



South Carolina Policy Council Education Foundation

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Lower the Rate and Eliminate Sales Tax Exemptions

South Carolina needs sales tax reform that is equitable and friendly to all businesses. The best way to achieve these goals is to lower the sales tax for everyone – both businesses and consumers – and eliminate all sales tax exemptions.

Depoliticize the tax code

Reforming the tax code should begin with lowering the sales tax rate for everyone. This will not only increase private investment, it will end the sales tax incentives game that rewards inside players and penalizes everyone else. By lowering sales taxes for one industry, sales tax exemptions shift costs to other taxpayers, often those who are not “politically connected.” Such exemptions also distort the free market. Most important, they provide only short-term, often political, benefits at the expense of long-term economic costs. In this way, they violate a basic principle of economics, but also of free democracy, which should be dedicated to safeguarding the good for all. As the famed economist Henry Hazlitt reminds us:

The whole of economics can be reduced to a single lesson, and that lesson can be reduced to a single sentence. The art of economics consists in looking not merely at the immediate but at the longer effects of any act or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups.

Here, in South Carolina the long-term consequences of the politicization of the tax code are clear. Consider the following:

- ✘ South Carolina is one of the poorest states in the country, ranking 45th overall in per capita personal income. This is up only 3 spots since 1929, when the state ranked last in the nation.
- ✘ Average income in South Carolina is \$31,884 – 80 percent of the U.S. average. At the current growth rate, it will take South Carolinians another 20 years to reach the 2008 U.S average of \$39,751.
- ✘ Economic growth has stagnated since the 1980s, averaging less than 1 percent a year in the 2000s. During the same period, the level of economic freedom in S.C. has fallen from 9th in 1989 to 25th in 2008. By contrast, Georgia and North Carolina are both tied for 3rd in the nation.

Everyone is losing from the sales tax incentives game. Yet the purpose of government is to secure the common good. At the minimum, the state should seek to “Do No Harm.” This requires not picking winners and losers in the marketplace and instead lowering the tax rate for everyone, making the tax equally applicable in a nondiscriminatory – and nonpolitical – fashion.

Lower the sales tax rate

South Carolina’s combined state and local sales tax rate is 7.04 percent – 16th highest in the country ([see attached map](#)). The statewide sales tax of 6 percent is also far higher than that of neighboring states Georgia (4 percent) and North Carolina (4.25 percent).

Lowering the sales tax, however, will require more than just eliminating sales tax exemptions. As this commission well knows, tax reform in South Carolina must be comprehensive. Toward this end, the Policy Council wishes to invite the Commission’s members and the general public to join us in a year-long public dialogue regarding comprehensive tax reform.

TRAC is a great beginning to this dialogue. For our part, we are today launching a new project dedicated to unleashing capitalism, unleashing free enterprise and prosperity, in South Carolina. To read more about this exciting new endeavor, I encourage the Commission to visit our website: www.unleashingcapitalismsc.com.

As our new book, *Unleashing Capitalism*, makes clear, tax reform is a vital component of free market reform in South Carolina. But we need real discussion as to what directions genuine tax reform should take. Some of the options include:

- Eliminating the sales tax altogether and replacing the tax with a flat-rate income tax.
- Eliminating the income tax altogether and replacing it with a broad-based sales tax.
- Finally, there is the FAIR Tax option the Commission will be studying in the near future.

We are not claiming to have all the answers, but want to help sustain an ongoing dialogue toward reforming the tax code and ending the generational cycle of poverty in South Carolina.

Simplify and streamline the tax code

Finally, the state needs to simplify the tax code. Again, the best means of doing so is to lower the rate for everyone and eliminate sales tax exemptions for everyone. As it is, even folks who qualify for certain exemptions may not even know it. Take this sample passage taken from the FAQ section that accompanies the sales tax code:

- *Are sales of farm machinery to a farmer subject to the sales and use tax?* Sales of farm machinery meeting the requirements of the exemption in the sales and use tax law for farm machinery are exempt from the sales and use tax. If the sale of farm machinery does not meet the requirements of the exemption, the sale is taxable.

We all know taxes can be confusing. But they don’t have to be. Consider that:

- The sales tax section of the South Carolina tax code is 306 pages. 52 pages are dedicated to FAQs alone. By comparison, the city-state of Hong Kong's entire tax code is only 200 pages. At the same time, per capita income in Hong Kong has gone from \$3,757 in 1960 to \$32,800 in 2002 – an annual growth rate of 5.3 percent. By comparison, South Carolina's annual growth rate is 1.2 percent and its per capita income is \$31,884.

Simplifying the tax code by eliminating all exemptions would also accomplish the goal of modernizing the tax code for the 21st century. Currently, the state provides for a number of arcane and selective exemptions that do little or nothing to create jobs or improve the economy. These include exemptions for:

- Sweet grass baskets made by local artists from locally grown sweet grass.
- Electricity used by cotton gins, manufacturers, miners, or quarries to manufacture, mine, or quarry tangible personal property for sales.
- Proceeds from the rental or lease of portable toilets; vacation time-sharing plans; and gold, silver or platinum bullion.

But why are sweet grass and portable toilets more important to the state's economic well-being than numerous other items and activities that are not exempt from the state sales tax? The government shouldn't have to decide which of these items and activities are essential to the economy. Rather, the state should let investors and consumers decide for themselves by lowering the sales tax rate for everyone and lifting all exemptions.

For more information about our ongoing research on sales tax reform, please contact:
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