Tax Policy Update November 2019

After a long quiet spell in South Carolina tax policy, there seems to be some movement on rethinking the three major sources of state tax revenue. The State House Tax Policy Review Committee has released a draft of the proposed changes in the income tax, and details have also been released on proposed sales tax changes. Property tax proposals are expected to follow

Proponents claim that the goal of the proposed reforms is to make the system simpler, fairer, and easier to comply with and administer. They are also setting up some confrontations between winners and losers. Consultations are underway with the Tax Foundation to consider reforms of the property tax, which is a local revenue source but administered under rules and regulations established by the state.

Income tax. The income tax proposal would reduce the rate from the present 2% to 7% graduated structure to a flat 4.5% (phased in), but with sweeping changes. The state tax calculation would still start from federal taxable income, but unlike the federal tax, it would not allow for itemized deductions, only the federal standard deduction for the taxpayer's income level and filing status.

Many of the changes would affect retirement income. Exceptionally favorable treatment of pensions, and Social Security benefits, which have made our state a haven for retirees in the past, will be substantially reduced. Low income retirees will still have the same exclusion of Social Security benefits as they have on the federal income tax, but above a certain income level, 85% of Social Security benefits are taxable on the federal income tax and would be treated the same way on the state income tax. The bill is H4334. The report from the House Tax Policy Review Committee is available at statehouse.gov under House Tax Policy Review Committee, Tax Foundation report can be found at https://files.taxfoundation.org/20181130131322/Tax-Foundation-South-Carolina-RB.pdf.

Sales Tax. The bill has not yet been drafted, but essential provisions are as follows:

- Set the new rate at 3 percent
- The rate applies to tangible property and services
- Removes almost all exemptions (except for those Constitutionally required/federals)

- Sunsets sales tax exemptions after 2022 and remains in effect until the exemptions or limitations to the contrary are authorized by the General Assembly.
- The elimination of exemptions must be phased-in in five equal installments of twenty percent. Exemptions would be eliminated in 2028.
- The rate must be reduced during each year by an amount to be determined by the Revenue and Fiscal Affairs office. The amount of the reduction must be determined by estimating the amount of sales and use tax that would be collected in the upcoming year if the provisions of this section did not exist and then reducing the rate to an amount that will produce the same sales and use tax revenue.

The biggest changes are phasing out exemptions, reducing taxation of business inputs, and expanded taxation of services. Eliminating exemptions and taxing more services will generate more revenue. To be offset by reducing the rate, which will make the state more competitive for retailers, residents and tourists.