Georgia Tax Reform – the Final Act

The stage lights dimmed on tax reform this week – but only as an intermission until April 11. On that day expect a substitute to HB 387 to be voted out of the Special Joint Committee on Revenue Structure, setting up a final 3 day journey through the House and Senate. Under the legislative rules, the Senate could vote no sooner than April 14, the last legislative day. The final Act is being casted.

The April 11 substitute bill could marquise as either "Reform - LITE" or an even slimmer, "CALORIE - ONE". This compared to the comprehensive recommendations included in the January 7, 2011 report by the Special Council on Tax Reform and Fairness for Georgians. The final caloric count will depend on political digestion between now and then. Reform - LITE (the one most likely to be introduced) will be a tweaked version of HB 387. It will probably include:

- New communication services tax (CST) and repeal of local sales tax on capital improvements (for consumers, this translates to a sales tax on wireless data service and on satellite TV);
- Repeal of casual sales tax exemption on sale of cars, boats and airplanes except between family members (the sales tax would be collected from buyer at time of title registration);
- New sales tax on auto repair services (parts and equipment are already taxed);
- Exemption on sales tax for energy used in manufacturing;
- Streamlined and rewritten agriculture sales tax exemptions; and,
- A flat 4.5 % personal income tax rate with limited deductions and exemptions.

CALORE ONE could have any combination of the above but with no personal income tax changes. Just imagine drinking flavored water while patronizing Beverage World.

The remaining drama will surely spotlight the personal income tax, representing about one-half of the state's revenue take. The stakes are high. Reform is not easy and it certainly doesn't follow a pre-written script.

HB 387 provides for a single 4.5% personal tax rate, thus eliminating the six brackets that have been in the law since silent movies. The 25% rate cut is headline news to business owners that operate as S corps, LLCs, and sole proprietorships. Income earned by these businesses will be taxed 25% less and not subject to the base broadening give-backs below. This alone will ensure an award nomination from the academy of economic think tanks.

The bill does broaden the tax base by eliminating the standard deduction and personal exemption for all tax filers and by limiting or eliminating itemized deductions for many. A deduction for dependents remains but is reduced from $3,000 to $2,000 per dependent. So that lower income taxpayers are not negatively affected, a revamped tax credit regime holds those taxpayers harmless to the loss of the standard deduction and personal exemption and to additional taxes imposed on income previously taxed at brackets less than the new 4.5%. Left unscathed are the current exemptions for social security benefits and retirement income (up to $35,000 per retiree) and all personal and business tax credits.

So is there a Shakespearean dagger? The victim portrayed by some lawmakers and critics this week was the middle class; but in reality, it would be a more defined subset – those with above-average itemized deductions or an unusually large number of dependents. HB 387 caps itemized deductions at $17,000 for joint filers ($8,500 for singles) for adjusted gross incomes under $75,000 ($37,500 for singles). Itemized deductions are completely phased out at adjusted gross income above $92,000 for married filing joint ($46,000 for single). The caps and phase-outs (along with a new low income dependent credit) were engineered to mitigate a tax increase to roughly 85% of those filers. 2008 DOR data shows that of the statewide audience of Georgia taxpayers, itemized deductions reduce income by about 16%. However, this percentage increases with lower income taxpayers. The average itemized deduction claimed by taxpayers with income under $80,000 is $16,200. Does the low calorie plan have a big enough sweet spot?

The scene this week involved searching the whole theatre of taxpayers to find hidden winners and losers. A substitute bill will likely narrow the outliers by adjusting the phase-outs and aiding a larger palate. The challenge will be to do so with an off-Peachtree budget. The final act may have a surprise ending! Either way, I'm having my popcorn butter free.

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