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Georgia Budget and Policy Institute

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## Final House Bill 481

### *Future Budget Cuts – Not Stimulus*

By Sarah Beth Gehl, Deputy Director

#### Summary

The Conference Committee substitute for House Bill (HB) 481, which awaits the governor's signature or veto, cuts the capital gains tax in half, eliminates the corporate net worth tax, and creates several temporary tax breaks for businesses, **costing more than \$1 billion in the coming years**. The numerous tax breaks do not stimulate the economy as purported. Doing more harm than good, the provisions carry an extremely high cost and low benefit. Considering the state's current and future fiscal situation, HB 481 is fiscally irresponsible.

#### Economic and Revenue Impact

Supporters of HB 481 argue that the bill's tax cuts will stimulate the economy by creating jobs and future state revenue. The author of the bill did not supply research or analysis demonstrating any net economic benefit to the state, let alone evidence that it would stimulate the economy. The state's fiscal note for HB 481, however, shows the opposite effect: a significant loss of state revenue, even after accounting for the marginal employment growth from certain provisions. In fact, the return on investment for one provision that gives businesses \$850 million in tax credits creates only 1.5 percent employment growth, recouping a low 6.5 percent of lost revenue (\$55 million).<sup>1</sup>

#### Budget Impact

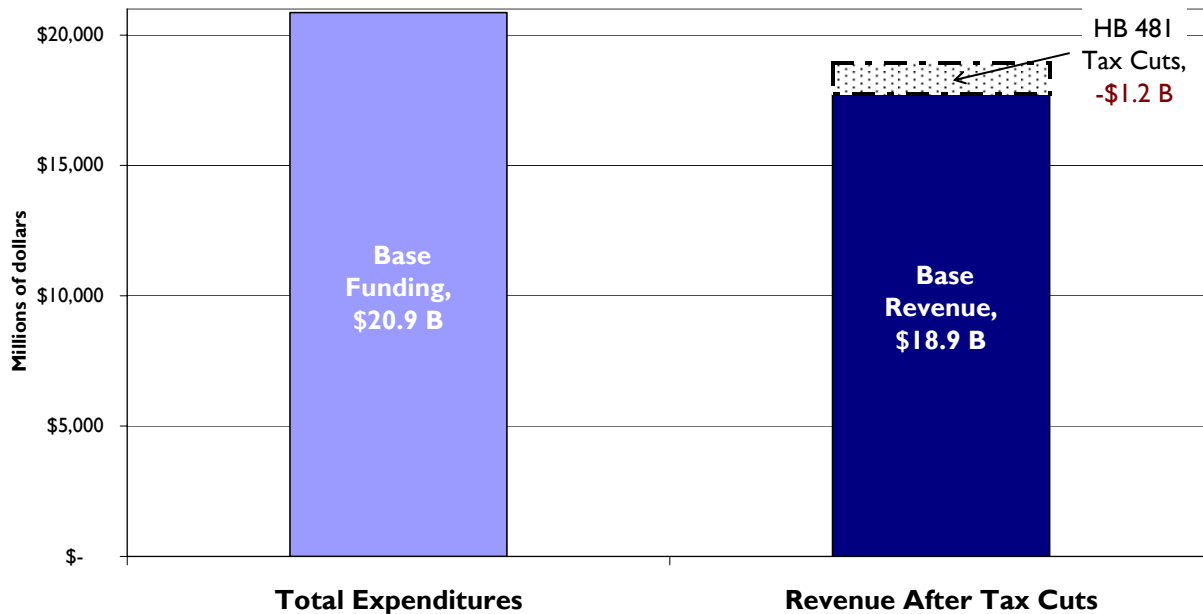
In order to balance the FY 2010 budget, legislators closed a \$3.3 billion deficit with \$1.5 billion in budget cuts, \$1.3 billion in federal stimulus funds, and several hundred million in reserve funds.

Beyond the immediate fiscal crisis of the recession, however, Georgia faces a structural deficit. Based on the state's projections and the governor's revised revenue estimate, Georgia will experience an estimated deficit of \$1.9 billion in FY 2012 even without restoring the current budget cuts (see Figure 1).<sup>2</sup> By signing HB 481 into law, with its many tax cuts, it compounds the budget deficit, reaching \$3.1 billion in FY 2012.

Georgia will not have any reserves or federal stimulus funds to help close the gap and balance the budget in FY 2012. A deficit of this enormity, on top of budget cuts continued from FY 2010, is fiscally irresponsible, leading to thousands of teachers and state employees facing furloughs and layoffs as well as further cuts to vital services.

Figure 1

**FY 2012 Expenditures & Revenue with HB 481's \$1.2 Billion Tax Cut**  
**\$3.1 Billion Budget Gap Between Funding & Revenues**



Note : Base funding and revenue from author's calculation using projections on p. 417 of Governor's Budget and governor's March 3rd revised revenue estimate. **Expenditures do not include any restoration of FY 2010 cuts or Homeowners Tax Relief Grant.**

## Bill Summary by Section

### Sections 2-4: Business Fee Holiday

The business fee holiday exempts corporations, limited partnerships, and LLCs from \$100 and \$225 filing fees for FY 2010, for a total revenue loss of \$9.1 million.

When the governor revised the FY 2010 revenue estimate downward during the legislative session, additional budget cuts were proposed “to reflect the revised revenue estimate.” With \$9.1 million, the state could avoid some of the additional service cuts made due to the revised estimate. A few examples include:

- Out-of-Home Care (temporary homes to protect neglected and abused children; \$3.9 million)
- Adult Developmental Disabilities Services (\$3.3 million)
- Adult Mental Health Services (\$1.7 million)
- Child and Adolescent Development Disabilities Services (\$2.1 million)
- Elder Community Living Services, allowing seniors to remain in their community rather than moving to a nursing homes (\$664,000)
- Vocational Rehabilitation Services, assisting Georgians with disabilities in finding and maintaining employment (\$194,000).

## Section 5: Unemployment Insurance Tax Credit

This provision of HB 481 gives employers a credit against unemployment insurance taxes up to \$500 in tax credits for each job provided to unemployed workers. It gives the Commissioner of Labor flexibility in setting the credit amount between \$25 and \$125 per quarter over four quarters. The commissioner must first seek permission from the federal government to implement the tax credits, as the current UI system taxes businesses based on their layoff history.

If the tax credit is set at the maximum of \$125 per quarter, there will be an estimated decrease in UI contributions to the state of \$171.1 million in FY 2010 and \$269.4 million in FY 2011. There will be some offset in those losses, as the tax credit “will cause an increase of 1 percent in the number of workers hired.”<sup>3</sup> The revised fiscal note estimates a drop in UI payments of \$56.3 million in FY 2010 and \$70.8 million in FY 2011.

## Sections 6-7: Capital Gains Tax Reduction

The reduction in capital gains taxes is one of two long-term tax cuts in the bill. In 2010, 25 percent of long-term capital gains for corporations and individuals will be excluded from taxation. In 2011 and thereafter, that reduction rises to 50 percent.

The capital gains tax reduction was added to HB 481 during the conference committee less than 48 hours before the end of session, without public testimony or regular committee hearings. A fiscal note for the provision was requested on the final legislative day; it shows an expected annual loss of \$400 million when the tax cut is fully implemented.

### **Capital Gains: Myth vs. Fact**

**Myth:** More and more people have stocks, so most people will benefit from a capital gains tax cut.

- **Fact:** There has been an increase in the number of people with Individual Retirement Accounts (IRAs) and 401(k)s; however, income from these investments are not taxed as capital gains income.
- **Fact:** Federal data from 2006 indicate that, in Georgia, taxpayers with adjusted gross income of less than \$50,000 comprised 69 percent of all federal tax returns filed, but constituted just 8 percent of all returns with income from capital gains.<sup>4</sup> Therefore the vast majority of Georgians will not receive this tax cut.
- **Fact:** More than 90 percent of the tax benefits from a 50 percent reduction in long-term capital gains taxation will flow to people with the top 5 percent of incomes in Georgia.<sup>5</sup>

**Myth:** Cutting the capital gains tax will act as an economic stimulus.

- **Fact:** On the federal level, the Congressional Budget Office found that “capital gains tax cuts would provide little fiscal stimulus,” in a study of federal tax proposals in 2002.<sup>6</sup> A draft policy statement by the state’s economist regarding HB 481 notes that “a cut in Georgia’s tax on capital gains will likely provide little incentive to increase investment in Georgia.”<sup>7</sup>

**Myth:** A reduction in capital gains will increase state revenue collections because of its stimulating effect.

- **Fact:** The state’s own analysis of cutting the tax on long-term capital gains showed an estimated revenue *decrease* of \$400 million.

## Section 8: Tax Credit for Hiring Unemployed Workers

This provision of HB 481 provides a \$2,400 tax credit to employers who hire unemployed workers and keep them employed for at least 2 years. According to the state's draft policy statement it causes \$850 million in revenue losses, with the loss primarily concentrated in FY 2012.<sup>8</sup> In exchange for this lost revenue, the state gains 1.5 percent in employment growth. Revenue from these incentivized jobs, an estimated \$55.4 million spread over FY 2010 and 2011, allows Georgia to recoup only 6.5 percent of lost revenue, for a net revenue loss of around \$800 million.

## Section 9: Elimination of Sales Tax Deposit

This provision of HB 481 phases-out the deposit vendors pay on their estimated tax liability. Under the current system, vendors with an estimated sales tax liability of over \$5,000 pay 50 percent of the estimated liability as a deposit, which is then credited against the final amount due. HB 481 increases the \$5,000 threshold to \$10,000 in FY 2010, \$20,000 in FY 2011, and \$40,000 in FY 2012, with complete elimination of the prepayment system beginning in FY 2013.

This deposit phase-out causes a cash-flow issue for the state, as it moves the full collection of sales taxes to a later date. According to the state's draft policy statement, the revenue loss would total \$186 million, with \$28.5 million of the loss occurring in FY 2010.<sup>9</sup>

## Section 10: Elimination of Corporate Net Worth Tax

Section 10 of HB 481 eliminates the corporate net worth tax in 2010, resulting in an annual revenue loss of \$38 million. Created in 1931, the corporate net worth (called franchise) taxes the value of a company's total assets. The tax ranges from \$10 for corporations with \$10,000 or less in net worth up to \$5,000 for corporations with over \$22 million in taxable net worth.<sup>10</sup> Along with the capital gains reduction, the elimination of the corporate net worth tax is a permanent change to the tax code.

## **Recommendation**

Given the significant negative fiscal and structural impacts of HB 481 and the nominal benefits, Governor Perdue should veto the legislation.

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<sup>1</sup> Heaghney, Ken. *Policy Analysis for HB 481 LC 18 8416ERS (Draft)*. April 3, 2009.

<sup>2</sup> Calculation based on Governor Perdue's revised revenue estimate of March 3, 2009, the revenue and expenditure projections contained in page 417 of the FY 2010 Governor's Budget Report, and the removal of Medicaid stimulus funds.

<sup>3</sup> Heaghney, K.

<sup>4</sup> IRS Statistics of Income data for 2006.

<sup>5</sup> Institute on Taxation and Economic Policy microsimulation model, April 2009.

<sup>6</sup> Congressional Budget Office. *Economic Stimulus: Evaluating Proposed Changes in Tax Policy*. January 2002.

<sup>7</sup> Heaghney, K. et. al. *Economic Effect of a Tax Rate Reduction for Capital Gains*. April 13, 2009.

<sup>8</sup> Heaghney, K.

<sup>9</sup> Ibid.

<sup>10</sup> Fiscal Research Center. *Georgia's Taxes: A Summary of Major State and Local Government Taxes*. 15<sup>th</sup> Edition. January 2009.

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