

REFORMING South Carolina's System of Business Licensing

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REFORMING

South Carolina's System of Business Licensing

Introduction

South Carolina's current system of business licensing is in dire need of reform. Chief among the many problems addressed in this report are the unnecessary complexity of the current system and the cost burden of compliance (for both businesses and localities seeking to enforce it). The current system drains resources from small businesses, discourages competition that would benefit consumers, is overly selective, and is subject to political manipulation. The licensing system has strayed from its original purpose and essentially functions as a revenue source for local governments, which both harms the economy and is needlessly costly to administer and enforce.

Unfortunately, since local governments have no incentive to improve the system on their own, reforms can only achieve success if they are implemented across all jurisdictions simultaneously, by state-level legislation. South Carolina's state constitution recognizes that local governments are indeed political subdivisions created by the State.¹ Their power of taxation is derived from the State: "...the legislative branch of the government has the exclusive power of taxation, but may delegate it to towns for municipal purposes and may, therefore, restrict the towns in that respect."² There is historical precedent for the State regulating the local licensing system when the State placed caps on the level of municipal business license taxes out of concern that localities were levying unreasonably high tax levels.³

It is the State's constitutional responsibility to reorganize and repair this outdated and burdensome system of business licensing that local governments have no incentive to improve. This is precisely the step recently taken by the neighboring state government in North Carolina, as explained in this report.

One specific problem with the current system, the fact that the tax must be levied on gross income, must be solved by state-level legislation, as it is mandated by state statute: "Each municipality can levy a business license tax measured by gross income. SC Code Sec. 5-7-30 No other basis is authorized, except for certain businesses,"⁴ and "[t]he general statutory basis for levying a business license tax requires it to be measured by gross income. SC Code Sections 4-9-30(12) and 5-7-30."⁵

This report begins by examining why improving the system matters, the logic behind a well-functioning system of business licensing and taxation, and how South Carolina's current system departs from these principles. The report concludes by examining how South Carolina can reform its business license system and discussing the steps taken by regional and competitor states that have recently enacted reform.

1 Municipal governments are creatures of statute and possess only the powers given to them by the State. S. C. Constitution, Article VIII, §§ 7, 9.

2 South Carolina Supreme Court, see Quirk, William J. "Nature of a Business License Tax." South Carolina Law Review, Vol. 32, 1981, page 482.

3 See the two examples given in Quirk, William J. "Nature of a Business License Tax." South Carolina Law Review, Vol. 32, 1981, footnote 68 and page 490.

4 Municipal Association of South Carolina, Business License Handbook, October 2013, page 1.

5 Municipal Association of South Carolina, Business License Handbook, October 2013, page 14.

Why It Matters

Despite South Carolina's abundant resources, educated workforce, growing population, and productive waterways, the state ranks poorly on measures of economic well-being. In terms of personal income per capita, South Carolina ranked 48th among the 50 U.S. states, making the Palmetto State the 3rd poorest state in the nation in 2013.⁶ With personal income per capita of \$35,453, the average South Carolinian's income is 79.6 percent of the U.S. average, and 89.2 percent of the average for states in the Southeast.

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South Carolina not only has a relatively low level of per capita income, but the growth rate of income also lags behind other states. Between 2012 and 2013, for example, South Carolina's per capita personal income grew at 1.13%, the 46th worst growth rate in the country that year, and only 61.1 percent of the average growth for the country as a whole (and 72.4 percent of the average growth of states in the Southeast).⁷

South Carolina's labor force participation rate is the 6th lowest in the country, with only 58.8 percent of the working-age population actively engaged in the state's labor market.⁸ There are many South Carolinians who could, and would, generate income for themselves if it were easier to become an entrepreneur or if employment opportunities with a new business were expanded.

A large share of the differences in economic growth rates across geographic areas is explained simply by differing levels of entrepreneurial activity—that is, areas with more entrepreneurship have faster economic growth. Reynolds, Hay, and Camp (1999), for example, find that one-third of the difference in economic growth rates across areas is explained by differing levels of entrepreneurship, while Zacharakis, Bygrave, and Sheperd (2000) find that differing levels of entrepreneurial activity explain approximately one-half of the difference.⁹

Entrepreneurship is a primary driving force behind economic growth and prosperity. If South Carolina wants to grow, prosper, and have more employment opportunities, the impact of policies on the environment for entrepreneurship must be critically examined. As this report will illustrate, South Carolina's current system of business licensing is an obvious impediment to entrepreneurship.

The actions of entrepreneurs not only create wealth and jobs, but also create new goods and services that improve the well-being of consumers. During the past century alone, medical innovations have resulted in life expectancy increasing by approximately 30 years in the United States¹⁰, and those years are spent in more comfort because of entrepreneurs such as Willis Carrier, who invented modern air conditioning, and Italian immigrant Candido Jacuzzi, who developed the first hydrotherapy pump for bathtubs to help his son who suffered from juvenile rheumatoid arthritis.

6 U.S. Department of Commerce, Bureau of Economic Analysis, series SA1-3, Personal income summary.

7 U.S. Department of Commerce, Bureau of Economic Analysis, series SA1-3, Personal income summary.

8 U.S. Department of Labor, Bureau of Labor Statistics, state and local area labor force statistics.

9 Reynolds, P. D.; Hay, M., and Camp, S. M. (1999) Global Entrepreneurship Monitor. Kansas City, Missouri: Kauffman Center for Entrepreneurial Leadership; and Zacharakis, A. L.; Bygrave, W. D. and Shepherd, D. A. (2000) Global Entrepreneurship Monitor: National Entrepreneurship Assessment: United States of America. Kansas City, Missouri: Kauffman Center for Entrepreneurial Leadership.

10 Life expectancy at birth was 78.7 in 2010 and 47.3 in 1900 [source: United States Centers for Disease Control and Prevention, National Vital Statistics Reports, Vol. 63, No. 7, November 6, 2014, Table 19].

Economists have long recognized the important role that entrepreneurs play in advancing society. Schumpeter (1942) described how entrepreneurs search for new combinations of resources, guided by the profit and loss system, and unleash a process of ‘creative destruction’ in which new goods and services replace old ones.¹¹ Kirzner (1997) argued that the entrepreneurial discovery process is vital to the effectiveness of markets.¹²

As Baumol (2004) demonstrates, most new innovations do not come from existing large companies, but rather from the entrepreneurial insights of new small businesses. Promoting entrepreneurship and economic growth means promoting the growth of new small businesses through policy reform that lowers the obstacles and barriers to opening and growing a small business.¹³

It is against this backdrop that this study examines the system of business licensing in South Carolina. The current system has significant negative impacts on both the creation and growth of new entrepreneurial businesses that can be eradicated with a few simple reforms.

Principles Underlying a Sound and Effective System of Business Licensing

From the standpoint of economic theory, a well-functioning system of business licensing would satisfy a clear list of criteria:

- A process that treats businesses fairly, similarly, and equally.
- A process that is reasonably straight-forward and economical so that businesses can comply with it, and government agencies can administer and enforce it.
- A process that promotes oversight of business and compliance with other laws, taxes, and reporting procedures.
- A process that creates a clear and rational link between the fees charged and the public services
- the license actually provides—that is, fees that are linked to the public services provided or consumed by business that are not already covered through other forms of business taxation.
- A process that promotes competition to improve quality and lower prices for South Carolina consumers.
- A process that does not seek to generate government revenue by unnecessarily draining businesses of the funds they would use to reinvest in order to grow.

Unfortunately, South Carolina’s current system fails to meet all six of these important criteria. This report continues by addressing each of the above principles in greater detail along with suggestions for reform.

11 Schumpeter, Joseph A. 1942. *Capitalism, Socialism, and Democracy*. New York: Harper.

12 Kirzner, Israel M. 1997. “Entrepreneurial Discovery and the Competitive Market Process: An Austrian Approach.” *Journal of Economic Literature*, 35(1): 60-85.

13 Baumol, William J. “Education for Innovation: Entrepreneurial Breakthroughs vs. Corporate Incremental Improvements,” NBER Working Paper 10578 (June 2004).

1. Treating Businesses Fairly, Similarly, and Equally

Standard public finance theory is clear that government taxes and fees should satisfy a principle known as ‘horizontal equity’—a principle that says that equals should be treated equally. The principle extends far beyond business licensing and taxation. We should all be equal before the law. Regardless of our sex, race, or income, laws are laws and should be applied equally and fairly to everyone. Individuals should not be arbitrarily treated differently. There should be no discrimination. Even more troubling than random arbitrary differences is when the differences are a function of the political influence that individuals have. Quite simply, people with political connections should not get favors or breaks that are not given to everyone.

South Carolina’s system of business licensing strays far from this basic principle. Each municipality requires businesses to pay a business license fee. However, the fee is not the same for all businesses, nor even calculated on the same basis. In the city of Charleston, for example there are seven ‘rate classes’ and dozens of specific rates and exemptions for selected industries. While food stores, auto dealers, and gasoline stations are under rate class 1, travel agencies, apparel stores, and eating and drinking establishments are in rate class 2. Although, eating and drinking establishments that are primarily nightclubs are instead in rate class 7. Rate class 3 includes concrete products, electrical equipment, and motor freight transportation; while rate class four includes tobacco, printing, and auto repair. Class 5 includes security and commodity brokers, passenger transportation and communication; while class 6 includes credit agencies, insurance agents, fishing and hunting, and social services. Finally, class 7 includes taxi licenses, billiard tables, and amusement machines.

In addition to this confusing system of classification, there are numerous exceptions and special rates for specific industries, including for radio telephone communications, railroad companies, night clubs, insurance companies, computer programming, and insurance.

Charleston is not alone. Similar mazes of rules exist for the other cities and counties that have business licenses, and these lists vary widely across the localities—resulting in an inconsistent system of fee formulas across the state that creates considerable confusion and administrative costs. Even the small town of Lincolnton has a lengthy 55-page business license ordinance document with which business owners must comply.¹⁴

This inconsistency is both defended by the localities and subject to their discretion under current law. Consider the following examples from the Municipal Association of South Carolina, Business License Handbook:

“Federal nor state law provides any guidelines for determining when a license tax is reasonable...If different rates are to be charged for different classifications, it necessarily follows that the city council must use its judgment and set the different rates to be collected. In deciding whether the tax is reasonable, it has been held that the reasonableness

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¹⁴ See <http://www.charlestoncounty.org/departments/revenue-collections/files/LincolntonBL.pdf>

is largely within the discretion of the city council.” [Page 4]

“The legislative purpose of the license tax is simply to raise revenue for operation of the city or county. Uniformity between classes is not required. *Carter v. Linder*, 303 SC 119, 399 S.E.2d 423 (1991)... the court may require a showing of a rational basis for a wide disparity in rates between classes, overlooking the general rule that equal protection applies only within a classification and not between classes. The settled rules regarding the burden upon the taxpayer to prove unconstitutionality beyond a reasonable doubt...” [Page 13]

In some (perhaps most) cases these different rates of fees are determined by political connections, a problem that has plagued this system throughout its entire history and has drawn the attention of South Carolina courts.¹⁵ In most areas, fees depend on whether the business owner is a local voter.¹⁶ Obviously, imposing taxes on a person who cannot vote on your re-election is less politically costly than imposing taxes on someone who can vote against you. According to the Municipal Association of South Carolina, *Business License Handbook*: “[m] any license ordinances provide that rates for nonresident businesses are classified higher than for residents, usually double the resident rates. The Supreme Court has upheld a differential rate...as fully justified...” [Page 13]

In other areas local governments waive the fee, lower, or offset it using other means for a specific large, politically-connected business. Specific car dealers have obtained special treatment, and companies such as Boeing were able to entirely change the system in North Charleston to reduce their rate and cap their fee; a change which also then affected the rates charged to a few other businesses in the city. For example:

“For the second time this year, North Charleston plans to reduce the business tax paid by one of the city’s largest companies...a change to the business license rate schedule that will reduce the tax rate for Select Health of South Carolina...Two smaller companies with the same business classification, which the city did not identify, also will benefit from the change in the rate...”

“In July, North Charleston cut in half the top business license tax rate for those with gross earnings of \$250 million or more — Select Health is among the four North Charleston companies in that category — and created a new top tier tailored for Boeing Co. with a rate 99 percent lower than the current levy. Those changes to the business license fee structure were meant to cap Boeing’s business license fees at \$1 million yearly, as the company ramps up aircraft production. Select Health, Trident Regional Medical Center, and Daimler Vans Manufacturing benefited to a smaller extent due to the reduction in the rate for earnings above \$250 million.”¹⁷

Even local officials argued that the underlying problem that encouraged them to make special provisions for these companies is that the license fee tax is incorrectly and unfairly based on gross revenue:

¹⁵ As examples, see the cases involving special treatment for Standard Oil Company and Confederate Veterans in Quirk, William J. “Nature of a Business License Tax.” *South Carolina Law Review*, Vol. 32, 1981, pp. 471-499.

¹⁶ For example, City of North Charleston, Ordinances, Sec. 10.5-19 (Article II), reads: “Unless otherwise specifically provided, all minimum fees and rates shall be doubled for non-residents and itinerants having no fixed principal place of business within the city.”

¹⁷ From “Select Health in North Charleston May Get Tax Break,” by David Slade, *Post and Courier*, Nov. 4, 2013.

“According to Mayor Keith Summey, the reduction targeted for Select Health is needed because the business license fee is based on gross revenues...putting an unfair burden on the company...Some council members have questioned whether the change is fair to other businesses, or even legal. ‘We’ve already done a business license reduction for four big entities,’ Councilman Todd Olds said at the committee meeting in October. ‘Now, one of them is coming back for another reduction.’”¹⁸

Treating politically-connected businesses differently than other businesses creates issues with fairness, and when the favors are granted to one business, others rush to secure their own personal rate reductions.

In other areas, delivery services such as UPS or FedEx do not have to pay the license fee to deliver due to deals with local officials, but a metro area furniture store would have to pay to deliver in the area.¹⁹ The issue is not really that these larger and politically-connected companies can get lower rates and caps on their payments—the issue is that other smaller businesses with less political pull cannot get equal treatment and assistance lowering their rates. Yes, the rates are too high and wrongly based on gross revenue, but this is a problem that needs to be fixed for everyone, not just those with the pull to get their local government officials to make special exemptions for them individually.

“The current system is one in which localities can selectively apply rates, granting favors to some and punishing others.”

The current system is one in which localities can selectively apply rates, granting favors to some and punishing others. This stands in stark contrast to the economic principle that laws and policies should be broad-based, and apply equally to all. The current system encourages favor seeking and lobbying, and is quite simply unfair to some businesses that are treated differently than others.

The fact that the fees differ so widely across types of businesses is not the only manner in which the current system seemingly violates principles of fair treatment. Business license fees, in virtually all cases, are levied as a fixed fee for obtaining a license plus an additional amount based on a percentage of the business’s gross income (or revenue), which is mandated by state statute: “Each municipality can levy a business license tax measured by gross income. SC Code Sec. 5-7-30 No other basis is authorized, except for certain businesses,”²⁰ and “[t]he general statutory basis for levying a business license tax requires it to be measured by gross income. SC Code Sections 4-9-30(12) and 5-7-30.”²¹ Because it is based on gross revenue, if a business sells \$100,000 in goods and services, it pays the same fee calculated as a percentage of this amount regardless of its costs of production. That is, a business with revenue of \$100,000 with costs of \$90,000 (and thus a \$10,000 profit) is charged the same fee as a similar business with revenue of \$100,000 with costs of \$20,000 (and thus a \$80,000 profit).

In essence, this means the license fee system is particularly burdensome for high-cost,

18 From “Select Health in North Charleston May Get Tax Break,” by David Slade, Post and Courier, Nov. 4, 2013.

19 “In Pee Dee Chair Co. v. City of Camden, the court held that for license purposes, a single delivery of merchandise within a municipality does not constitute doing business therein....Although a single delivery does not constitute doing business, the courts have held that repeated deliveries can be considered doing business,” Municipal Association of South Carolina, Business License Handbook, October 2013, page 10. In practice, different areas enforce it differently, for example in the city of Goose Creek, a business would not need a business license if it was for a no-charge delivery in a personal vehicle; however, if a company truck does the delivering and charges a delivery fee, they would need a business license based on the delivery charges unless they use a common carrier like UPS, then they would not need a business license for the delivery charges.

20 Municipal Association of South Carolina, Business License Handbook, October 2013, page 1.

21 Municipal Association of South Carolina, Business License Handbook, October 2013, page 14.

low-margin businesses, particularly those with inventory costs, and for very small firms. An advertising agency who purchases \$1 million in advertising for a client, but who only made \$10,000 in profit on it; or a homebuilder who sells a \$300,000 home but only makes \$20,000 in profit are both charged a percentage based on the full amount of the revenue, not just the profit. Complicating the issue is the contested interpretation of defining what counts toward gross income, particularly in the case of real property transactions, resulting in legal challenges to the interpretation local governments use which differs from those used in the federal tax code.

Although the current gross income basis for the business license tax is mandated by state law, the underlying basis is less clear: "A business license tax ... is a method of requiring a business or occupation to

contribute its share in support of the government 'as it regards the profits or advantages of such occupations.' *State v. Hayne*, 4 SC 403 (1873). It is not a sales or income tax, although it is measured by gross income."²² The question should be whether the current gross income basis is indeed the best measure of the 'profits or advantages' of doing business. Gross income is clearly not a basis for determining the 'profits' part of this definition.

Because the fee is based on gross revenue, this puts South Carolina at a major disadvantage in recruiting and keeping new businesses that have higher costs and lower margins. Keep in mind that these 'costs' are also being taxed in several ways. Labor costs create wages that are taxed under the income tax; property is taxed under the system of local property taxation, and the income of the suppliers of the resources is taxed under other business income taxes such as the corporate income tax or personal income tax (in the case of LLC's or sole proprietorships).

The less obvious, but perhaps more important, issue here is that the current gross revenue basis for the license fee is equivalent to a turnover tax that pyramids by taxing the same exact item multiple times. For example, if the homebuilder mentioned above pays the \$280,000 in costs out to sub-contractors who do the work on the house, each of these subcontractors will have to pay a business license fee based on their total revenue as well. Consequently, not only is the builder essentially taxed on the \$300,000 sale price of the final house that includes the costs of construction, the sub-contractors are also taxed on the \$280,000 of their work. The pyramid scheme goes on, as when the subcontractors purchased their supplies from hardware stores, these stores are also taxed on their sales to the contractors. The process continues as the lumber company who harvests the trees must pay based on its revenue even though the hardware store had to pay when it sold the wood to the contractor. In essence, each time the good or service changes hands, it is essentially subject to additional taxation under the current system of business license fees based on gross income.

The pyramiding, 'turnover-tax' present in the current licensing system creates unfair distortions as companies who can vertically integrate—handling multiple steps within the same firm without the need for an explicit transaction—pay less in total fees than those who must out-source their resources from other firms. If a single person chops down a tree, cuts it into boards, assembles a chair, then sells it at the retail level, they will pay the license fee based on the chair sales revenue only once. Alternatively, if these activities are undertaken by four different business firms, the value of the chair will essentially be taxed four times in the process since each business will have revenue as the between-business transactions occur.

This issue has been a frequent argument in efforts to reform or dispute the tax in court.

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Despite the fact that obviously the value of the final consumer good has been used as the basis for a tax applied multiple times, and that this clearly meets the economic textbook definition of double taxation, localities are insistent that it is not a double tax in their view. Consider the following examples from the Municipal Association of South Carolina, Business License Handbook:

“Subcontractors are not exempt from a business license tax even though the general contractor may pay a tax on the full contract price of a project. A general contractor cannot deduct the amount paid to a subcontractor from the gross income upon which he computes his license tax. The contractor and subcontractor are two different people or entities engaged in two different business activities. Each is subject to a license tax based upon the gross income received. The tax is levied upon the privilege of doing business not on the income. Therefore, there is no double taxation, as is frequently argued.” [Page 26]

“Independent insurance agents sometimes argue that they should not pay a business license tax because the company pays a tax on the gross premiums. They contend this would be double taxation because their commissions are paid from gross premiums. This is a misconception... There is no double taxation. The taxes are levied on two different businesses. For example: manufacturers, wholesalers and retailers may be subject to license taxes on gross income from the sales of the same goods because each activity is a separate business. Neither the goods nor the sales transactions are the subjects of the tax.” [Page 31]

“Double taxation is a common objection raised by contractors and subcontractors. See the discussion in Part 3 for responses to this objection.” [Page 46]

Despite these statements, the charge of double taxation is a ‘common objection’ precisely because “a rose by any other name is still a rose.”

To reform South Carolina’s system of business licensing requires adopting a system that is more broadbased, with fewer exemptions and differentials—a system in which all businesses are treated fairly and equally. Applying the same rate structure or fee system to all businesses

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would be the ideal goal of reform. This reformed system must also avoid unfairly and multiplicatively taxing gross income and be either a flat fee or based on net income—income minus costs. Any reform should strive to have fewer categories and exemptions while maintaining uniformity across the state. However, these reforms will have to come from the state legislative level: “[b]ecause flat or fixed fees are not based on gross income, they do not comply with the state law authorization and

would be discriminatory. However, it is generally accepted practice to charge a minimum base rate sufficient to cover administrative costs.”²³

23 Municipal Association of South Carolina, Business License Handbook, October 2013, page 16.

2. Ease of Compliance and Enforcement

The current system of business licensing requires many small businesses to have dozens of local business licenses—for no reason other than to collect local revenue. An air conditioning repairman, realtor, or electrician, who works in the Charleston metro area, for example, is required to have licenses in each and every county and municipality in which he does work. The Charleston metro area, while all within an easy drive for a local service provider, consists of many different smaller cities and municipalities and encompasses three counties. To serve all of the towns within a short drive from their office, a Charleston service provider would need to obtain 3 county business licenses and a minimum of 28 municipal business licenses.²⁴ In some cases, municipalities allow the county to renew and collect their licenses; however, this practice is limited and is far from solving the problem.²⁵ The different areas also have differing annual periods, some January to January, while others may be July to July.



Photo courtesy of Greg Mappus, owner of the Charleston area franchise of Mister Sparky.

Many new small businesses can only survive by selling over a larger geographic area as the product appeals only to a limited percentage of customers. Quite simply, a company specializing in a narrow area—something that might only apply to a few houses per square mile per year such as repairing fire damage—needs to serve a larger geographic area in order to survive. The father of economics, Adam Smith (1998, [1776]) argued that specialization and the division of labor are the primary drivers of economic wealth and prosperity.²⁶ A pet store specializing in only birds, for example, needs a larger metro area to serve to have enough customers than a pet store that carries a general line of assorted pets. As Adam Smith noted, this degree of specialization is limited by what he termed ‘the extent of the market’—or the size of the overall market within which a business can sell. A small specialized company may need to serve an entire metro area to be able to generate enough customers to survive.

Solving this problem is an issue of state statute, as is clear in the Municipal Association of South Carolina, Business License Handbook, page 9: “A license may be charged for the privilege of doing business within the city or county regardless of whether there is an established place of business therein, except for businesses given special treatment by statute. See Atty. Gen. Op. No. 1262, January 12, 1962; and *Crosswell & Co., Inc. v. Town of Bishopville*, 172 SC 26, 172 S.E. 698 (1933)... SC Code Sec. 5-7-30 contains no general prerequisite that there be a place of business in the taxing municipality.”

The current system of business licensing, with its maze of duplicative licenses, makes it more difficult and costly for small businesses to serve larger areas, specialize, and grow. Thus the cur-

24 The counties of Charleston, Berkeley, and Dorchester, and the municipalities of Awendaw, Bonneau, Charleston, Edisto Beach, Folly Beach, Goose Creek, Hanahan, Harleyville, Hollywood, Isle Of Palms, James Island, Jamestown, Kiawah Island, Lincolnville, McClellanville, Meggett, Moncks Corner, Mount Pleasant, North Charleston, Ravenel, Reevesville, Ridgeville, Rockville, Saint George, Saint Stephen, Seabrook Island, Sullivan's Island, and Summerville.

25 As examples, the towns of Rockville, Awendaw, McClellanville, and Lincolnville allow Charleston County to administer their licenses.

26 Smith, Adam. 1998 [1776]. *An Inquiry into the Nature and Causes of the Wealth of Nations*. Washington: Regnery Publishing.

rent system stifles both the creation of specialized small businesses and the creation of wealth.

Most importantly, business owners must spend substantial time and effort to obtain and keep records to apply for the multitude of different geographic licenses. Local business owners estimate that they spend a minimum of 3 to 4 hours per year, per license, to simply comply with the procedures. While some municipalities have on-line systems, most do not, and this requires business owners to sometimes visit or repeatedly call to obtain the necessary forms for each area. Local business owners complain that smaller cities, like the city of Hollywood, for example, are particularly difficult places to renew as notices are not automatically mailed and forms are difficult to acquire, given the limited local government resources to help with the process.

Making matters worse, each business must try to keep track separately of the business activity it does in each municipality. While in theory this may sound easy, in some areas a house next to another may be in the city versus unincorporated county. Even the most advanced small business accounting systems provide reports mostly by zip code, which do not align with these boundaries. Local business owners report in many cases that they must simply guess at the percentages that are in the city versus unincorporated county for reporting purposes. To identify each property would take hours of effort for the business. But if a city were to audit the business, they would use city resources to do this for each recorded transaction and fine the business for not properly reporting the amounts.

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Even if it were easier to identify which revenue was earned in which locality, the current system of licensing does not even rely on actual business revenue. For a new business, its first license would require it to try to estimate the revenue it will earn in each locality. For renewals, the amount is based on the prior year's revenue in the area, but there is no system to rectify the differences annually to the true amounts. If a business does less revenue (or maybe even no revenue) in a year than estimated or in the prior year, there is no refund on the overpayment based on lower revenue. However, if the

business has higher revenue than estimated, it may have local officials coming to penalize the business for underpayment.

For example, City of North Charleston, Ordinances, Sec. 10.5-19 (Article II), reads: “A license fee based on gross income shall be computed on the gross income for the preceding calendar or fiscal year, and on a twelve (12) month projected income based on the monthly average for a business in operation for less than one (1) year. The fee for a new business shall be computed on the estimated probable gross income stated in the license application for the balance of the license year and updated prior to renewing for the following year. No refund shall be made for a business that is discontinued or for over payments of prior year license fees.”

Several businesses reported having to fight localities in the legal system over whether the license applies or over specifics of the fee, including which deductions are allowed from gross revenue or gross income. A Charleston area real estate broker who wished to remain anonymous, said in an interview that he was forced to hire tax law experts to fight local officials' interpretation of the specific rules. Complicating the issue, some local ordinances explicitly state the basis as 'gross income' while others state the basis as 'gross receipts.' Because not all municipal ordinances incorporate the same language, inconsistencies arise in how

business license fees are calculated and applied. For instance, the City of Goose Creek ordinance uses ‘gross income,’ while the Mount Pleasant ordinance refers only to ‘gross receipts.’

Conflicts such as this have led to lawsuits over the interpretation. The City of Goose Creek is facing a lawsuit over a city employee’s interpretation of gross income versus gross receipts in a case involving the purchase and resale of property.²⁷ An employee of the city of Goose Creek is trying

to levy the business license tax on the entire sale value of the property, that is—the gross revenue, which is substantially different from the taxable gross income—which is the difference between the sale price and the purchase price. In other words, if a business purchases a home for \$550,000 and resells it for a price of \$600,000, the gross revenue is \$600,000 but the gross income is \$50,000. Thus, a tax based on gross revenue is different amount than a tax based on gross income.

Fines for non-compliance are sharp and the burden of proof is on the business, even if the locality is wrong on the issue. The system is complex enough to confuse anyone, including local employees in charge of administering the system.

On an on-going basis, the license tax renewal process is cumbersome and uncertain. While a business serving a metro area may do one job in a smaller rural municipality in a given year, it is not always sure it will have business in that area in the coming year. If a business only services one home every three years in a small surrounding town this process is frustrating. If it chooses to renew, but gets no business in the area, there is no refund of the license tax, costing the business money for no reason. If it chooses not to renew in January, based on the expectation of no business in the area, but gets a job call in September, it can obtain a license at the time of the job in September but only with substantial fees and penalties due to its lateness in renewing for the year. After renewing with penalty in September, the license would then only be valid for the remaining three months of the year. Local businesses reported basically having to maintain and renew licenses in areas ‘just in case’ they get a call, even though they routinely end up doing no business in the area, all without any refund in the fee. In addition, businesses must have a current license in many areas just to bid on a job, even if they do no current work in the area and even if they are not selected for the final contract. The intent to do business is the basis, as is clear in the Charleston County business license ordinance: “[e]very person engaged or intending to engage in any calling, business, occupation or profession”

In many cases, with overburdened local enforcement resources, it is easy for some businesses to evade the system. Unmarked pickup trucks doing work on a house may never be questioned while a truck with a company name on the side will often be inspected for compliance. Business owners who do try to comply properly reported being upset that their attempt to comply put them at a cost disadvantage relative to firms who try to evade the system.

Keep in mind that these local area service-type businesses who are subject to this overly burdensome and complex system are precisely the types of businesses that provide job and entrepreneurial opportunities for the lowest-skilled and unemployed citizens who need jobs most—the painter, lawn mower, or house cleaner. For a large, one-location major retailer with more stable revenue, while the fee may be large, the compliance is much easier than for a small business that performs services in a wider geographic area.

“Fines for non-compliance are sharp and the burden of proof is on the business, even if the locality is wrong on the issue. The system is complex enough to puzzle anyone, including local employees in charge of administering the system.”

²⁷ County of Berkeley, Court of Common Pleas, Case No. 2011-CP-08-2814, Todd Olds v. City of Goose Creek.

This system is not only burdensome for small businesses, but also for local governments. Keep in mind that a business in theory could accomplish everything truly needed and pay all proper amounts of fees by simply having one license, paying one full amount, and with

“Even the book aimed at helping local governments understand the rules of the business license system, *The Municipal Association of South Carolina, Business License Handbook* (October 2013) is a 102 page document!

a record of sales by area submitted, the total tax could be split and redistributed across the localities just like is done under the local-option sales tax collection system. Instead, each business must be processed repeatedly by many small jurisdictions, with many duplicate forms and the workers necessary to compute payments, collect them, send out paper licenses, administer the system, and to enforce the system. The current system is unnecessarily costly for municipalities to administer and to enforce. Even a revenue-neutral re-

form that centralized the processing system could generate substantial cost savings (and additional local revenue to spend) across the entire state by eliminating the duplicative local administrative structures. A central administration could even be paid for with a surcharge on the revenue from the system and still result in more net revenue for localities due to their cost savings from administration and enforcement. The dozens of policemen and other enforcement officers involved in this process create an unnecessary drain on local government resources that could be better spent elsewhere to reduce crime and solve more pressing community problems. In the end, each municipality must duplicate the efforts and process already undertaken effectively by another municipality. While some municipalities allow their county to collect and issue their licenses, this practice is limited and comes far from solving the problem.

Even the book aimed at helping local governments understand the rules of the business license system, *The Municipal Association of South Carolina, Business License Handbook* (October 2013) is a 102 page document!

As an example, the City of North Charleston pays \$200,000 per year to Charleston County to help administer part of its business licensing system (including billing, renewals, inspections, auditing). Thus, its internal operations are only a small portion of what it would take to perform the entire operations for a stand-alone business licensing system. Even so, the city employs 3 people within its Finance Department whose primary job duties are to handle new business license applications, permit collections, contractor updates, and handle questions relative to the business licensing process, at an estimated cost of approximately \$300,000 per year to the city. In addition, the city has two compliance officers in the Building Inspection and Executive Department involved in specific inspections and renewals. Along with the cost of their operational support, this costs the city an estimated additional \$150,000 per year. So even in the case of a city that does partially contract its services to the county, the total cost of the system is \$450,000 internally plus the amount charged by the county, for a grand total of approximately \$650,000 in administrative and enforcement costs—which amount to 3 percent of the revenue collected by the tax, or \$16.89 per household in the city.²⁸

Using the data for North Charleston to extrapolate to the statewide costs is possible. One method would be to assume all localities spend the same percent of revenue, the other assuming all localities have the same cost per resident household. Because North Charleston has a

28 Estimates provided to Todd Olds, North Charleston City Council Member, by E. Warren Newton, Director of Administration & Finance, City of North Charleston, March 10, 2010.

few very large businesses, like Boeing, that contribute disproportionately to revenue, the cost as a percent of revenue basis likely understates the cost for other localities. However, the two techniques produce estimates of statewide administration and enforcement costs of \$9.4 million and \$30.7 million respectively. A reasonable approach would be to average these two numbers, thus giving an estimate of roughly \$20 million, or roughly 6.5% of license revenue collected.

Reforming South Carolina's system of business licensing requires adopting a system by state statute that is both easier for businesses to comply with and for governments to administer and enforce.²⁹ Having a system in which each business must apply for a single business license, enforced by a single jurisdiction (perhaps even a state-wide administrative department) but recognized by all municipalities would be the ideal goal of reform. If this system were integrated with the state income tax system, not only could proper accounting of the fees based on actual annual revenue or income be implemented, but local resources would be conserved, and substantial reductions in compliance costs for businesses would result.

3. Promoting Oversight and Compliance with Other Laws, Taxes, and Reporting Procedures

In theory, licensing laws have their primary justifications in terms of protecting consumers by ensuring the legitimacy of the provider, and making businesses pay revenue to the government that is in line with the public services the business consumes. The first of these is the subject of this section. This is made clear in the Municipal Association of South Carolina, Business License Handbook:

"Licensing of a trade may be referable to the police power of a local governing body when done to regulate avocations that disturb public order, health or morality. However, a business license ordinance enacted to raise revenue is an ordinance levying a tax. *State v. Columbia*, 6 S. C. 1 (1874)...A business license fee is an excise tax levied on the privilege of doing business, and the value of the privilege extended is measured by the business's gross receipts." [Page 1]
"Although business licenses primarily are used as a revenue source, they also may be used to regulate businesses. The business license ordinance may impose health requirements, bonds, regulation of operating hours, etc. Most business license ordinances require a statement that personal property taxes have been paid as a condition for the license. This requirement is considered appropriate under the power to regulate by license ordinance." [Page 4]

At the outset it is critical to understand that this is clearly a process that does not require the duplicative efforts of multiple municipalities, but rather a single clearinghouse for each business in the state. This could be accomplished alternatively by a single state agency or a system of localities each with responsibility for only a fraction of the businesses—the ones that primarily reside in their area. North Carolina's recent reform accomplishes this, albeit temporarily prior to the fees being eliminated entirely, as it currently requires a business to obtain a single license only in the area of its main physical location, even if it serves mul-

²⁹ "SC Code Sec. 5-7-30 contains no general prerequisite that there be a place of business in the taxing municipality," Municipal Association of South Carolina, Business License Handbook, October 2013, page 9.

multiple jurisdictions. A simple application of this, for example, is for each business to apply for a license only in the geographic area from which it files its state income taxes (i.e., based on its address for state tax purposes).

In practice, the current licensing is not a check for the legitimacy of the business, but is rather simply a system for revenue collection. Generally, at most, the process requires proof that property taxes have been paid. This same check on the payment of local property taxes for automobiles, in contrast, is done even though the registration process is a state registration.

South Carolina's separate occupational licensing system, along with the long-standing multitude of private and professional certification organizations, is what serves the purpose of ensuring legitimacy. A person would need to be a licensed electrician or board certified CPA, but this is a separate process from the business license process. The system of business licenses serves *solely* as a procedure for a business to pay revenue to county and municipal governments. The system has essentially turned into a new form of taxation, rather than a process of certification. Even in this new capacity, the system performs poorly with its high administrative and enforcement costs per dollar of revenue raised.

Given that the current system does nothing to protect consumers and simply functions as a revenue source and, in some cases, a check that property taxes are paid, the objective of reform should be simplification and lowering the administrative and enforcement costs of revenue collection. As previously mentioned, even the local option sales tax in South Carolina is collected centrally, but then re-distributed to local jurisdictions. Under reform, each business could pay one fee, whether just to one locality or even as part of its state income tax form. The process for fee administration and collection could be handled more effectively and efficiently, and this is a process that can and perhaps should be different from the process of actually distributing the fee revenue.

“The system has essentially turned into a new form of taxation, rather than a process of certification. Even in this new capacity the system performs poorly with its high administrative and enforcement costs per dollar of revenue raised.”

4. Reasonable Fees, Linked To the Public Services Provided Or Consumed By Business That Are Not Covered Through Other Forms Of Business Taxation

Returning to the other primary justification for licensing laws, an economic activity (such as a business) should have to contribute to government revenue in line with the public services it consumes or that is provided to it. This purpose is clear in state law: “A business license tax ... is a method of requiring a business or occupation to contribute its share in support of the government ‘as it regards the profits or advantages of such occupations.’ State v. Hayne, 4 SC 403 (1873).”³⁰

A new business requires local law enforcement, fire protection, water and sewer, etc. But the business license fee does not exist in isolation, and these fees are wildly inconsistent with the

³⁰ Municipal Association of South Carolina, Business License Handbook, October 2013, page 1.

actual public services provided to the businesses. Businesses pay other taxes including property taxes on their land, equipment and machinery, and trucks; gasoline and other energy taxes on fuel consumption; income taxes on their profits; and sales taxes on their total sales; etc. In addition, the employees and suppliers pay income tax on their wages and profits (which are costs to the business included in gross income on which fees are based). These taxes already ensure that businesses, and residents alike, help pay for the public services they consume. Fundamentally, the business license fee system is not the place to cover all of these governmental service costs. The business license fee system should charge for the single service it does provide—the oversight of the legitimacy and legal accountability of a business located in the jurisdiction. In some areas, such as Kiawah Island and Seabrook, service provider’s trucks, for example, must pay separate fees to have a sticker to enter the area, making it clear that there are many avenues other than the business license system through which businesses contribute their fair share to cover the costs of the government services they consume.

In economic theory, it is competition between local governments that helps to ensure governments charge reasonable taxes and fees in line with the public services provided. Just as competition between business firms reduces prices for consumers, competition between local governments reduces their ability to charge unreasonably high taxes or fees. If one locality in a metro area has taxes much higher than services provided, a business may move to another locality in the metro area to get a better combination of taxes and public services. While a single location retailer may be able to move between two localities in a metro area based on lower business license fees, for small businesses that have one location but serve a larger geographic area, this competitive process is not at work to help the system improve internally through inter-governmental competition. A service provider must pay to all local municipalities in proportion to their gross revenues earned in each area. So whether it locates in jurisdiction A or B, the total license revenue paid to the two jurisdictions is not affected by the choice of location of the business. It is instead based on the location of the work performed. This defeats and circumvents any notion of inter-governmental competition. Without competitive pressures, the inefficient municipal business license system is unlikely to improve without state-level legislative reforms imposed on the system, reforms that are in the best interest of all South Carolinians.

5. Promoting Competition to Improve Quality and Lower Prices for South Carolina Consumers

Competition among businesses is a powerful regulator that results in lower prices and better quality for South Carolina consumers. Bad restaurants are driven out of business by new and better restaurants, and places charging high prices are driven out of business by more efficient new rivals. Airfares to and from Charleston, for example, have fallen over recent years primarily because of increased competition as new airlines have started providing service.

Unfortunately, South Carolina’s current business license system restricts competition among businesses. A high-quality, low-price painter that has only a Charleston business license cannot compete legally for a job in North Charleston. To compete in each jurisdiction, a license must be obtained. Therefore, particularly in smaller municipalities—where the total number of customers for a business would be small—competition is severely restricted as there are fewer competing producers from whom a consumer can purchase.

31 Maurizi, Alex. 1974. Occupational Licensing and the Public Interest. *The Journal of Political Economy* 82(2): 399-413.

32 Adams, Frank, John Jackson, and Robert Ekelund Jr. 2002. Occupational Licensing in a “Competitive” Labor Market: The Case of Cosmetology. *Journal of Labor Research* 23(2): 261-278.

This is precisely the reason why the current system is so open to manipulation for political gain. A politically well-connected, but high profit business or industry that charges consumers high prices for lower quality service can try to manipulate and use the local government licensing process to keep out or limit the number of competitors—particularly if they can secure differential (lower) rates for local owners and higher rates for ‘outsiders’—and keep in mind that these ‘outsider’ businesses may be located within a few miles of the jurisdiction’s boundaries. This is not simply conjecture; the use of licensing laws to restrict competition is a long and widely studied area in the academic literature in economics [see, for example, Maurizi (1974)].³¹

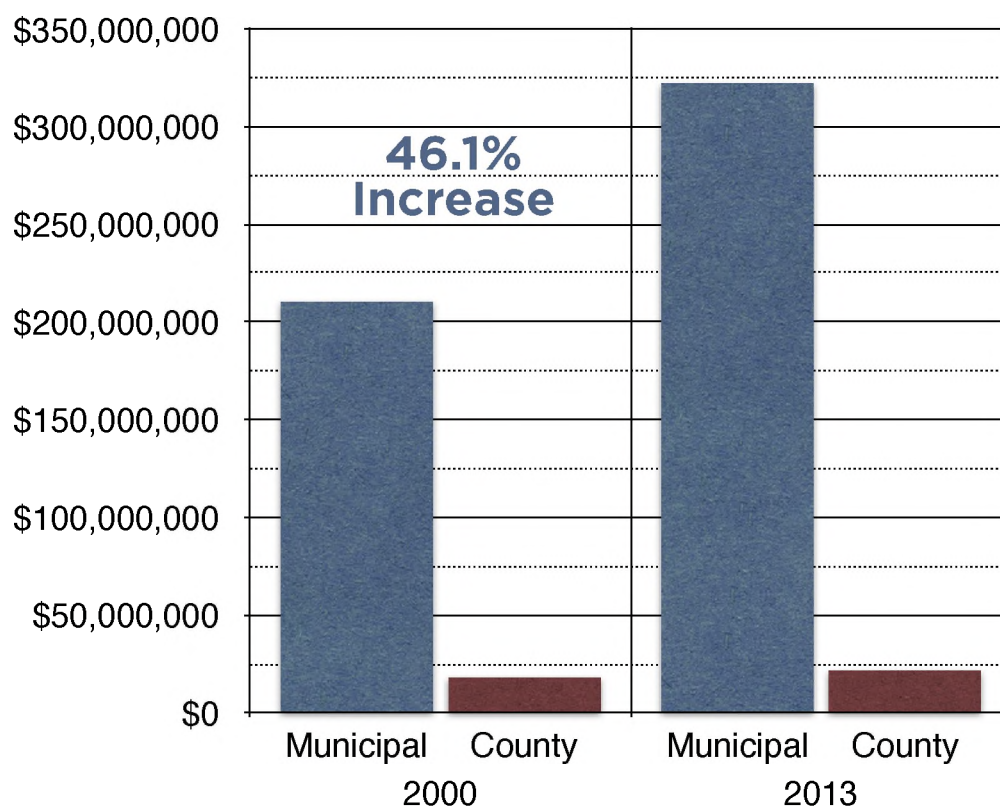
The higher prices for South Carolinians may be substantial. At the national level, for example, licensing laws for a single industry—cosmetology—is estimated to reduce competition enough to create losses for consumers approaching over \$1.7 billion [see Adams, Jackson, and Ekelund (2002)].³² In addition to the higher costs to South Carolina consumers from reduced competition, consumers are also the ones who end up bearing higher prices that businesses need to charge to pay, and comply with, these license fee taxes. Based on fiscal year 2013 revenue data (presented in the next section), business license fees per household in the average area amount to approximately \$500 annually, and this does not even include the additional costs businesses must incur to comply with the laws in terms of time spent on application paperwork and recordkeeping. As a result, the average household in the state not only pays more per year for what it consumes due to the license fees passed on to them through higher prices, but also pays more due to reduced competition causing prices to be even higher than just by the amount necessary to cover the costs of the system imposed on businesses. This problem is exacerbated if one recalls the pyramiding examples discussed earlier. Ultimately, the cost for a buyer purchasing a new home includes the costs (including these license fees) for the builder, all the subcontractors, and all of their raw material suppliers.

“The business license system has become simply a revenue source to fund local budget wish lists. It’s a tax that was never intended or envisioned to get to the current levels, and oversteps the statedelegated taxing authority given to municipalities by basing the fees on gross revenue without regard to costs, profit, or public services provided to the business.”

Perhaps ironically, the political opposition to reform may be quite different from the political support for creating the system in the first place. Long ago, when small mom-and-pop service providers did not want competition in their area, they would support a restrictive licensing system. However, today’s small business is no longer that small and narrow. Modern small businesses that were interviewed see the current licensing system as limiting their ability to succeed and never discussed the fear of increased local competition. Mostly gone are the days of very small, localized entrepreneurs—one person with one truck serving a community. While small businesses may have supported a licensing system in the past—those days are long over as current small businesses want the opportunity to do their business without the cumbersome process imposed by the current system. As the system stands today, the compliance costs are a larger expense to small businesses than is the threat of increased competitive pressures. If any political constituency would fight meaningful and productive reform, it would likely be the local governments and the employees who have jobs due to the complexity of the

33 Data for 2000 were converted to 2013 constant dollars for comparability with the 2013 values using the Consumer Price Index (CPI) from the Bureau of Labor Statistics.

Figure 1: The Growth of Business License Tax Revenue (*inflation adjusted*)



system. When governments are the only political constituency for an inefficient program, their obvious disconnect with the well-being of state citizens becomes obvious.

Government policy should protect consumers by ensuring competitive markets and competition. Ideal reform would embody these principles by ensuring that each business does have a license, but has the right to compete for customers throughout the state. On the flip side, South Carolinians should be able to purchase goods and services from whom they see fit—those businesses who provide quality at a low cost—regardless of whether those firms reside 1 mile away, 10 miles away, or 50-plus miles away.

6. Ensuring Businesses Have the Money Necessary to Grow – Why Revenue Can’t Be The Justification

The business license system has become simply a revenue source to fund local budget wish lists. It’s a tax that was never intended or envisioned to reach the current levels, and it oversteps the state-delegated taxing authority given to municipalities by basing the fees on gross revenue without regard to costs, profit, or public services provided to the business.

In fiscal year 2013, counties and municipalities in the state collected over \$300 million in business license fee revenue. To put this in perspective, the revenue amounts to roughly \$860 per business firm in the state, and approximately \$500 per household. It has become a major source of local revenue, not constrained by intergovernmental competition. One electrical contractor serving the Charleston area, with \$1.9 million in revenue, reports paying approximately \$6,000 per year in total license fees across all of the jurisdictions that it serves.

County and Municipal license fee taxes have grown substantially through time. Since

2000, even after adjusting for inflation, there has been a 46.1 percent increase in total business license tax revenues in the state, as is shown in Figure 1.³³ The percentage growth shown in Figure 1 has occurred about equally at both the county and municipality level. Again, the data shown in Figure 1 are corrected for the effects of inflation—these increases are increases in real tax burdens. South Carolinians are paying almost 50 percent more in business license taxes than just over a decade ago. Without legislative action and reform, this rapid growth in taxes will continue.

At a more local level, Tables 1 and 2 give the average annual business license revenues for South Carolina counties (Table 1) and municipalities (Table 2) for fiscal years 2009 through 2013. These data are not the totals over the four years, but the average amount per year during that period. This data is from the South Carolina Revenue and Fiscal Affairs Office's Local Government Finance Report as of December 10, 2014. The data show both the average annual revenue collections, as well as revenue per household in the area. Obviously, larger cities will have more revenue, and computing the amount per local household allows a better understanding of the true relative tax burden that is paid by local households when they purchase goods and services in their area.³⁴

Table 1: County Government Business License Revenue

County	Average Annual Revenue FY 2009-13	
	Total	Per Household
Barnwell	\$664,489	\$74.93
Beaufort	\$1,422,633	\$22.26
Charleston	\$2,803,441	\$20.35
Darlington	\$480	\$0.02
Dorchester	\$647,658	\$12.00
Horry	\$4,067,542	\$38.33
Jasper	\$349,798	\$35.77
Lancaster	\$616	\$0.02
Marion	\$105,002	\$8.12
Orangeburg	\$206	\$0.01
Richland	\$6,098,094	\$40.31
Sumter	\$716,721	\$16.99
Williamsburg	\$5,070	\$0.38
County Total	\$16,881,750	
County Average	\$1,298,596	\$32.85

Data sources: S.C. Revenue and Fiscal Affairs Office, Local Government Finance Report; and U.S. Census Bureau population and household data.

33 Data for 2000 were converted to 2013 constant dollars for comparability with the 2013 values using the Consumer Price Index (CPI) from the Bureau of Labor Statistics.

34 To arrive at house hold level averages, actual county and municipal-level populations were obtained from the 2010 U.S. Census, and converted to the number of households using the average number of persons per household in South Carolina (this household-persons average is for the 2009-2013 period from the U.S. Census Bureau of 2.55).

Table 2: Municipal Government Business License Revenue

	Average Annual Revenue FY 2009-13	
Municipality	Total	Per Household
Abbeville	\$1,190,690	\$580.88
Aiken	\$5,564,584	\$478.48
Allendale	\$126,654	\$93.42
Anderson	\$3,975,508	\$383.82
Andrews	\$127,412	\$113.60
Arcadia Lakes	\$14,011	\$41.40
Atlantic Beach	\$74,210	\$563.20
Awendaw	\$24,146	\$47.55
Aynor	\$108,769	\$491.77
Bamberg	\$279,756	\$197.89
Barnwell	\$852,502	\$457.56
Batesburg-Leesville	\$703,693	\$334.40
Beaufort	\$3,571,860	\$729.07
Belton	\$471,597	\$289.15
Bennettsville	\$703,401	\$197.56
Bethune	\$36,066	\$275.36
Bishopville	\$409,206	\$300.80
Blacksburg	\$263,639	\$363.20
Blackville	\$93,745	\$99.31
Blenheim	\$11,678	\$193.36
Bluffton	\$2,169,166	\$424.61
Blythewood	\$419,135	\$516.08
Bonneau	\$49,882	\$260.65
Bowman	\$95,469	\$252.01
Branchville	\$84,851	\$211.71
Brunson	\$1,898	\$8.77
Calhoun Falls	\$262,113	\$334.53
Camden	\$1,522,496	\$566.27
Cameron	\$27,063	\$163.53
Campobello	\$92,583	\$468.43
Carlisle	\$12,810	\$75.09

	Average Annual Revenue FY 2009-13	
Municipality	Total	Per Household
Cayce	\$2,473,042	\$502.49
Central	\$295,515	\$145.50
Central Pacolet	\$2,059	\$24.31
Chapin	\$397,555	\$698.67
Charleston	\$25,282,247	\$533.66
Cheraw	\$643,844	\$280.94
Chesnee	\$73,777	\$216.49
Chester	\$145,704	\$66.28
Chesterfield	\$229,278	\$399.36
Clemson	\$1,189,981	\$217.41
Clinton	\$678,869	\$203.52
Clio	\$12,774	\$44.93
Clover	\$685,025	\$340.84
Columbia	\$20,301,382	\$397.18
Conway	\$3,699,894	\$542.41
Cope	\$3,753	\$124.27
Cordova	\$20,458	\$308.69
Cottageville	\$12,692	\$42.25
Coward	\$36,858	\$124.32
Cowpens	\$281,276	\$331.45
Cross Hill	\$709	\$3.59
Darlington	\$869,169	\$352.53
Denmark	\$218,684	\$158.06
Dillon	\$799,411	\$298.77
Donalds	\$60	\$0.44
Due West	\$204,256	\$418.02
Duncan	\$156,953	\$125.58
Easley	\$2,450,370	\$311.64
Eastover	\$6,462	\$20.22
Edgefield	\$222,833	\$119.58
Edisto Beach	\$265,888	\$1633.77

Table 2: Municipal Government Business License Revenue (continued)

	Average Annual Revenue FY 2009-13	
Municipality	Total	Per Household
Ehrhardt	\$25,365	\$118.03
Elgin	\$86,268	\$167.42
Elko	\$868	\$11.47
Elloree	\$17,986	\$65.43
Estill	\$95,898	\$119.99
Eutawville	\$27,898	\$226.56
Fairfax	\$149,439	\$189.49
Florence	\$7,093,262	\$486.69
Folly Beach	\$468,896	\$455.85
Forest Acres	\$1,131,460	\$277.21
Fort Lawn	\$47,912	\$136.51
Fort Mill	\$2,033,571	\$450.65
Fountain Inn	\$395,759	\$131.56
Furman	\$2,533	\$27.25
Gaffney	\$2,017,665	\$409.70
Gaston	\$105,061	\$162.96
Georgetown	\$2,373,902	\$660.78
Gilbert	\$2,516	\$11.33
Goose Creek	\$4,787,739	\$335.63
Govan	\$514	\$20.16
Gray Court	\$83,129	\$266.30
Great Falls	\$30,268	\$39.00
Greeleyville	\$17,981	\$106.63
Greenville	\$21,157,921	\$909.29
Greenwood	\$2,907,005	\$318.01
Greer	\$3,992,933	\$395.89
Hampton	\$620,375	\$564.58
Hanahan	\$1,108,460	\$156.37
Hardeeville	\$850,144	\$715.94
Harleyville	\$97,779	\$366.67
Hartsville	\$1,420,059	\$465.62

	Average Annual Revenue FY 2009-13	
Municipality	Total	Per Household
Heath Springs	\$73,849	\$237.47
Hemingway	\$196,437	\$1,093.70
Hickory Grove	\$17,689	\$102.05
Hilton Head Island	\$7,276,289	\$497.89
Hodges	\$39,519	\$650.15
Holly Hill	\$289,710	\$580.33
Hollywood	\$74,562	\$40.25
Honea Path	\$312,328	\$223.40
Inman	\$434,264	\$472.23
Irmo	\$1,555,704	\$354.90
Isle Of Palms	\$1,791,945	\$1,103.20
Jackson	\$50,977	\$76.20
James Island	\$140,022	\$31.86
Jamestown	\$13,969	\$494.73
Jefferson	\$59,102	\$200.41
Jenkinsville	\$5,224	\$289.61
Johnsonville	\$145,073	\$249.62
Johnston	\$162,365	\$175.21
Jonesville	\$81,070	\$227.67
Kershaw	\$201,455	\$283.66
Kiawah Island	\$1,618,350	\$2,531.78
Kingstree	\$575,249	\$441.17
Lake City	\$783,424	\$299.02
Lake View	\$45,870	\$144.58
Lamar	\$85,910	\$221.28
Lancaster	\$1,668,459	\$497.20
Landrum	\$71,058	\$76.04
Latta	\$144,649	\$266.90
Laurens	\$1,012,467	\$282.53
Lexington	\$3,542,627	\$502.43
Liberty	\$345,353	\$269.64

Table 2: Municipal Government Business License Revenue *(continued)*

	Average Annual Revenue FY 2009-13			Average Annual Revenue FY 2009-13	
Municipality	Total	Per Household	Municipality	Total	Per Household
Lincolnvillle	\$2,940	\$6.57	North	\$18,938	\$62.88
Little Mountain	\$1,843	\$16.09	North Augusta	\$2,679,091	\$319.16
Livingston	\$2,109	\$39.55	North Charleston	\$23,352,943	\$606.85
Lodge	\$121	\$2.57	North Myrtle Beach	\$4,717,753	\$867.05
Loris	\$592,953	\$629.49	Norway	\$6,008	\$45.59
Lowrys	\$7,921	\$100.99	Olanta	\$22,746	\$102.84
Luray	\$2,604	\$52.29	Olar	\$1,500	\$14.88
Lyman	\$289,994	\$227.60	Orangeburg	\$2,737,078	\$500.58
Lynchburg	\$22,722	\$155.34	Pacolet	\$153,521	\$174.92
Manning	\$748,270	\$463.92	Pageland	\$261,635	\$242.43
Marion	\$1,020,369	\$376.00	Pamplico	\$102,434	\$212.71
Mauldin	\$2,816,891	\$309.63	Parksville	\$4,191	\$91.35
Mayesville	\$37,701	\$131.51	Patrick	\$672	\$4.88
McBee	\$69,737	\$204.40	Pawleys Island	\$493,896	\$12,227.52
McClellanville	\$67,267	\$341.70	Paxville	\$4,685	\$62.88
McColl	\$48,142	\$56.57	Peak	\$2,539	\$101.18
McConnells	\$15,505	\$155.05	Pelion	\$78,257	\$291.32
McCormick	\$163,514	\$149.82	Pelzer	\$78,044	\$2,236.09
Meggett	\$108,946	\$225.31	Pendleton	\$188,273	\$159.02
Moncks Corner	\$1,278,055	\$408.55	Perry	\$10,468	\$114.08
Monetta	\$9,932	\$109.64	Pickens	\$564,732	\$460.53
Mount Croghan	\$14,102	\$184.42	Pine Ridge	\$124,195	\$152.92
Mount Pleasant	\$11,798,086	\$441.96	Pinewood	\$36,964	\$175.20
Mullins	\$498,198	\$272.56	Plum Branch	\$52	\$1.62
Myrtle Beach	\$17,766,596	\$1,664.21	Pomaria	\$22,026	\$313.77
Neeses	\$17,114	\$117.00	Port Royal	\$810,798	\$192.29
New Ellenton	\$49,879	\$61.89	Prosperity	\$103,157	\$222.55
Newberry	\$1,284,283	\$318.17	Quinby	\$24,512	\$67.43
Nichols	\$33,225	\$230.85	Ravenel	\$77,996	\$80.59
Ninety Six	\$169,287	\$211.71	Reevesville	\$20,562	\$266.16
Norris	\$31,747	\$99.57	Reidville	\$6,415	\$27.17

Table 2: Municipal Government Business License Revenue (continued)

	Average Annual Revenue FY 2009-13	
Municipality	Total	Per Household
Richburg	\$33,839	\$313.78
Ridge Spring	\$58,519	\$201.93
Ridgeland	\$604,986	\$381.39
Ridgeville	\$48,971	\$62.97
Ridgeway	\$89,742	\$719.63
Rock Hill	\$7,295,621	\$279.49
Rockville	\$10,090	\$192.02
Rowesville	\$3,015	\$25.29
Saint George	\$261,172	\$318.20
Saint Matthews	\$97,087	\$122.86
Saint Stephen	\$167,896	\$251.99
Salem	\$30,959	\$537.04
Salley	\$34,685	\$218.93
Saluda	\$332,984	\$238.11
Santee	\$189,520	\$503.94
Scranton	\$69,092	\$204.63
Seabrook Island	\$468,242	\$695.00
Seneca	\$1,833,527	\$573.96
Sharon	\$36,074	\$185.09
Silverstreet	\$123	\$1.94
Simpsonville	\$2,490,184	\$344.12
Six Mile	\$66,683	\$251.91
Smoaks	\$9,749	\$197.29
Smyrna	\$2,469	\$139.92
Snelling	\$188,140	\$1,750.94
Society Hill	\$3,825	\$17.32
South Congaree	\$195,048	\$215.50
Spartanburg	\$9,080,948	\$624.80
Springdale	\$307,014	\$296.55
Springfield	\$7,823	\$38.14
Stuckey	\$14,233	\$148.14

	Average Annual Revenue FY 2009-13	
Municipality	Total	Per Household
Sullivan's Island	\$742,670	\$1,053.87
Summerton	\$55,933	\$143.06
Summerville	\$6,121,537	\$360.61
Summit	\$22,896	\$145.23
Sumter	\$5,036,489	\$316.39
Surfside Beach	\$1,671,277	\$1,106.66
Swansea	\$104,042	\$319.26
Sycamore	\$2,964	\$42.22
Tatum	\$63	\$2.14
Tega Cay	\$652,908	\$214.39
Timmonsville	\$187,771	\$202.89
Travelers Rest	\$283,290	\$156.43
Trenton	\$50,160	\$652.60
Troy	\$4,890	\$134.09
Turbeville	\$41,092	\$125.94
Ulmer	\$2,686	\$79.64
Union	\$1,041,637	\$317.12
Vance	\$7,914	\$118.71
Varnville	\$78,405	\$92.56
Wagener	\$27,198	\$86.80
Walhalla	\$328,466	\$197.22
Walterboro	\$1,778,805	\$838.90
Ware Shoals	\$156,835	\$184.04
Waterloo	\$14,669	\$235.26
Wellford	\$211,490	\$226.50
West Columbia	\$2,204,243	\$364.04
West Pelzer	\$62,444	\$183.24
West Union	\$35,251	\$291.85
Westminster	\$95,613	\$99.80
Whitmire	\$115,177	\$203.39
Williams	\$161	\$3.51

Table 2: Municipal Government Business License Revenue (continued)

	Average Annual Revenue FY 2009-13	
Municipality	Total	Per Household
Williamston	\$152,309	\$98.38
Williston	\$165,897	\$134.81
Winnsboro	\$426,952	\$308.16
Woodford	\$197	\$2.72
Woodruff	\$406,759	\$253.48
Yemassee	\$87,475	\$218.05
York	\$588,305	\$193.55
Municipal Total	\$283,622,754	
Municipal Average	\$1,112,246	\$462.36

Data sources: S.C. Revenue and Fiscal Affairs Office, Local Government Finance Report; and U.S. Census Bureau population and household data.

The data presented in Table 1 show that 13 of the 46 county-level governments in South Carolina reported having business license tax revenue during one or more of these 5 fiscal years. On average, annually, these counties collected almost \$16.9 million in business license revenue, or an average of \$32.85 per household within their boundaries. Because a business must both have a city and a county license, these fees are in addition to the fees paid at the city/municipality level. Equivalent data for the cities and municipalities in South Carolina are presented in Table 2. During this period 255 of the 270 municipalities in the state reported having positive revenue in at least one year. On average, annually, these municipalities collected just over \$283.6 million in fee revenue, or an average of \$462.36 per household within their boundaries. Again, these fees are in addition to the fees paid at the county level.

Thus, a typical household in the City of Columbia bears higher costs for the goods and services they buy equal to the sum of the amounts for the City of Columbia (\$397.18) and the County of Richland (\$40.31) for a total of \$437.49. Similarly, the City of Charleston (\$533.66) combined with the County of Charleston (\$20.35) amounts to \$554.01. Across all jurisdictions the average combined amount is \$495.21.

One can also see the large variation across jurisdictions. The jurisdictions with the highest per-household fee revenue are the smaller residential beach towns, with ten municipalities exceeding \$1,000 per household.

The 'hidden' cost of all government revenue is that while it does fund certain government activities, these come at the expense of the activities that could have been undertaken with these resources had they been left in the hands of the person or entity paying them. When state government takes \$100 of my income in taxes, we get \$100 in state government services, but I no longer have the \$100 to spend on goods and services for myself. Thus, the system of government revenue doesn't create—it replaces—substituting government provided goods and services for those that I would have chosen to purchase for myself.

For a business, each dollar paid in fees is one less dollar they may use to invest in growing their business—purchasing inventory, supplies, new machinery, trucks, opening a new location, hiring another employee, and so forth. This represents money that businesses no longer can use to invest and grow. This reduced growth means fewer new jobs created, fewer new locations, and fewer customers served—all translating into reduced income and wealth in the state. Recall that the system is particularly burdensome precisely on the smallest new businesses that wish to serve a metro area.

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A quick comparison of the census-defined metropolitan statistical areas (MSA's) for Charleston and Columbia can help to illustrate the degree to which these tax differentials translate into higher costs of living, and a lower standard of living, for residents. In 2012 the MSA's had almost an identical number of business establishments, with Charleston MSA at 16,694 and the Columbia MSA at 16,642. In addition, small businesses in both areas that travel have to deal with about the same number of total county and municipal licenses, 30 in the Columbia MSA and 29 in the Charleston MSA. The big difference however, is that the total business license tax revenue is twice as high in the Charleston MSA (\$83.44 million versus \$42.47 million), meaning the same number of businesses pay twice as much in local taxes, even though they pay the same state and federal taxes.

The result of this higher level of business license fee taxes is a burden on local consumers. According to the Bankrate Cost of Living Calculator [available at <http://www.bankrate.com/calculators/savings/moving-cost-of-living-calculator.aspx>], the cost of living is 9.9% higher in the Charleston MSA. Of the 58 items they compare (from the cost of Sugar and Shampoo to Washer Repairs and Dry Cleaning Services), 70 percent of these items are more expensive in Charleston. Most importantly, when one views the items most subject to the problems created by the overly complex licensing system, the cost differential grows. For example, while the cost of a haircut, a business having to deal with only one municipal license (and one county), averages only slightly (1.2%) higher in Charleston (\$14.50 versus \$14.33), the cost of a washer repair, a business that travels and must deal with the multitude of permits, is substantially more (15.8%) in the Charleston MSA (\$86.48 versus \$74.66). Cases in which the taxes pyramid the worst by taxing multiple times show large differentials as well, such as in homebuilding, where the average new home price is 29 percent higher in the Charleston MSA.

The opponents of reforms that would cap the maximum fee, such as the system recently adopted in North Carolina, generally cite only one basis for their objections—lower local government revenue. But revenue alone cannot, and should not, be the single justification for levying a tax or fee. If it were, we could justify taxing people based on the number of hairs on their head, or the number of buttons on their shirts; or tax businesses based on the number of letters in the company name. Regardless of the revenue it would generate, these are not legitimate ways to charge citizens for public services provided. The revenue raised should be collected in a simple, fair, and efficient manner that is linked to the public services consumed. As addressed earlier, these are mainly already covered under other taxes, and bear little resemblance to the patchwork of license fee structures across the state.

Reforms in Other States

In 2014, the state legislature in North Carolina undertook substantial reform of its system of business licensing.³⁵ HB 1050 repealed the business privilege license tax in the state as of July 1, 2015. In the meantime, municipalities are only allowed to levy business license tax if the business is physically within their boundaries. The action, which came as a recommendation of the Revenue Laws Study Committee was passed as part of a larger omnibus tax reform bill that significantly improves North Carolina's overall tax system.

The justifications for the reforms enacted in North Carolina were the same issues currently present in South Carolina's system. Consider the following quotes from the discussion of the justification for reform in North Carolina:³⁶

"...[fees] vary significantly across localities, creating considerable confusion and administrative costs... What's more, municipalities have free reign to charge multiple privilege taxes simultaneously, or grant exceptions to certain trades...Another bewildering aspect of these taxes hinges upon the broad definition of what it means to be 'doing business' in a locality, which does not necessarily require that a business or franchise be physically located within a city's borders"

"...originally instituted on the simple basis that it would allow the state government to identify every business that participates in the state's economy, was never meant to become a steady source of revenue for municipal governments...these 'license' privilege taxes –a name which is slightly misleading, as these are usually not contingent upon meeting any additional certification standards. North Carolina's patchwork... violates the principle of neutrality that is essential for sound tax policy. The tax also fails the test of transparency, as it is largely hidden in the form of higher prices for goods and services for consumers."

Similarly, Alabama's Business License Reform Act of 2006 was enacted in an attempt to make the local patchwork system more uniform through their state. HB 754 reads:³⁷

"...to provide a statewide uniform system for the issuance and calculation of the cost of municipal business licenses; to promulgate a common business license application form for use by all municipalities; to provide a uniform definition of "gross receipts" and "delivery license;" to provide for a uniform system for the municipal business license audit process and the taxpayer's appeal of municipal business license assessments and for the filing of claims for and payment of refunds; to provide uniform statutes of limitation for assessments and refunds that substantially conform with their counterparts for municipal sales and use taxes; to allow municipalities to lawfully exchange tax information related to business license taxpayers; and to provide delayed effective dates and transition rules."

35 See "North Carolina Builds on Tax Reform, Repealing Burdensome Local Privilege Taxes," by Liz Emanuel, June 5, 2014 [<http://taxfoundation.org/blog/north-carolina-builds-tax-reform-repealing-burdensome-local-privilegetaxes>], "NC Retail Merchants Applaud Reform Of The Business License Tax," May 29, 2014 [<http://mediapartnersinc.com/news/nc-retail-merchants-applaud-reform-of-the-business-license-tax/>] and "McCrorry Signs NC Bill Setting Business Tax Repeal," May 30, 2014 [http://www.independenttribune.com/news/mccrory-signs-nc-billsetting-business-tax-repeal/article_b638c60a-e804-11e3-8f7c-001a4bcf6878.html].

36 Both of these quotes are from "North Carolina Builds on Tax Reform, Repealing Burdensome Local Privilege Taxes," by Liz Emanuel, June 5, 2014 [<http://taxfoundation.org/blog/north-carolina-builds-tax-reform-repealingburdensome-local-privilege-taxes>].

37 Quoted from HB754 available at: <http://www.amroa.org/HB754Final.pdf>

South Carolina is not alone in having issues with its system of business licensing—other states have recognized the same issues as well—and they are acting to adopt state-level reforms to address the issues. South Carolina is quickly falling behind North Carolina in measures of growth and prosperity, precisely because North Carolina has undertaken significant policy reforms to improve their system of taxation and business licensing.

Conclusion

Reforms to South Carolina's system of business licensing have a real potential to promote entrepreneurship and increase prosperity in the state. Several simple reforms could do much good to help promote small business activity in the state, as well as significantly lower the system's administrative and enforcement costs that detract from the net revenue it generates. These reforms must be done at the state legislative level, as most of the rules governing the complex system are a creature of state statutory law.

The current system is cumbersome and complex, and the burden of it falls on the State's small businesses and consumers. The basic functions the system serves could be maintained through the establishment of a unified, state-wide, business licensing system. The license could be administered and enforced either centrally by the State, or by the locality from which the business files its state income taxes.³⁸ This one license would be recognized by all counties and municipalities within the State. A uniform system with only one or very few rate structures and classes should be adopted.

While it would be desirable to lower the fees so that businesses would be able to have lower costs and invest more in their own growth (by adopting a cap as the South Carolina

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legislature has done in the past), even a revenue-neutral reform could fix many of the current compliance issues. If businesses were required to report revenue by jurisdiction (as they do now), a centralized single fee could be collected and the revenue distributed among the localities as is currently done with the local-option sales tax. If the process were incorporated as part of an annual state income tax form, the business license payments could even more accurately reflect the true business revenue generated

in each area, through a system similar to the income tax, in which withholding is rectified with actual tax due based on final incomes at the end of the year.

The cost savings for local government budgets from lower administrative and enforcement costs would be substantial. This could not only allow them to re-direct these resources toward other important local government functions, but in theory could allow even lower fee rates that could generate the same net revenue.

South Carolina's patchwork system of business licensing has become outdated, overly complex, repurposed, and subject to manipulation and interpretation. Many potential reforms could be adopted with widespread support from all citizen groups involved in the process. Given the current state of the economy, now is the time for the South Carolina legislature to pursue reforms to the Palmetto State's system of business licensing in order to promote economic growth and provide a more prosperous future for all South Carolinians.

³⁸ A state license tax however, may be held unconstitutional based on the precedent in the 1930 case of *Martin v. Chief Game Warden*, see Quirk, William J. "Nature of a Business License Tax." *South Carolina Law Review*, Vol. 32, 1981, page 483, however this proposal is different from a state-wide license because the revenue is returned to the localities.



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