Bill Analysis: House Bill 386 (LC 34 3484S)
Tax Package a Complex Hodgepodge of Reforms
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Overview

In the final days of the 2012 legislative session, the General Assembly passed an omnibus tax bill, HB 386, that falls short of the comprehensive tax reform Georgia needs to bring the tax system into the 21st century. While it exhibits some fiscal prudence by acknowledging the importance of revenues, HB 386 essentially combines a series of recycled proposals – most of them tax breaks or incremental reforms attempted before – into a single large package.

This year’s package was lawmakers’ second attempt to pass tax reform legislation during the 2011-2012 session. The ultimately-failed effort in 2011 was a comprehensive package modeled on the recommendations of the 2010 Special Council on Tax Reform and Fairness for Georgians, which proposed far-reaching (and controversial) revisions to sales and income taxes. This year’s bill is much narrower. Rather than repeating the full-fledged approach attempted last year, HB 386 simply combines a collection of largely-disjointed policy changes: an income tax cut for married couples; special exemptions for the manufacturing, agriculture, and airline industries; cuts or caps to credits and exclusions for film productions, conservation, and retirement income; and new revenues through taxing of e-commerce and revamping taxes collected on automobiles.

The package does include some positives. Primarily, the bill rejects the reckless tax cuts of recent years in favor of a more measured, balanced approach to addressing Georgia’s fiscal challenges. It also includes some promising tax policies GBPI has advocated previously, such as taxing online sales, reigning in the tax break for wealthy seniors, streamlining tax breaks to maximize effectiveness, and killing the corporate giveaway to Delta.

Even with HB 386, the state’s tax system remains relatively unchanged since the 1950’s, and it no longer serves the needs of a rapidly-growing state. Georgia desperately needs fundamental tax reform. A modern tax system that strengthens and broadens the tax base will position Georgia to reverse the bone-deep cuts of prior years and invest in critical areas like education, transportation, and infrastructure that grow the economy and create jobs. HB 386 falls short of addressing this fundamental challenge, and must be viewed as merely a small step forward – and a missed opportunity – on tax reform.

Cost

Viewed as a whole, the tax package would decrease state revenues by approximately $63 million over the next three budget years and likely increase it longer-term. Major expenditures in the bill include an expanded personal exemption for married income tax filers, a phase-out of the sales tax on energy used in manufacturing, and a two-year revival of Georgia’s sales tax holiday. These costs are partially offset by changes in how retirement income is taxed, how the state taxes autos, a new “e-fairness” law for taxing Internet sales, and some cost-saving revisions to existing business tax breaks.
The short-term revenue impact is significantly different for local governments. Where the state loses money at first then gains it later on, local governments see a slight uptick in FY 2013 ($22 million) before suffering heavy losses in the next two years ($82 million in FY 2014 and $158 million in FY 2015). According to the projections in the fiscal note, localities could collect an estimated $217 million less than they otherwise would have over the next three fiscal years.

Because the official fiscal projections only go through FY 2015, the bill’s long-term implications are impossible to predict with certainty. Having said that, certain aspects of the package – namely the changes to retirement income exclusion and the taxing of automobiles – appear likely to enhance state revenues long-term, perhaps considerably. For example, even though capping the retirement exclusion only nets an estimated $92 million in the first three years, the dynamics of that change could lead to much larger gains beginning in 2016—as much as $172 million per year when compared to current law, according to estimates from the nonpartisan Institute on Taxation and Economic Policy.1 With regards to automobile taxes, the bill not only adds “casual sales” to the tax base, but also includes procedural safeguards designed to make sure state revenues remain steady or even show growth in later years.

What the Bill Would Do

Expand Personal Exemption for Married Couples

The bill’s largest expenditure is an income tax cut for married couples. Proponents describe this cut as eliminating the “marriage penalty,” but due to the intricacies of the bill, this is not technically correct.

Currently, Georgia’s income tax includes a marriage penalty only for taxpayers who select the standard deduction. The disparity does not apply to those who itemize their deductions. Georgia’s standard deduction is $2,300 for individuals and $3,000 for married couples filing jointly, which means that raising the deduction for couples to $4,600 would directly eliminate the penalty. But that is not what HB 386 does.

Instead, it takes a roundabout path by increasing the personal exemption for married couples by $2,000. This is a curious choice, since Georgia’s personal exemption is already equalized for singles ($2,700 exemption) versus couples filing jointly.
($5,400 exemption). While the difference may seem semantic, it has two very real consequences: it causes Georgia to lose nearly four times more revenue than eliminating the marriage penalty actually requires, and it slants the tax cut further toward wealthier Georgians (Table 2).

**Table 2 Impact of Increasing Standard Deduction versus Personal Exemption**

<table>
<thead>
<tr>
<th>Georgia Residents, 2011 Income Levels</th>
<th>Eliminating the Standard Deduction Marriage Penalty*</th>
<th>Increasing the Personal Exemption for Married Couples†</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Range</td>
<td>Average Change per Affected Couple</td>
<td>Share of Tax Change</td>
</tr>
<tr>
<td>Lowest 20%</td>
<td>$-37</td>
<td>2%</td>
</tr>
<tr>
<td>Second 20%</td>
<td>$-70</td>
<td>17%</td>
</tr>
<tr>
<td>Middle 20%</td>
<td>$-93</td>
<td>19%</td>
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<tr>
<td>Fourth 20%</td>
<td>$-92</td>
<td>42%</td>
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<tr>
<td>Next 15%</td>
<td>$-95</td>
<td>18%</td>
</tr>
<tr>
<td>Next 4%</td>
<td>$-96</td>
<td>2%</td>
</tr>
<tr>
<td>Top 1%</td>
<td>$-96</td>
<td>0%</td>
</tr>
<tr>
<td>$ Annual Cost to State (thousands)</td>
<td>$ -39,000</td>
<td></td>
</tr>
</tbody>
</table>

Source: Institute on Taxation and Economic Policy Microsimulation Tax Model, March 2012

* By increasing standard deduction for married couples to $4,600
† By increasing personal exemption for married couples to $7,400

Directly addressing Georgia’s marriage penalty by changing the standard deduction would have been a middle class tax cut, costing the state an estimated $39 million per year, according to estimates from the nonpartisan Institute on Economic Policy and Taxation. An estimated 80 percent of the benefit would have gone to affected taxpayers (i.e. couples filing a joint return) making less than $76,000 per year. The personal exemption provision embraced by HB 386, however, expands the tax cut to include wealthier Georgians at approximately four-times the total cost to the state. Under this scenario, less than half of the benefit goes to those same lower and middle income couples.

**FY 2013 – FY 2015 Total Revenue Impact:** ($362.60 million)

**Phase out the Sales Tax on Energy Used in Manufacturing**

Georgia is the only state in the Southeast and one of 10 in the nation that levies a sales tax on energy used in manufacturing. Many argue this puts Georgia manufacturers at a disadvantage, even though the state’s manufacturing industry already enjoys the second lowest tax costs for “labor-intensive” operations and the eighth lowest for “capital-intensive” ones. HB 386 would phase out this tax over four years. While the estimated cost rises from approximately $21 million in the first year to $98 million in the third, the exemption will eventually cost the state an estimated $137 million per year once fully implemented. The bill would also provide the governor with discretionary authority to remove this tax immediately in some cases, such as a large manufacturing plant relocating to the state (e.g. Caterpillar). Lastly, it would allow local governments to continue imposing a 2 percent excise tax on energy, which should help shield them from a potentially sizable loss of revenue.

**FY 2013 – FY 2015 Total Revenue Impact:** ($177.60 million)

**Reinstate the Sales Tax Holiday for Two Years**

Sales tax holidays allow consumers to purchase certain items tax-free on a few days each year. Georgia held an annual sales tax holiday for eight years until 2010, when lawmakers decided to forego it due to the budget crisis. As of 2011, all the states bordering Georgia have a sales tax holiday, which some believe puts Georgia at a disadvantage. HB 386 would
revive the tax holiday for two years at a fairly significant cost to state revenues. There would be a three-day holiday in the summer for various “back-to-school items,” as well as one in October for qualified energy-efficient household appliances.

Despite their political popularity, sales tax holidays are universally viewed as poor tax policy, as described in GBPI’s analysis of an earlier bill, HB 993. The Special Council on Tax Reform and Fairness for Georgians put it this way: “Though economic literature is somewhat limited, it does provide some evidence against sales tax holidays. Among the findings are that consumers tend to shift consumption in time to take advantage of these holidays rather than increasing consumption, that higher income households are more likely than lower income ones to shift consumption in time, and that retailers do not fully pass along the tax savings from the sales tax holiday to consumers, absorbing a portion into profits instead.”

**FY 2013 – FY 2015 Total Revenue Impact: ($81.14 million)**

**Exempt Sales Taxes on Certain Local Projects**
Stemming from Governor Deal’s Competitiveness Initiative, this proposal would exempt “local projects of regional significance,” such as new sports stadiums, from paying sales taxes on construction materials. The Department of Economic Development would craft rules for determining which projects are eligible. As the bill is written, the exemption would last for two years before expiring in June 2014.

**FY 2013 – FY 2015 Total Revenue Impact: ($42 million)**

**Replace the Delta Subsidy with a Jet Fuel Subsidy**
Since 2006, Georgia has maintained an annual subsidy for Delta Airlines, which reported a net profit of roughly $850 million in 2011. Originally scheduled to expire in 2011, lawmakers extended it at a projected cost of $20 million in FY 2012 and $10 million in FY 2013. As GBPI described at the time, Georgia’s Delta giveaway was unashamed corporate welfare. HB 386 would sensibly eliminate this tax subsidy, but would also undermine the value of doing so by creating a new tax break available to all airlines—a reduction in the state sales tax on jet fuel to 3 from 4 percent.

Although proponents of the bill describe this tax break as a job creator, it is unclear why subsidizing one industry over another will have any impact whatsoever on Georgia’s overall economy. Moreover, creating new exemptions explicitly rejects the findings of the Special Council on Tax Reform, which said, “Exemptions have the effect of reducing the sales tax base, which requires a higher tax rate to generate the same revenue. Limiting exemptions on final consumption transactions will enhance fairness and equity among taxpayers, enhance stability of sales tax revenues, and improve clarity and predictability.”

**FY 2013 – FY 2015 Total Revenue Impact: ($55.20 million)**

**Streamline and Expand Agricultural Exemptions**
Georgia’s code contains a number of tax breaks devoted to helping the agriculture industry, many of which have been on the books for several decades. Under HB 386, several of these tax preferences would be replaced with a broad new exemption for the energy, equipment, and business inputs used in agriculture. The Special Council on Tax Reform recommended streamlining Georgia’s agricultural exemptions.

**FY 2013 – FY 2015 Total Revenue Impact: ($42.4 million)**

**Reform Motor Vehicles Taxes**
The most widely-discussed aspect of HB 386 is a complicated reform to how Georgia taxes automobiles. Currently, car owners in Georgia pay two taxes on their autos: the annual ad valorem tax paid to local governments, and the state and local sales taxes paid on vehicles purchased at dealerships. HB 386 would change this system by swapping the two
existing taxes for a new 7 percent title fee levied whenever a car changes ownership. The new fee would be divided between state and local governments based on a funding formula laid out in the bill (i.e. 3.85 percent state fee and 3.15 percent local fee, with slight adjustments over time). Current auto owners would continue to pay the ad valorem tax until they change vehicles, at which point they would switch to the new process and pay the 7 percent title fee up front. After 10 years, all car owners would enter the title fee system.

Aside from eliminating the politically-unpopular “birthday tax,” this reform would increase state revenue by extending motor vehicle taxes to two types of vehicles not currently subject to Georgia’s sales tax: vehicles sold between individuals (“casual sales”) and autos purchased out of state. The projections indicate the state will bring in considerable revenue in the first three years, while the local governments will collect much less than they would under the current system. However, responding to concerns from local governments, HB 386 includes some safeguards that prevent local revenues from falling beneath a certain revenue level. Specifically, the state will guarantee local governments a revenue “floor” of $1 billion each year (plus 2 percent annual increase), and the portion of the title fee provided to local governments will automatically increase to meet that goal.

Such a guarantee could conceivably lead to revenue reductions for the state (i.e. if state government had to increasingly compensate localities long-term), but the bill has a mechanism designed to prevent that. The legislation includes a provision that will automatically increase the overall title fee, to as much as 9 percent, to ensure that both the state and local governments meet their revenue projections.

**FY 2013 – FY 2015 Total Revenue Impact: $503 million**

**Cap the Retirement Income Exclusion**

In 2010, Georgia lawmakers passed legislation that dramatically increased the amount of retirement income, such as pensions and investments that Georgians over age 65 could shield from state taxes. The exclusion was increased to $35,000 for individuals ($70,000 for couples) in 2011; $65,000 ($130,000 for couples) in 2012; and is currently scheduled to continue rising until 2016, when the exclusion becomes unlimited. Since the previous exemption excluded the vast majority of seniors paying state income taxes, the change was aimed solely at Georgia’s wealthiest seniors (those in the top 10 percent of incomes)—as critics clearly noted at the time. This was especially true because wage income was not shielded from taxes in the same way as unearned income. If the retirement income exclusion were allowed to go unlimited in 2016, a senior citizen supplementing her income by working at Wal-Mart would be subject to income taxes, whereas one receiving a million-dollar pension would not.

HB 386 would freeze the senior exemption at $65,000 per year ($130,000 for couples), which is similar to the Special Council on Tax Reform’s proposal. While the official fiscal note estimates a $92 million increase in state revenue through FY 2015, the intake could rise substantially in 2016, since that is when the current cap is scheduled to disappear. The savings from this change will increase even more in later years, as the state’s retiree population expands with the retirement of the Baby Boomers.

**FY 2013 – FY 2015 Total Revenue Impact: $91.7 million**

**Tax E-commerce Sales**

An estimated $3.4 trillion worth of retail and wholesale transactions, or 17 percent of all U.S. shipments and sales, were conducted over the Internet in 2009. Under federal law, out-of-state retailers are not required to collect taxes on these purchases unless they have a physical presence in the state. In practice, this means that a Best Buy or Target is required to collect taxes from online purchases, whereas an Amazon or EBay is not. Georgians are technically required to report these taxes (as “use tax”) on their annual tax forms, but few actually do. As a result, lost revenue is significant—Georgia will lose more than $400 million in 2012 due to its inability to tax e-commerce. Additionally, the loophole puts local brick-and-mortar businesses at a disadvantage—the Georgia Retail Association estimates online retailers offer pricing that is 7 percent lower since the tax is not included.
In response, many states have begun implementing controversial “Amazon laws” that allow them to collect sales tax on certain online purchases. HB 386 would collect taxes on less than one-tenth of all online sales made in Georgia, specifically those made through online businesses that have some form of physical presence (technically known as “nexus”) in the state. One example would be a website based in Georgia whose owner receives a commission from ads that national retailers place on the site. As described in GBPI's analysis of HB 993, taxing online sales is good tax policy because it levels the playing field with physical retailers and takes a positive first step toward collecting hundreds of millions in lost revenue.

**FY 2013 – FY 2015 Total Revenue Impact: $52.2 million**

**Revise the Film Tax Credit**
Proponents claim that Georgia’s film tax credits, expanded in 2008, have helped grow Georgia’s entertainment industry from a $240 million industry in 2006 to a $1.2 billion one now. The credits have two main components: a 30-percent income tax credit and a sales tax exemption for purchased or leased equipment, such as materials bought locally for set design or wardrobes. HB 386 would eliminate the sales tax exemption while keeping the 30-percent tax credit. These improvements to Georgia’s film tax credits are a prime example of how tax expenditures can, and should, be periodically reviewed to maximize effectiveness.

**FY 2013 – FY 2015 Total Revenue Impact: $35.80 million**

**Cut-Back the Conservation Easement Tax Credit**
Since 2006 Georgia has had an income tax credit for individuals, corporations, or partnerships who donate land to government entities or qualified nonprofits for the purpose of conservation. The credit was modified in 2011 so that taxpayers are now allowed to sell any unused credits without limit, which has notably increased its cost—the state’s loss of revenue rose from $14 million in 2011 to $33 million in 2013. HB 386 would eliminate this unlimited transferability and cut back the maximum credit for partnerships.

**FY 2013 – FY 2015 Total Revenue Impact: $15.46 million**

**Conclusion**
The 2012 tax bill, HB 386, is a mix of good tax policy, bad tax policy, and unknowns. Viewed as a whole, it is a fiscally-prudent package that acknowledges the importance of revenues and avoids exacerbating Georgia’s long-term structural deficit. It rejects the kind of reckless tax-cutting that has defined prior sessions, and certain aspects of the bill — such as capping the retirement income exclusion — could over time help Georgia collect enough money to meet the state’s growing needs. It includes some positive policy changes like taxing Internet sales and capping the retirement exclusion, which GBPI has strongly advocated for in the past. However, the long-term implications are somewhat unknowable, given the complexity of the bill and the lack of hard fiscal projections beyond three years.

At the same time, the bill’s appealing aspects are undermined by some ill-advised moves like reviving the sales tax holiday and providing an expensive tax cut for married Georgians (regardless of whether they suffer the “marriage penalty” or not). Had lawmakers rejected these irresponsible components, they could have avoided the $86 million revenue hit in the first two years, which will now have to be paid for through more budget cuts. The bill also creates an unneeded tax break for Georgia’s airline industry, a clear example of the kind of special tax preferences that the Special Council on Tax Reform recommended eliminating. Such industry-specific tax breaks do nothing to grow the economy or create jobs, and they drain the state of revenue needed for strategic investments like education. In the future, all tax breaks should be submitted to periodic review and analysis, as was proposed by HB 920 this year.
But frankly, HB 386 is basically the same-old, same-old—only combined in new wrapping and matched with a few positive
tweaks. It must be viewed as merely a small step forward for tax reform in Georgia, rather than the end of the process. To
provide Georgians with a modern tax system capable of funding the state’s ever-growing needs, lawmakers must return
to the well in coming years and address the issue once again. The work is not done and requires the political will to pass
comprehensive reform.

Endnotes

1 Institute on Taxation and Economic Policy, by email. 3/16/2012
2 Institute on Taxation and Economic Policy, by email. 3/22/2012
4 Official fiscal note for a previous piece of legislation, HB 86, which in 2011 proposed an immediate elimination of the sales tax on energy used in manufacturing.
5 Special Council on Tax Reform and Fairness for Georgians; Final Report, 2011
7 Special Council on Tax Reform and Fairness for Georgians; Final Report, p. 20. 2011