Georgia State University

POLICY brief

THE SALES TAX IN GEORGIA: ISSUES AND OPTIONS

FISCAL RESEARCH PROGRAM
SCHOOL OF POLICY STUDIES

The sales tax is critically important to the finances of the State of Georgia and to its local governments. As one of 46 states that rely on the general sales tax, the sales tax accounts for 17 percent of state and local tax revenue.

There are changes that are likely to occur over the next decade that will result in pressure to change the sales tax. For example:

- Population and economic growth in the state along with changes in social policy will pressure the state to make its tax system more revenue productive.
- The changing consumption pattern of Georgians will exert pressure to expand the sales tax base.
- The differences in sales tax rates across the state and in the treatment of food for home consumption will force consideration of equity, fiscal viability, and administration.

The report from which this Policy Brief is drawn addresses these and other issues concerning sales taxation in Georgia. This report evaluates Georgia's sales tax against the norms for a good sales tax, identifies problem areas, compares sales tax practices in Georgia to those of other states, and proposes and evaluates alternative reform options.

The following is a summary of the findings and recommendations found in the full report.

The state sales tax rate in Georgia is 4 percent, while local governments may add up to an additional 3 percent. Georgia's top current rate, which is now 7 percent, is no longer low for the Southeast region.

The sales tax has some significant advantages for Georgians, and voters seem to prefer new sales taxes to increases in income or property taxes. One advantage of the sales tax is the relatively small liability per transaction; many Georgians have no idea how much sales tax they pay over the course of a year. Additional advantages are: taxpayers understand the structure of the sales tax, the sales tax reaches virtually everyone, and the state collects tax revenue from consumers who live in other states (e.g., tourists).

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On the disadvantages side, many Georgians believe the tax is regressive, tax payments are not deductible from the federal income tax (while income and property tax payments are deductible), and sales tax revenue can be surprisingly unstable over the business cycle. Another important disadvantage of the Georgia sales tax is the collection of revenue from numerous purchases by firms from other firms; the tax on these purchases increases the cost of doing business in Georgia and masks the true burden of the sales tax to consumers. Based on the recent actions of Georgia lawmakers and voters, the advantages are seen to far outweigh the disadvantages.

The volume of taxable sales in Georgia is equivalent to 50 percent of personal income in the state, ranking Georgia 18th highest among the 46 states that levy a retail sales tax. This relatively large sales tax base is due more to the heavy taxation of intermediate goods, i.e., purchases by businesses, than to the coverage of consumer purchases in the base. In fact, Georgia taxes services more narrowly than do other states. Of 164 services that are taxable in at least one state, Georgia taxes only 35. If all service purchases by consumers were taxed and special interest exemptions were removed, the state government could cut the state sales tax rate below 3 percent and raise the same amount of revenue.

The historical revenue-income elasticity of the Georgia sales tax is 0.87, meaning that for every 10 percent growth in state personal income, sales tax revenue automatically grows by 8.7 percent. The exemption of slow-growing food for home consumption expenditures actually increases the elasticity of the Georgia sales tax base (because it leaves faster growing items in the base), but it does so at a revenue cost equivalent to about 20 percent of total collections. If all services were included in the sales tax base, the automatic response of sales tax revenues to growth would rise to a level near that of the Georgia economy.

A household with an income of $13,700 pays, on average, $347 per year in state sales tax, while a household with an income of $57,000 pays $1,200 per year, i.e., higher-income Georgians pay 3.5 times more than lower-income Georgians. However, as a share of income, the wealthy pay a slightly lower percent (2.58 and 2.13 percent respectively for these two income levels). Thus, the Georgia sales tax is regressive, but not as severely regressive as some critics have argued.

In 1995, a household of six paid an estimated $680 in sales taxes (2.54 percent of personal income) while a household of size two paid only $535 (2.35 percent of household income). This difference exists because larger households tend to purchase more taxable items than do smaller households. Arguably, with a broader sales tax base, this difference would disappear. It seems counterproductive to allow larger households greater relief from income taxes, but to structure the sales tax to discriminate against them.

There are major policy choices facing the State with regard to the sales tax. The State could consider the following:

- broadening the base to include more services (a revenue gain);
- extending the food exemption to all local option sales taxes (a revenue loss);
- raising the sales tax rate while keeping the base narrow (a revenue gain);
- eliminating some intermediate goods from the tax base to enhance the economic development potential of the state (a short-term revenue loss); or
- moving to less reliance on sales taxation in favor of more reliance on income or property taxes.

There is much to recommend the expansion of the sales tax base to sevices. It would increase the overall income elasticity of the sales tax base, it would make the tax less regressive, it would increase fairness across consumers, and it would generate significant revenue that would allow a reduction in the sales tax rate. Had the state sales tax included all services in 1995, it could have raised the same amount of revenue at a rate of 2.9 percent.

Local sales taxes in Georgia require attention. At present, there is a complicated set of rules concerning the cap on the total local rate, and there are five different choices regarding local options (LOST, SPLOST, MARTA, HOST, and the education tax). In some cases food is included in the base, in others it is not. If the sales tax base is extended to services in the future, local governments would benefit, but if the state chooses to increase the state tax rate, they would not. With the sentiment in Georgia running heavily toward replacing property taxes with sales taxes, there is a premium on reforming the local sales tax in a comprehensive way. In particular, the following three issues should be considered:

- a common treatment of food for home consumption;
- a clear set of rules about local ceilings. It would seem appropriate to allow local governments to choose their rates by referendum, rather than prescribing exactly what kind of local sales tax will be allowed. Instead of asking local governments to choose among five different types of tax, a wise course might be to restrict them to a 3 percent (or higher) cap and let the voters decide on the purpose; and
- a clear set of rules about the relationship between property and sales taxes. If sales tax options are to be chosen by referendum, then voters need clear information on any property tax consequences.

RECOMMENDATIONS

Based on the analysis, the following specific recommendations are offered for consideration.

The legislature should begin a process of gradually bringing services into the sales tax base. Lessons from other states suggest that a phase-in is preferred to a comprehensive overhaul where most services are brought into the base at one time.

Voter acceptance of new local sales taxes and the exemption of food from some, but not all, local sales taxes is the largest sales tax policy now facing the state. State policies toward local governments must now be related to the larger question of how local government expenditures will be financed in the future. The General Assembly and the Governor should continue to rethink the entire system of state and local finance.

The taxation of business inputs is not healthy for the state economy. The General Assembly and the Governor should readdress how the sales tax on certain business inputs can be removed without too seriously compromising revenue yield.

The current list of statutory exemptions from the sales tax includes 55 transaction types. This list is long and laden with special interests. It should be reviewed, and some of the more obvious special interest exemptions should be eliminated.

The General Assembly and the Governor should continue to rethink the place of the sales tax in the revenue structure. If it is to occupy its present level of importance, or even a greater importance, then options for reform should be considered. If an increase in the state revenues are needed in the future, broadening the base to include services is preferred to an increase in the tax rate.

Roy Bahl Richard Hawkins

For a free copy of the study from which this Policy Brief is drawn, or any of the other publications listed, call the Fiscal Research Program at 404/651-0422 or fax us at 404/651-0416.

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