



Study Says State Tax System Unfair Regressive Taxes Hit Poor, Middle Class Disproportionately

by : Al Dozier

A new study showing South Carolina's tax system weighs more heavily on the poor and middle class than the rich is unlikely to spark any restructuring of the state's tax system, according to local advocates for change.

That conclusion comes even as a new study panel, the Tax Realignment Commission (TRAC), is hearing experts and preparing new recommendations for legislative consideration.

The study, released Nov. 18 by S.C. Fair Share, was prepared by the Washington, D.C. based Institute on Taxation and Economic Policy (ITEP). It finds low and middle-income families in South Carolina pay a higher share of their incomes in state and local taxes than do the richest families.

Families earning less than \$16,000 pay 7.4 percent of their income to state and local taxes. Middle-income South Carolina taxpayers, those earning between \$27,000 and \$44,000, pay 7.9 percent on average. Upper-middle income taxpayers pay 8.2 percent (on incomes of \$44k to \$74k) and 8.5 percent (on incomes of \$74k to \$150k), respectively.

But the richest South Carolina taxpayers, those making more than \$390,000 — with average salaries just over \$1 million — pay only 6.4 percent. Meanwhile, those making between \$150,000 and \$390,000 per year pay just 7.4 percent — a smaller percentage of their income than those making \$27,000.

"We have a very antiquated tax system," says state Rep. Anton Gunn, a freshman lawmaker from Richland County who headed up Barack Obama's campaign in South Carolina and who once worked for South Carolina Fair Share. "We rely [too much] on sales tax, a regressive tax that hurts people with the least amount of money."

While some changes might be in store for sales tax exemptions, the basics are likely to remain the same, according to those familiar with the core policies.

That's because the goal of TRAC is not poverty reduction, but rather simplifying the tax code, ensuring steady revenue streams and making the state more competitive economically.

"Decades of additions and tweaks [have] produced a state tax structure that is convoluted and complicated with no unified goal guiding our state's revenue," House Speaker Bobby Harrell, R-Charleston, said in August upon announcing TRAC appointees. "Made up entirely of non-legislators, the TRAC commission will bring an outside perspective to this debate and will focus on making our tax system and our state more competitive."

But Gunn says there is a huge omission in TRAC's mission: fixing Act 388. The controversial measure swapped property tax funding for schools with a state sales tax in 2006, but the commission is not reviewing the system.

"It's the biggest boondoggle ever passed," Gunn says of Act 388.

Matthew Gardner, ITEP's executive director and lead author of the study, titled "Who Pays?"

A Distributional Analysis of the Tax Systems in All 50 States," says the main reason for the unfairness of South Carolina taxes is the state's reliance on regressive sales and excise taxes. Those taxes fall disproportionately on the worst-off families. The state's one progressive tax, the income tax, is not enough to offset the unfair impact of these other taxes.

"Relying more heavily on income taxes, and less on regressive sales and excise taxes, could help make the South Carolina tax system substantially less unfair," Gardner says.

Sue Berkowitz of the Appleseed Justice Center says her organization hopes to work with S.C. Fair Share to make sure the inequities cited in the report are not hidden from view.

Berkowitz says an important new initiative that should be considered is an earned income tax credit for the working poor.

The federal Earned Income Tax Credit is considered an effective anti-poverty program for working families, lifting 6.5 million people — including 3.3 million children — above the poverty line each year. Some 24 states have enacted similar programs.

John Ruoff, a research director for South Carolina Fair Share, says one of the most interesting findings of the ITEP study is that it's not just the poor people who are carrying a heavy tax burden.

"It's the middle class that's getting hit hardest," he says.

Ruoff says there is a way to fix that problem: create a new bracket at the higher income level that would lift some of the burden at the low and middle class level.

Another area that could be considered is more taxes on services, something the poor use far less than the rich.

But such reforms do not appear to be on the table during the tax panel's initial inquiries.

What's far more likely is the removal of many sales tax exemptions. According to The State House Report, the percentage of sales subject to state tax has been dropping and is now close to just 40 percent. Early meetings of the commission indicate that it is looking carefully at the many exemptions to the sales tax.

The tax study panel is headed by Bernie Maybank, former head of the state's Revenue Department, who has publicly stated that change is needed in sales tax and that exemptions are not fair to everyone.

Internet sales are under scrutiny as possible tax revenue sources.

During a recent TRAC meeting, North Carolina Secretary of Revenue Ken Lay said some \$4 billion in Internet sales in his state annually could produce up to \$500 million in tax revenue.

But for all of those possibilities, the prospect of relieving the tax burden for the poor and middle class does not seem to be in the cards.

Change in the Composition of Revenue



Source: U.S. Census Bureau, Government Finances

South Carolina's Tax System

Progressive Features

- Income tax uses a graduated rate structure
- Offers an income tax credit for child and dependent care expenses

Regressive Features

- Comparatively high state and local sales taxes
- Provides an income tax deduction equal to 44 percent of capital gains income

Recent Developments

- Created a zero percent bottom income tax bracket
- Increased the state sales tax rate
- Removed groceries from the state sales tax base
- Eliminated school property taxes on owner-occupied properties

Source: *Institute of Taxation and Economic Policy*

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