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LEGAL ALERT

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Georgia Special Council on Tax Reform and Fairness Releases Report: Proposes Broader Consumption Taxes and the Elimination of Tax Credits in Lieu of Lower Income Tax Rates

The Special Council on Tax Reform and Fairness for Georgians (the Council) released its Report (the Report) on January 7, 2011. The Council was formed to review the tax code for fairness and to recommend a new tax structure to stimulate the Georgia economy. Unlike many other jurisdictions' tax reform committee recommendations, the Council's recommendations must be referred to a newly created state legislative committee, the Special Joint Committee on Georgia Revenue Structure (the Committee). The Committee is required to introduce legislation during the 2011 session incorporating the Council's recommendations "without significant changes." If the Committee passes the legislation containing the Council's recommendations, then the Georgia legislature must vote the legislation up or down *without amendment.* State lawmakers are not permitted to pick and choose among the recommendations.

Specific Areas of Recommendation

In general, the Report recommends expanding the sales tax base to services; reducing or eliminating tax preference items; and reducing personal and corporate income tax rates.[1]

Sales and Use Tax

Elimination of Exemptions and Tax Base Expansion

Georgia's current sales tax system generally taxes sales of tangible personal property and only a few specified services. The current tax code contains more than 110 statutory exemptions. The Council found that, with a shift to a services-based economy and with the numerous sales tax exemptions, the sales tax base has been eroded over time. As a result, the Council recommended eliminating or allowing to sunset most of the sales and use tax exemptions. Perhaps the most controversial of these exemptions that would be eliminated are the casual sales of automobiles and the state (4%) portion on the sale of food for home consumption.

However, the Council recommended retaining permanent sales tax exemptions for sales of business inputs (insurance, equipment, software, etc.), manufacturing inputs (machinery, replacement parts, industrial materials, etc.), and agricultural inputs, thereby preventing pyramiding of the sales tax. In

[1] *See, e.g.*, South Carolina Taxation Realignment Commission – Final Report (Dec. 1, 2010), available at www.scstatehouse.gov/citizensinterestpage/TRAC/TRAC.html (accessed Jan. 10, 2011).

addition to making these exemptions permanent, the Report also recommends a full, permanent exemption for all energy used in manufacturing, mining and agriculture.

In its effort to “broaden” the sales tax base, the Council recommended taxing a number of personal services. The Report contains an appendix with the types of personal services which would presumably become taxable. Examples include digital downloads of books and music, garbage and trash pick-up, household appliance service contracts, housekeeping, lawn care, haircuts, car repairs, and many types of membership fees. However, in the Report, the Council indicated that it focused on those services purchased by consumers and avoided adding those services that are mainly purchased by businesses to avoid tax “pyramiding.”

Sutherland Observation: The Report indicates that the revenue impact of subjecting digital downloads of books, music, etc., is “negligible.” Currently, Georgia only taxes items sold via tangible medium, thus excluding digitally downloaded books, music and software. It is unclear whether the Council is recommending the taxation of other electronically delivered or transferred items, such as prewritten computer software, or whether the concern to avoid tax pyramiding would preclude such taxation.

To bring consistency to the enactment of future tax laws (in particular sales tax exemptions), the Council recommended that future tax exemption and tax credit legislation be required to be filed in the first year of a legislative term; that any such legislation be required to layover until the next year in the term; and that the legislation contain a stated sunset date. If an exemption or credit warranted passage in the introductory year of a legislative term, a 2/3 vote would be required for passage.

E-Commerce and Nexus

The Council recognized that Georgia is restrained by the Commerce Clause from requiring remote sellers to collect use tax on sales made to Georgia residents[2] and acknowledged that collecting use tax from buyers may not be administratively feasible. The Report further notes that Georgia needs to enact additional conformity legislation to become fully compliant with the Streamlined Sales and Use Tax Agreement (the Agreement); Georgia became an “associate member” to the Agreement as of January 1, 2011.[3] As an associate member to the Agreement, Georgia may collect sales tax from remote sellers who volunteer to do so. However, Georgia may not collect tax from other voluntary remote sellers who register under the Agreement’s centralized registration system unless and until Georgia achieves “full member” status. As a result, the Council recommended that measures be adopted to collect sales and use tax on remote purchases on a voluntary basis, such as using state resources and/or external recruiters, to entice vendors to collect sales and use taxes for Georgia.

Sutherland Observation: The Council’s recommendation regarding using external recruiters dovetails with Senate Bill 512, proposed in 2010 but not approved by the House, which would provide the State Revenue Commissioner with the discretion to engage contractors on a contingency-fee basis to collect sales and use taxes. Under the bill, the “bounty hunter” contractors may only be compensated on a commission or contingency-fee basis. This proposal may be at odds with prior rulings of the Georgia Supreme Court regarding contingency-fee auditors. In 1991, the Georgia Supreme Court held that a contract with a contingency-fee auditor was void as against public policy because of the contingency scheme of compensation for those services. *Sears, Roebuck and Co. v. Parsons*, 401 S.E.2d 4 (Ga. 1991).

[2] *See Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

[3] *See* House Bill 1221 (eff. Jan. 1, 2011).

Communication Services Tax

The Council recommended repealing the current sales and use taxes and franchise fees on video and telecommunications services, and instituting a 7% excise tax on all "communication services." This excise tax would not be assessed on internet access services, which states are prohibited from taxing by the Internet Tax Freedom Act.

Income Tax

The Council recommended that the current 6% corporate and personal income tax rate be reduced, in a phased-in approach, to 4%, by 2014. The Council also recommended eliminating all current economic development tax credits in 2012 and sunsetting all other existing corporate tax credits in 2014. Credits earned prior to the sunset date should be grandfathered. In place of the existing credit structure, the Council recommended that the legislature create a fund to be allocated by the Department of Economic Development to attract new and existing businesses considering locating or expanding in Georgia. Grants from this fund would be allocated on a competitive basis, going to those firms that will generate the greatest net economic benefit for Georgia.

Sutherland Observation: Similar to the tax study commission reports in Maryland, South Carolina and Virginia, the Council did not recommend mandatory unitary combined reporting. State policymakers have begun to recognize the uncertain revenue impact that mandatory unitary combined reporting may have on corporate income tax collections, especially when a state has adopted expense disallowance provisions (such as Georgia), because revenue derived therefrom may be eliminated under a combined reporting regime.

Insurance Premium Tax

The Council recommended that the total state and local insurance premium tax rate for both life and property casualty insurance be reduced to 1.75%, which the Council believes will be revenue neutral and leaves it up to the Legislature to determine the portion of state and local premium taxes that should make up the 1.75%.

Other Recommendations

The Council also recommended that the legislature adopt the following reforms: 1) establish a tax court; 2) establish a commission to study local property taxation; 3) provide local governments additional flexibility regarding the use of local sales and use taxes; 4) review the organization, practices and processes of the Department of Revenue; 5) establish better alignment and coordination between the Department of Revenue and local governments; 6) review the state's tax revenue structure every four to eight years, immediately following the gubernatorial election cycle; 7) review the effectiveness of credits and exemptions; and 8) seek to build reserves to protect Georgia's AAA bond rating.

A full copy of the Report, along with other information, can be found on the Council's website at http://fiscalresearch.gsu.edu/taxcouncil/index.htm.

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If you have any questions about this development, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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