



**Report of the**  
**Tax Reform Study Committee**

**January 2012**

Dear Rep. Bingham:

I am pleased to present the recommendations of the House Republican Caucus' Tax Reform Advisory Committee. This document is the result of the outstanding work of our 18 fellow Caucus members who contributed many hours of work during the "off session".

Over the last 30 years, South Carolina has taken great strides to reform and broaden our economic foundation. Now, we need to reform our state's tax code so we can lay a stronger foundation for growth in the years ahead.

This report reflects our conservative view that South Carolina must modernize its approach to taxation – to improve not only our business climate, but to relieve the burden on individual taxpayers.

We believe that our recommendations, when enacted, will transform South Carolina into a hub for economic growth and job creation in the Southeast and improve our state's competitiveness in the global race for economic development.

This report presents a clear path for the House Republican Caucus and the entire General Assembly to protect individual taxpayers while opening the door to business in the increasingly competitive global economy. The report is based in a firm belief that, if South Carolinians get the chance, we can compete with workers anywhere in the world.

We believe these proposals will enable businesses of every size to thrive and expand – creating a new generation of high-quality jobs in every corner of our state.

We present this report with the confidence that our recommendations will provide an immediate return and spark a renewal of the great quality of life that our state markets, boasts, and enjoys.

On behalf of the Committee, thank you for the opportunity to serve the Caucus. We urge quick enactment of our recommendations.

Rep. Tommy Stringer  
Chairman

## **Background**

Historically, changes to South Carolina's revenue code have seldom contained sweeping reforms. This lack of comprehensive reform stems from the complex nature of revenue legislation rather than an absence of political will. Revenue laws are normally reactive rather than proactive and are almost always incremental.

As our state added manufacturing to our agricultural base during the 20<sup>th</sup> Century, our revenue code became more complex out of necessity. This complexity will only increase as the 21<sup>st</sup> Century offers us an opportunity to attract a wide range of new industries in an atmosphere of high economic volatility. These circumstances require us to update our existing revenue code and establish the necessary procedures to pass proactive tax legislation in the future.

Fortunately, the General Assembly made an important first step by establishing the 2010 Tax Realignment Commission. Their TRAC report along with the work of previous committees formed the knowledge base used by the Caucus Tax Reform Study Committee.

## **Purpose**

The focus of the Committee was to reform our state's tax code to:

- relieve the tax burden for South Carolina families, and
- make the tax code more friendly, competitive, and fair for our state's employers.

Both of those goals were considered in the larger framework of lowering our state's unemployment rate and getting our hard working friends and neighbors back on the job.

The Committee held meetings over four months, including a half-dozen public meetings, to hear testimony from experts in the field. Attention was paid by the Committee to include testimony from "independent" parties – namely scholars, accountants, and experts who had nothing to gain from the Committee's work. Therefore, the Committee did not ask for testimony from major industry groups, lobbyists, or partisan groups.

## **Findings**

The Committee makes ten recommendations to reform the South Carolina revenue code. These recommendations are not revenue neutral in total fiscal impact. They are designed to implement targeted strategic tax cuts where needed to encourage economic growth while simplifying the parts of the revenue code that are inefficient. The fiscal impact estimates were provided by the South Carolina Budget and Control Board.

## **Implementation**

The Committee suggests that these recommendations be implemented over the next three years.

## **The Committee**

The Tax Reform Study Committee was appointed in June 2011 by House Majority Leader Kenny Bingham and House Speaker Bobby Harrell. The Committee consisted of Republicans from across South Carolina with attention paid to geography, time served, and legislative experience.

The Republican Caucus thanks each of the following members for their service.

### **Tommy Stringer**

Chairman

*District 18 – Greenville County*

### **Rita Allison**

*District 36 – Spartanburg & Greenville Counties*

### **Todd Atwater**

*District 87 – Lexington County*

### **Nathan Ballentine**

*District 71 – Richland & Lexington counties*

### **Shannon Erickson**

*District 124 – Beaufort County*

### **Dan Hamilton**

*District 20 – Greenville County*

### **Bill Herbkersman**

*District 118 – Beaufort County*

### **Jenny Horne**

*District 94 – Dorchester County*

### **Jay Lucas**

Speaker *Pro Tempore*

*District 65 – Chesterfield, Darlington, Kershaw, & Lancaster counties*

### **Jim Merrill**

*District 99 – Berkeley & Charleston counties*

### **Tommy Pope**

*District 47 – York County*

### **Rick Quinn**

*District 69 – Lexington County*

### **Garry Smith**

*District 27 – Greenville County*

### **Eddie Tallon**

*District 33 – Spartanburg County*

### **Bill Taylor**

*District 86 – Aiken County*

### **Mac Toole**

*District 88 – Lexington County*

### **Brian White**

*District 6 – Anderson County*

### **Tom Young**

*District 81 – Aiken County*



## RECOMMENDATION #1

**Eliminate or modify two-thirds of the current sales tax exemptions and caps.**

**FISCAL IMPACT: First-year revenue increase would be \$259,803,067.**

**The net revenue increase resulting from the elimination of exemptions should be used to offset the revenue loss from enacting item 2 below.**

*Eliminating the state's many sales tax exemptions was a major focus for the Committee, as it is for people throughout our state. The state has 76 sales tax exemptions and caps that can be modified.*

*The Bureau of Economic Advisors found that eliminating all of the sales tax exemptions would cost South Carolina families at least \$1,100 each year (not including the additional cost of products and services that would be raised as a result of the increased tax burden on business).*

*In this case, we believe that we can lower everyone's sales tax burden while keeping "core" exemptions that are easily and economically justified – public utilities, groceries, agricultural products and raw materials for manufacturing.*

### Retained Sales Tax Exemptions

*Electricity irrigation*

*Farm Machinery*

*Farm products*

*Feed for poultry/livestock*

*Fuel for curing*

*Fuel for poultry/livestock*

*Insecticides, chemicals, etc.*

*Sale of livestock*

*Meals for schools and needy*

*Prescriptions sold to charity clinics*

*Coal/fuel sold to power companies*

*Const. materials for facility costing over \$100m*

*Const. materials used in R&D facility*

*Electricity used in manufacturing, etc.*

*Machines used in manufacturing, etc.*

*Material handling systems in dist centers*

*Shipping containers*

*Tangible property sold to Federal*

*Government*

*Vessel bunkering*

*Durable medical equip. bought by Medicaid*

*Fuel*

*Medicine, etc.*

*Recycling property*

*Residential electricity*

*Respiratory virus medicines*

*Unprepared food*

*Water sold by public utility*

## **RECOMMENDATION #2**

**Reduce the assessment ratio on commercial/rental properties from 6% to 5%. These properties account for 46.9% of the total property tax collected statewide.**

**FISCAL IMPACT: First-year revenue reduction would be approximately \$500,000,000.**

*After the General Assembly approved Act 388 in 2008, local governments shifted a huge tax burden onto commercial and rental properties. As with several of the other recommendations, this one specifically targets small businesses and helps relieve their tax burden so their owners can have extra capital to expand and hire more workers.*

*This item contains a major fiscal impact, but the Committee believes it is important to improving the health of our small business sector. The Committee also believes strongly that this item needs to be tied to a comprehensive education funding reform plan, but such a plan was outside the charge given to this Committee.*

## **RECOMMENDATION #3**

**Reduce the personal income tax rate on small business active income from 5% to 3%. This reduction would lower the average tax paid per return by approximately \$1,000.**

**FISCAL IMPACT: First-year revenue reduction in the first year would be \$59,727,608.**

*Small businesses are frequently called “the backbone of the American economy”. In our state, they provide strong job creation and these are our major employers of the future. Small businesses – such as LLCs, S Corporations, and Sole Proprietors – flow their business income on to their personal income taxes.*

*Reducing the tax rate on “active income” will help the thousands of self-employed and micro-business owners. Since active income is reported on an individual’s tax return, a lower tax rate these sole proprietors and small business owners take home more money for their families. It will provide an instant boost in the income these entrepreneurs can bring home and spend in their communities.*

#### **RECOMMENDATION #4**

**Reduce the number of personal income tax brackets by eliminating the 3%, 4%, 5% and 6% brackets and replacing them with a 3% bracket. With these changes, 79% of filers will have a lower or unchanged liability. The committee also recommends raising the income for the top 7% income tax bracket to \$14,000.**

**The Committee recommends this as a first step in a multi-year effort to flatten the state income tax by dropping the top marginal rate to 5% from 7%.**

**FISCAL IMPACT: First-year revenue reduction would be \$51,000,000.**

*According to South Carolina's income tax brackets, you are wealthy (and pay the top tax rate of 7%) if you make more than \$13,800. The Committee agrees with our constituents that making \$13,800 each year does not make a family wealthy in 2011. Reforming this extremely outdated set of income tax brackets is a simple reform that will benefit a huge number of our fellow citizens.*

*The Committee recommends this as a first step in a multi-year effort to flatten the state income tax by dropping the top marginal rate to 5% from 7% and reviewing existing deductions.*

#### **RECOMMENDATION #5**

**Establish a House Revenue Committee that would be responsible for all revenue related legislation including but not limited to future tax reform efforts, federal tax compliance and sunset requirements on future sales tax exemptions. This committee would also have oversight of DOR regulations and enforcement issues.**

**FISCAL IMPACT: Negligible**

*A Revenue Committee can provide an ongoing, bi-partisan review of the tax code. The current House Ways and Means Committee has done an admirable job in managing both revenue and budgeting. However, as the Republican Caucus continues to advocate a shorter legislative session, the Committee believes it is vital that revenue considerations be split into its own committee. Any fiscal impact would be in the form of committee staff, which could be shared with the Ways and Means Committee.*



**RECOMMENDATION #6**

**Establish a provision to require a cost benefit analysis to be performed on any current or future sales tax exemptions after 5 years of being implemented.**

**FISCAL IMPACT: None**

*To anyone studying the state’s sales tax exemptions, it is clear that many of the exemptions are worthy and necessary. However, as we wrote above, many of the purposes of these exemptions have been lost to time.*

*In order to keep future sales tax exemptions from outliving their usefulness, the Committee makes this recommendation.*

**RECOMMENDATION #7**

**Reduce the assessment ratio on manufacturing and business personal property from 10.5% to 6%. This reduction would be phased in over 4 years at a rate of 1.125% each year.**

**FISCAL IMPACT: First-year revenue reduction would be:**

<b>Manufacturing w/o Fee in Lieu</b>	<b>\$ 28,986,646</b>
<b>Business Personal</b>	<b><u>\$ 26,969,296</u></b>
<b>Total</b>	<b>\$ 55,955,942</b>

*To reduce our state’s unemployment rate, it is vital that we are able to attract new companies and encourage our small manufacturers to grow. The fiscal impact of this reform is spread over a long period of time, so there should be no major immediate impact. The reduction was modeled after the reduction in the automobile property tax a decade ago.*

**RECOMMENDATION #8**

**Propose a constitutional amendment to remove the property tax assessment ratios from the constitution.**

**FISCAL IMPACT: None**

*By eliminating the constitutional barriers, comprehensive tax reform would be easier to achieve. Any tax reform package must consider sales, income, and property taxes. With one of the legs of*

*that stool needlessly enshrined in the state constitution, a comprehensive tax reform plan will be extremely difficult to approve.*

#### **RECOMMENDATION #9**

**Eliminate the 5% corporate income tax rate. This reduction would be phased in over 4 years at a rate of 1.25% each year.**

**FISCAL IMPACT: First-year revenue reduction would be \$54,725,000 in the first year.**

*Reducing or eliminating the state corporate income tax is a proven boost to economic development in other states across the country. And as with the 10.5% property tax rate, this recommendation will help economic developers market our state as a favorable location for business. The fiscal impact, especially when phased in over a period of time, will be small when compared to the expected impact on job creation in our state.*

#### **RECOMMENDATION #10**

**Replace the \$300 cap on motor vehicles and manufactured homes with a \$1,200 cap.**

**FISCAL IMPACT: First-year revenue increase would be \$92,700,000.**

**The Committee recommends the revenue be used to offset taxes in one of three ways:**

- **offset the first year of property tax on a newly purchased vehicle/home, or**
- **the entire cap could be eliminated altogether and replaced with a revenue neutral sales tax rate of 2.3% or**
- **offset the revenue loss from enacting item 4 below.**

*An automobile is an essential part of life in today's South Carolina. The \$300 tax cap was enacted in 1984, when the average cost of a new car was about \$12,000. Today, that number is nearly \$30,000. This tax cap clearly impacts working families who may buy more inexpensive or used vehicles while giving huge tax breaks to drivers of new luxury cars. The Committee believes that reforming this item is a key step toward a fairer tax system.*

*It is essential that while reforming the sales tax procedure on cars, we must keep it in line with neighboring states, given that five major population centers lie along our borders with North Carolina and Georgia. In comparison to this proposal, Georgia imposes 4% sales tax rate (in addition to local taxes) on vehicles. North Carolina imposes a 3% sales tax rate.*