. The increase in the value of the exemption will depend on the increase in energy prices and in energy consumption. To project this estimate to FY 2012, we assumed an annual average increase of 3.5 percent.

This estimate did not include an exemption for coal used in the generation of electricity. The industry estimated that the cost of this exemption in 2009 would have been $59 million. Coal prices have been increasing 13 percent per year over the past five years, so we increased the estimate by that rate.

**Adding Services to the Sales Tax Base**

The revenue estimate of $247 million in the Final Report was for 2009. We started with that estimate, which is based on the Consumer Expenditure Survey conducted by the Bureau of Labor Statistics. Since that estimate was based on consumer expenditures on services we added addition expenditures on auto repair in order to capture non-consumer expenditures. We used receipts from the Census of Business for auto repair industry, adjusted to account for parts since they are already taxed. We reduced the number by 10 percent to account for possible repairs made to tax exempt organizations such as government. We used the percentage change in actual sales tax collections between 2009 and 2010 to get a 2010 estimate. For the next years we assumed the growth rate that the State's Fiscal Economist had used to project sales tax revenue.

The estimates were not adjusted for any behavioral responses. There are two factors to note. First, the data used to develop the revenue estimate include household observations in states that tax these services, and thus, the data reflect the behavioral response to some degree. Second, we were unable to find a published estimate for the price elasticity for the composite service package that is proposed to be taxed. However, since the tax would apply to a broad set of services, we expect that the demand will be relatively price inelastic. Taking these two factors into consideration, we assume a price elasticity of -0.2. This implies that the taxable expenditures on services would fall by 0.8 percent.

**Cigarette Tax**

We started with the estimate of $120 million in the Final Report. The average annual growth rate of tobacco revenue between 2008 and 2010 was -2.6%. We assumed cigarette tax revenue would decrease at this rate. A behavioral response is built into the estimate. Details of the estimation procedure are described in Sjoquist (2010).
Motor Fuel

There was no estimate in the Final Report of the revenue effect of this recommendation. The revenue effect will depend on the increase in the highway construction price index and the increase in the price of fuel. But there will be no increase in the first year.

Insurance Premium Tax

No estimate of the change in the Insurance Premium Tax was included in the Final Report, although it was stated that a 1.75 percent rate would generate revenue equal to the state’s revenue. (This was based on calculation prepared by the Department of Insurance.) The proposal is to replace the state and local tax insurance premium tax rates with one rate of 1.75 percent. The Final Report said that the General Assembly would have to determine how the (reduced) revenue would be split between the state and local governments. We started with the 2009 total premiums written and multiplied that by 1.75 percent. A significant question that was not addressed by the Tax Reform Council is what happens to the various deductions allowed against the state insurance premium tax. The state allows abatements that effectively reduce the tax rate for firms that invest a substantial portion of their assets in Georgia. We assume that this policy remains in place. There is also a credit against the local insurance premium tax levied on life insurance policies. Given that the tax rate is being reduced, we assumed that this credit would no longer exist; for their calculations the Insurance Department assumed it would continue. If that is not correct, than the estimated change in tax liability in 2009 would be reduced by $93 million. We also assumed that the credit for retaliatory taxes paid would be discontinued. The Department of Insurance developed an estimate of retaliatory tax revenue of $24.7 million compared to the current revenue of less than $1 million. (We discuss this estimate with the Department and both parties agree that this is a conservative estimate.) The average premium growth rate over the period 1993 to 2007 was 5 percent which is what we assume for the forecast; this is consistent with the forecasted increase between 2009 and 2012 in premium tax revenue as reported in the Governor’s Budget Report. The resulting estimated change in tax liability in FY 2012 is -$496 million.

Local insurance premium tax revenue forecasted to FY 2012 is about $489 million. Thus, if local governments were allocated no revenue, state revenue would increase by $6 million (=$489 - $495), which is under the Alternative 1 column in Table 1. If the state reduced its revenue by the reduced revenue, its revenue would fall by $495 million, which is the Alternative 3 column. Alternative 2 assumes that the state and local governments reduce their revenue by the same amount, that is, by half of $495 million.

Any change in the volume of insurance purchased is likely to be small, so no adjustment was made for behavioral response. It is expected that the lower tax rate will increase the employment of non-agent employees in the insurance industry in Georgia. However, that effect will take time, so we assume no response.

Communication Tax

The recommendation is to replace the current franchise fees and sales tax on telecommunication with a 7 percent excise tax (4 percent state plus 3 percent local) on all telecommunications. We started with the industries estimate of $166 million in additional state revenues from the 4 percent state excise tax rate, which is a 2009 estimate. This is what is in the Final Report. To project this to future fiscal years, we calculated the annual average growth rate in revenues for cable, wired and wireless, and satellite services over the period 2004 to 2008, as reported in Table 1128 of the 2011 Statistical Abstract. The calculated growth rate is 5.4 percent. No behavioral response is included. The change in revenue is small, so the effect will be very small. (The estimated increase in revenue to local governments for FY 2012 from the 3 percent local excise tax rate is $37 million.)

References


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