

How High Are South Carolina Taxes?

Facts and Figures on South Carolina State and Local Revenues

Institute on Taxation and Economic Policy
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Executive Summary

Legislators and advocates in South Carolina often debate whether the state's taxes are "too high" or "too low" based on a simplistic and misleading view of tax data. This report delves deeper into the data and finds that rudimentary measures of South Carolina tax levels can conceal more than they reveal about the true burdens facing South Carolina taxpayers. When the actual impact of state and local taxes on South Carolina families is accounted for, the state's taxes are clearly well below the national average.

South Carolinians at all income levels experience South Carolina as a low-tax state—and none more so than the very wealthiest taxpayers. However, South Carolinians at different income levels experience the tax system very differently; the poorest South Carolinians pay much more of their income in state and local taxes than the wealthiest South Carolina families must pay.

In the opening months of the 2007 legislative session, lawmakers have considered a "tax swap" that would reduce the progressive income tax and increase the cigarette tax. The report's findings suggest that such a change would make South Carolina's tax system even more unfair.

lected officials in South Carolina are increasingly scrutinizing the state’s “tax climate.” In his proposed budget for the fiscal year beginning in July of 2007, Governor Mark Sanford has called for substantial cuts in the state’s income taxes, arguing that these cuts would make the state’s business climate more competitive with neighboring states.

But little critical attention has been paid to the question of whether the taxes paid by South Carolinians are actually as high as anti-tax advocates have claimed.

This report aims to help inform the tax and spending debate by taking a close look at trends in South Carolina state and local taxes. The report gives special attention to the different tax rates paid by poor and wealthy South Carolinians. The report also highlights the distinction between overall tax levels and the levels of specific South Carolina taxes, and also discusses the critical difference between the taxes paid to the state of South Carolina and the taxes actually paid by South Carolina residents.

South Carolina Taxes: Below Average By Any Measure

The most frequently cited measure of a state’s overall tax level is total state and local tax collections expressed as a share of some measure of a state’s economy. The Bureau of the Census collects data allowing direct comparisons of each state’s tax levels; the most recent data currently available is for fiscal year 2004. The chart below shows how South Carolina stacks up by these various measures.

- Expressed as a share of statewide Gross State Product (a measure of all the economic activity in the state), South Carolina’s taxes were 8.6 percent in 2004, 31st highest nationally and over 4 percent below the national average.

| Total State & Local Taxes in 2004: Three Measures | | | | | | | |
|---|-----------------|------|-----------------|------|-------------|------|--|
| | % of Pers. Inc. | | Per Capita | | % of GSP | | |
| | | Rank | | Rank | | Rank | |
| Alabama | 8.5% | 50 | \$ 2,326 | 50 | 7.6% | 44 | |
| Florida | 10.2% | 36 | \$ 3,092 | 27 | 9.2% | 18 | |
| Georgia | 9.9% | 39 | \$ 2,906 | 33 | 7.8% | 43 | |
| North Carolina | 10.3% | 29 | \$ 2,928 | 31 | 7.9% | 42 | |
| South Carolina | 10.1% | 38 | \$ 2,662 | 44 | 8.6% | 31 | |
| Tennessee | 8.7% | 49 | \$ 2,533 | 48 | 7.1% | 47 | |
| ALL STATES | 10.7% | | \$ 3,433 | | 9.0% | | |

- As a share of statewide income, South Carolina taxes were 10.1 percent, 38th highest nationally and almost 6 percent below the national average.

| Addendum: South Carolina Compared to National Average | | |
|---|-------|--------|
| | -5.9% | -22.5% |
| | | -4.1% |

SOURCE: Bureau of Economic Analysis; Bureau of the Census

- On a per capita basis, South Carolina taxes were \$2,662 in 2004, 22 percent below the national average, and were 44th highest nationally.

Tax-by-Tax Variation in 2004

While South Carolina taxes are below average overall, there is some variation in the levels of particular South Carolina taxes: some taxes are more “below average” than others. In particular:

- None of the major taxes levied by South Carolina state and local governments are above the national average as a share of the state's personal income.
- South Carolina income taxes were 4 percent below the national average in 2004, or 31st highest in the nation.
- South Carolina's sales and excise taxes were 5 percent below the national average in 2004. At 3.6 percent of personal income, South Carolina's consumption taxes also ranked 31st highest in the nation.
- South Carolina property taxes were 1 percent below the national average in 2004, and ranked 20th highest nationally.
- South Carolina was 38th highest, and 25 percent above the national average, in its reliance on all other taxes.

South Carolina Taxes as a % of Personal Income in 2004

| | Personal | | Sales & Gross | | Property | | Other | |
|--|------------|------|----------------|------|------------|------|-------------|------|
| | Income Tax | Rank | Receipts Taxes | Rank | Taxes | Rank | Taxes | Rank |
| Alabama | 1.9% | 36 | 4.2% | 17 | 1.3% | 50 | 1.1% | 28 |
| Florida | — | 45 | 5.2% | 7 | 3.5% | 19 | 1.5% | 14 |
| Georgia | 2.6% | 17 | 3.6% | 29 | 3.0% | 29 | 0.6% | 50 |
| North Carolina | 3.1% | 8 | 3.7% | 27 | 2.5% | 40 | 1.0% | 32 |
| South Carolina | 2.2% | 31 | 3.6% | 31 | 3.3% | 20 | 0.9% | 38 |
| Tennessee | 0.1% | 43 | 5.2% | 8 | 2.1% | 42 | 1.4% | 16 |
| All States | 2.3% | | 3.8% | | 3.4% | | 1.2% | |
| Addendum: South Carolina Compared to National Average | -4% | | -5% | | -1% | | -25% | |

Source: Bureau of Economic Analysis; Bureau of the Census

In other words, South Carolina's tax system relies fairly evenly on the "big three" taxes (income, sales and property) that typically make up the bulk of state and local tax collections. None of these taxes stick out, in the aggregate, as being above the national average.

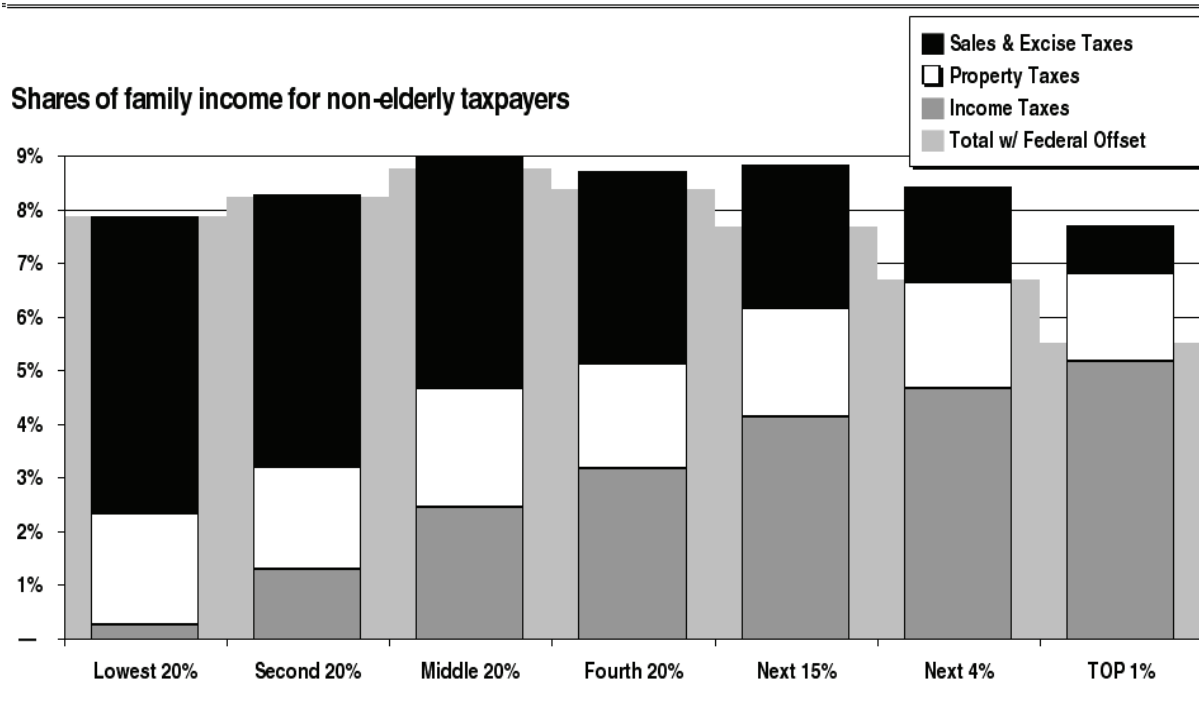
Many South Carolina Taxes Are "Exported"

The main problem with the aggregate tax comparisons presented so far is that they don't tell us whether specific groups of taxpayers experience South Carolina as a low-tax or high-tax state. Taxes can affect different taxpayers very differently depending on their income level and other factors.

A second, especially important problem with aggregate tax comparisons is that they include all taxes collected in the state, regardless of whether state residents actually pay those taxes. For example, because of the importance of gambling-related tourism to South Carolina's economy, an especially large percentage of South Carolina tax revenues come

from out of state visitors. In addition, much of the taxes paid by businesses to the state of South Carolina do not ultimately come out of the pockets of South Carolina residents at all, but are instead “exported” to non-South Carolinians.

South Carolina State & Local Taxes in 2002



Tax Fairness in South Carolina: The Poor Pay More

The South Carolina state and local tax structure is *regressive*—that is, it requires low- and middle-income South Carolinians to pay higher shares of their incomes in taxes than the wealthiest taxpayers have to pay. In other words, South Carolina’s tax laws actually redistribute income away from ordinary families and towards the richest South Carolinians. A January 2003 report by the Institute on Taxation and Economic Policy¹ found that:

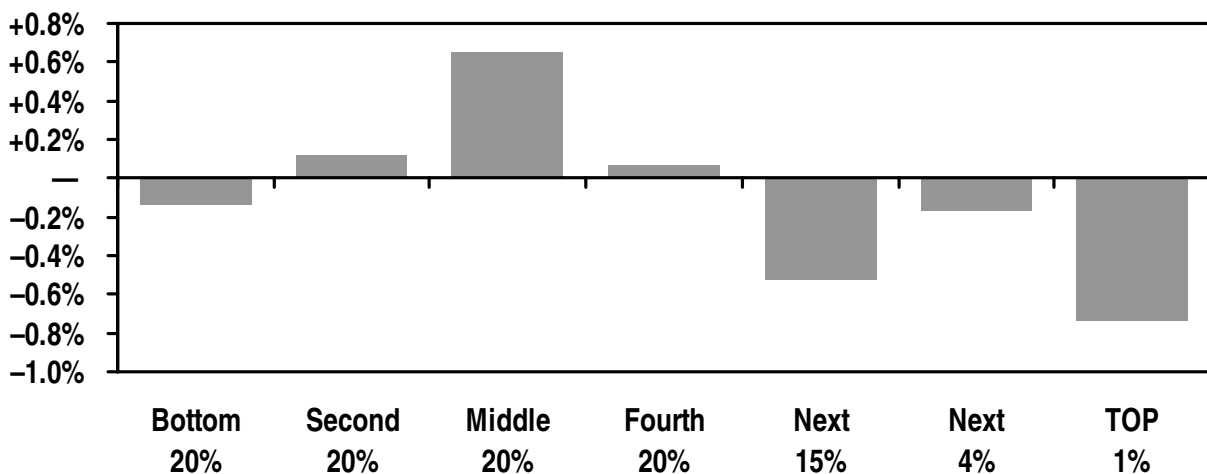
- The poorest twenty percent of South Carolinians paid, on average, 7.9 percent of their income in South Carolina taxes, while the wealthiest one percent of taxpayers paid only 7.7 percent of their income in state and local taxes.
- After taking into account the deductibility of state taxes on federal tax forms, the effective tax rate on the wealthiest 1 percent of taxpayers was an average of 5.5 percent—almost one-third lower than the tax on the poorest South Carolinians.
- According to ITEP’s January 2003 report, the wealthiest 20 percent of South Carolina families pay less of their income in taxes, on average, than the poorest 80 percent of families must pay.

¹*Who Pays? A Distributional Analysis of the Tax Systems in All 50 States.* McIntyre, Denk, Francis, Gardner, Hsu and Sims (Institute on Taxation and Economic Policy, 2003). The findings of this study do not reflect tax increases, reductions, or other tax changes (including either tax increases or tax cuts) enacted after 2002. Recent tax changes imposed do not impact this report’s basic findings.

The ITEP report also showed that the South Carolina tax system became even more unfair as a result of tax changes enacted in the 1990s. Growth in property taxes has made the South Carolina tax system more regressive in 2002 than it was in 1989.

- The poorest 80 percent of South Carolina families paid more of their income in state and local taxes in 2002 than in 1989.
- The wealthiest 20 percent of non-elderly South Carolina taxpayers—those earning more than \$59,000 in 2002—saw a decline in their South Carolina taxes between 1989 and 2002.
- The net result is a “tax shift” away from the wealthiest South Carolina families—onto the backs of the poorest.

Changes in South Carolina Taxes as Shares of Income, 1989 – 2002



Implications for South Carolina Tax Reform in 2007

This report reveals that despite South Carolina’s overall below-average tax rankings, the cost of funding South Carolina public services falls disproportionately on the very poorest South Carolina families. The main reason for this is the state’s sales and excise taxes. Sales taxes are inherently regressive because the lower a family’s income, the more of its income the family must spend on things subject to the tax.

Income taxes, by contrast, are progressive—the more you earn, the more of your income you pay in taxes. For lawmakers seeking to offset the basic regressivity of sales and excise taxes, the income tax is the only option available.

South Carolina lawmakers are to be applauded for engaging in an important debate over how, if at all, South Carolina taxes should be reduced. But shifting away from the income tax will inevitably make the state’s tax system even more regressive.

The “Federal Offset”: An Opportunity to Reduce South Carolina Taxes

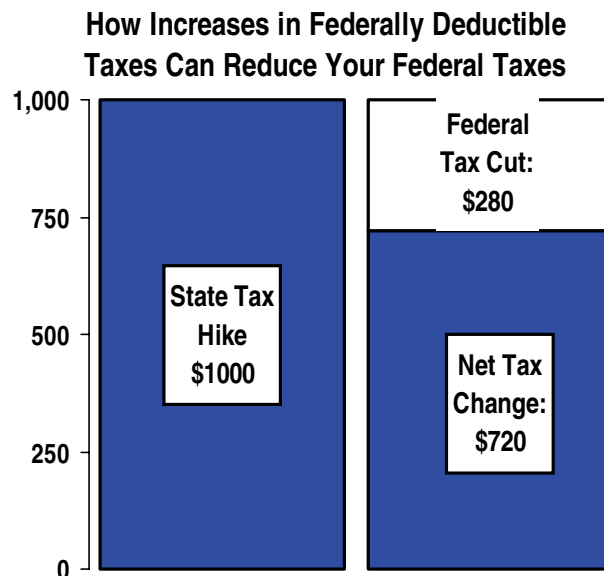
South Carolina residents who itemize deductions on their federal tax returns are allowed to deduct the state and local income taxes and property taxes they pay—which directly reduces their federal taxable income and their federal tax bill. Sales and excise taxes, by contrast, are generally not deductible on federal tax forms.² Thus, for every dollar in income or property taxes paid to a state or local government, taxpayers who itemize get a offsetting federal tax cut of up to 35 cents, depending on which federal tax bracket they are in. This is commonly known as the “federal offset.”

The chart below shows this effect. Suppose that under a hypothetical South Carolina income tax, an itemizing South Carolina taxpayer in the 28 percent federal tax bracket is subject to a \$1,000 state income tax hike. Her federal itemized deductions will increase by \$1,000 as a result—which means that \$1,000 less of her income will be subject to federal income tax. Since this last \$1,000 of income was originally taxed at 28 percent, this person’s federal income taxes will go down by \$280 (28 percent of \$1,000). So the state of South Carolina receives the full \$1,000—but only \$720 comes out of the wallet of the South Carolina taxpayer. The remaining \$280 is effectively paid to the state of South Carolina by the federal government. This “federal offset” amounts to a federal subsidy for states that rely on personal income taxes, through which the federal government effectively helps a state’s itemizers to pay their state income taxes.

Low-income South Carolina families pay much more of their income in state and local taxes than the wealthiest South Carolina families must pay. Future tax reforms should remedy this inequity—not make it worse.

The federal offset has clear implications for proposals to increase state income and property taxes. When state income taxes go up, part of that tax hike will not come out of state residents’ wallets at all, but instead will be paid by the federal government in the form of federal tax cuts for South Carolina itemizers. Because the federal offset is most useful for wealthy taxpayers who are more likely to itemize, the state can maximize its “bang for the buck” from state income tax hikes by targeting these tax hikes to the wealthy South Carolinians who will enjoy the largest federal tax cuts as a result.

The federal offset is not limited to the



²Federal legislation passed in 2004 allowed a temporary tax deduction for itemizers (mostly living in states without an income tax) who pay more sales tax than income tax. This optional deduction was only available in 2004 and 2005.

income taxes paid by individuals. Corporations can export up to 35 percent of their state corporate income taxes to the federal government. This means that when they act to cut the state's corporate income tax, South Carolina lawmakers are actually proposing to *increase* the federal corporate income taxes for South Carolina businesses.

Federal deductibility means that the differences in tax levels between income-tax and non-income-tax states are never really as large as they appear to be. Federal deductibility is a good deal for states like South Carolina that rely on income taxes, because it allows states with progressive income taxes to export part of their tax to the federal government. Conversely, the federal offset is an especially *bad* deal for non-income tax states like Florida, because the state is unable to take advantage of the federal offset's matching grant for state income taxes.

The general inapplicability of the federal offset to sales and excise taxes makes these regressive taxes a bad deal for South Carolina residents, since virtually every dollar of a sales tax hike that is paid initially by state residents will ultimately come out of their pockets.

Conclusion

Anti-tax advocates have tried to make the case that South Carolina's taxes hurt the state's business climate. But as this report has shown, the simplest measures of South Carolina tax levels can actually conceal more than they reveal about the actual taxes paid by South Carolina families at different income levels. When the actual incidence of South Carolina state and local taxes on South Carolina taxpayers is accounted for, the state's taxes are clearly well below the national average. Of course, this does not mean that all is well with South Carolina's tax system. In fact, low-income South Carolinians pay much more of their income in state and local taxes than the wealthiest South Carolinians must pay. Efforts to reform the state's tax structure should focus on remedying this basic inequity—rather than making it worse.

APPENDIX : ITEP TAX MODEL METHODOLOGY

The Institute on Taxation & Economic Policy has engaged in research on tax issues since 1980, with a focus on the distributional consequences of current law and proposed changes. ITEP's research is frequently used by other groups in their work, and ITEP is frequently consulted by government estimators in performing their official analyses. ITEP has built a microsimulation model of the tax systems of the U.S. government and of all 50 states and the District of Columbia.

What the ITEP Model Does

The ITEP model is a tool for calculating the yield and incidence, by income group, of federal, state and local taxes. It calculates revenue yield for current tax law and proposed changes. Separate incidence analyses can be done for categories of taxpayers specified by marital status, the presence of children and age.

The ITEP model relies on one of the largest databases of tax returns and supplementary data in existence, encompassing close to three quarters of a million records. To forecast revenues and incidence, the model relies on government or other widely respected economic projections.

The ITEP model's federal tax calculations are very similar to those produced by the Joint Committee on Taxation, the U.S. Treasury and the Congressional Budget Office (although each of these models differs as to how the results are presented). The ITEP model, however, adds state-by-state estimating capabilities not found in those government models.

Below is an outline of each area of the ITEP model and its capabilities:

The Personal Income Tax Model analyzes the revenue and incidence of current federal and state personal income taxes and amendment options including changes in:

- rates—including special rates on capital gains,
- inclusion or exclusion of various types of income,
- inclusion or exclusion of all federal and state adjustments,
- exemptions and standard deductions,
- itemized deductions and deduction phase-outs, and
- credits, such as earned-income and child-care credits.

The Consumption Tax Model analyzes the yield and incidence of current sales and excise taxes. It also has the capacity to analyze the revenue and incidence implications of a broad range of base and rate changes in consumption taxes. There are more than 250 base items available to amend in the model.

The Property Tax Model analyzes revenue yield and incidence of current state and local property taxes. It can also analyze the revenue and incidence impacts of statewide policy changes in property tax—including the effect of circuit breakers, homestead exemptions, and rate and assessment caps.

The Corporate Income Tax Model analyzes revenue yield and incidence of current corporate income tax law, possible rate changes and certain base changes.

Local taxes: The model can analyze the statewide revenue and incidence of aggregate local taxes (not, however, broken down by individual localities).

Data Sources

The ITEP model is a “microsimulation model.” That is, it works on a very large stratified sample of tax returns and other data, aged to the year being analyzed. This is the same kind of tax model used by the U.S. Treasury Department, the congressional Joint Committee on Taxation and the Congressional Budget Office. The ITEP model uses the following micro-data sets and aggregate data:

Micro-Data Sets:

IRS Individual Public Use Tax File, Level III Sample; IRS Individual Public Use Tax File; Current Population Survey; Consumer Expenditure Survey; U.S. Census, 1990.

Partial List of Aggregated Data Sources:

Miscellaneous IRS data; Congressional Budget Office and Joint Committee on Taxation forecasts; other economic data (Commerce Department, WEFA, etc.); state tax department data; data on overall levels of consumption for specific goods (Commerce Department, Census of Services, etc.); state specific consumption and consumption tax data (Census data, Government Finances, etc.); state specific property tax data (Govt. Finances, etc.); American Housing Survey 1990; 1990 Census of Population Housing; etc.

A more detailed description of the ITEP Microsimulation Tax Model can be found on ITEP’s website at www.itepnet.org.