

Tax Restructuring Policy Proposal

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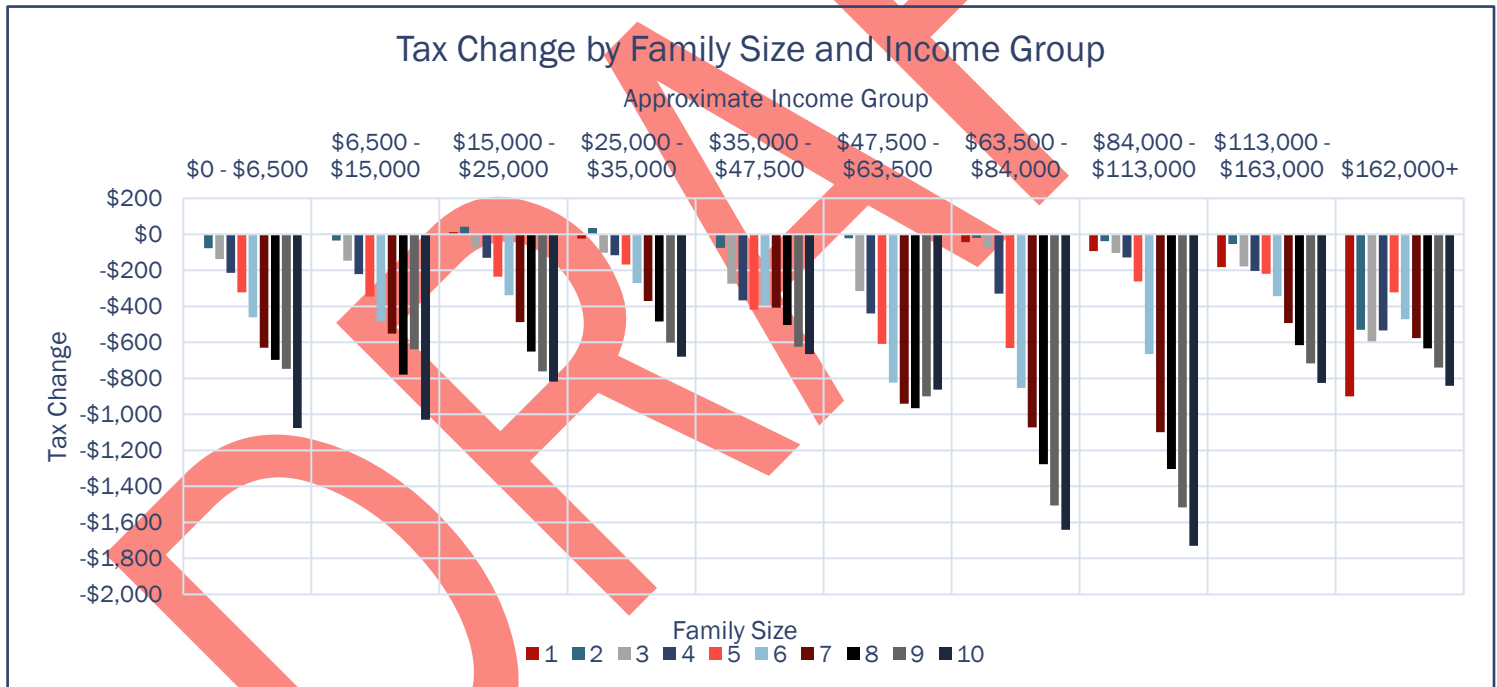
Executive Summary:

This proposal would take many steps to address the state’s structural revenue imbalance. The result of these policy changes would be a tax structure with increased flexibility for the Legislature in choosing how to fund state programs and would address several policy concerns.

Budgetary Impact

- Results in an overall net tax reduction of approximately \$75 million.
 - A family of four making \$60,000 per year would see an estimated average total tax reduction of more than \$400 per year
- Restores funding of Higher Education to the sales tax-backed General Fund, holding Public Education harmless.
- Fully implements an Accountable Budget Process that reviews all state spending on a rolling five-year schedule.

Incidence of Tax



Policy Impact:

- The sales tax base would be increased and would better track ongoing changes in consumer expenditures.
- Impacts to lower-income and/or fixed-income residents from a higher sales tax rate on food would be mitigated by a Grocery Tax Credit, as well as an increased Utah Dependent Exemption and a new income tax credit for certain Social Security retirement income.
- Funding for transportation infrastructure would be partially shifted away from General Fund sources by removing an existing sales tax exemption on motor vehicle fuels to help bridge the gap until an alternative funding mechanism, such as a road user charge, is viable as a primary funding source for transportation.

Policy Summary:

This proposal includes the following policy modifications:

Reductions

Income Tax

- Reducing individual and corporate income tax rates
- Expanding the “Utah Dependent Exemption” provision of the taxpayer tax credit
- Creating an income tax credit for certain Social Security retirement income
- Creating a “Grocery Tax Credit” for low-to-middle-income residents

Expansions

Sales Tax

- Restoring the full sales tax rate on unprepared food
- Expanding the sales tax base by repealing certain sales tax exemptions
- Expanding the sales tax base by repealing the sales tax exemption for motor and special fuels
- Transitioning to direct user fees for transportation costs
- Reducing sales tax earmarks for transportation
- Expanding the sales tax base by charging sales tax on certain services

Other

- Increasing the state Motor Vehicle Rental Tax

Revenue Neutral Shifts

- Establishing meaningful funding security for education and removing the constitutional restriction on income tax
- Funding school lunch program from Education Fund and depositing the portion of the liquor mark-up that currently funds the program in the General Fund

Policy Description:

Reduce Individual and Corporate Income Tax Rates

- Reduce the state income tax rate by at least 0.25%

Expand the Utah Dependent Exemption

- Increase the exemption amount per dependent from \$565 to \$2,500
- Credit remains 6% of exemption amount
- Phaseout rate of credit remains \$0.013 per dollar over:
 - \$14,256 for single filers
 - \$21,384 for head of household filers
 - \$28,512 for joint filers
- Phaseout thresholds adjust for inflation

Create an Income Tax Credit for Social Security Income

- Non-refundable tax credit equal to total Social Security income included in Adjusted Gross Income (AGI) x State Income Tax Rate
- Amount of credit reduced by \$0.025 per dollar that modified AGI (including Social Security and all other income) exceeds:
 - \$24,000 for married filers filing separately
 - \$30,000 for single filers
 - \$48,000 for head of household or joint filers

Create a “Grocery Tax Credit” for Low-to-Middle-Income Residents

- \$100 refundable income tax credit per household member
- Phaseout rate of credit is 2% per dollar above thresholds of:
 - \$30,000 for one exemption, increasing by \$10,000 per household member;
- For example, a family of four with a household income of up to \$60,000 per year would qualify for the full grocery credit amount ($4 \times \$100 = \400). That amount would be reduced for each dollar the family makes over \$60,000, with the credit phasing out entirely at \$65,000.
- Maximum income before phaseout starts, regardless of number of household members, is \$90,000
- \$150 refundable income tax credit per exemption if claimant has income less than \$15,000
- In addition to the income parameters, to qualify, a claimant must:
 - Be considered a resident for income tax purposes
 - Not have been a convicted felon in state prison for any portion of the year
 - File a completed form with the Tax Commission
- A separate form will be created for claimants who do not file income taxes

Restore Full State Sales Tax Rate on Food

- The sales tax rate on unprepared food and food ingredients (e.g. groceries) would return to the full state sales tax rate of 4.85% from the currently reduced rate of 1.75%

Repeal Certain Exemptions

- Remove certain existing sales tax exemptions to make the sales tax a broader consumption tax
- The following exemptions would be repealed:
 - Construction materials for life science research facility (material converted to real property only)
 - Construction materials for new airport in 2nd class county (material converted to real property only)
 - Electricity to ski resorts for lifts
 - Vehicles used for temporary sporting events
 - Admissions to college athletic events
 - Textbooks purchased by a student (not including a college book store; seller sales primarily textbooks)
 - Certain electricity produced from a new alternative energy source
 - Gold, silver, platinum (bars, coins, etc.; not legal tender; content 50%+ gold, silver, or platinum)
 - Primarily unassisted cleaning of property (coin operated laundry, etc.)
 - Use of unassisted amusement device
 - Vending machine food sold for \$1 or less under certain circumstances
 - Car wash that does not include cleaning the interior of the vehicle
 - Sales to a public transit district (includes construction materials converted to real property)
 - Fuel sold to a common carrier railroad and used in a locomotive engine
- The following exemption would be repealed in 2022:
 - Construction materials for Salt Lake International Airport (material converted to real property only)

Repeal the Sales Tax Exemption on Motor and Special Fuel

- Remove existing sales tax exemption on motor and special fuels (gasoline and diesel, does not include aviation fuel) to make the sales tax a broader consumption tax
- Tax would be imposed at the distributor level on the wholesale price of gasoline at the existing sales tax rate (4.85%)
- Tax would be used to fund transportation in the medium term as a user fee until future user fee options that rely on more advanced technology become viable

Broaden the Sales Tax Base by Charging Sales Tax on Certain Additional Services

- Include certain services in the tax base to make the sales tax a broader consumption tax and providing more similar treatment to goods and services
- Newly taxed services would be those primarily consumed by the end user to minimizing tax pyramiding
- The following services would be included in the tax base:
 - Maintenance and repair of real property (e.g. landscaping, painting, cleaning)
 - Installation of tangible personal property
 - Veterinary services (with agriculture exemption)
 - Newspaper publishing
 - Taxi and limousine service
 - Peer to peer ride sharing
 - Scenic and sightseeing transportation
 - Tour operators
 - Portrait photography services
 - Photofinishing laboratories
 - Sports and recreation instruction
 - Exam preparation and tutoring
 - Fine arts schools
 - Miscellaneous schools and instruction (e.g. yoga studios, public speaking training)
 - Motor vehicle towing
 - Parking lots and garages
 - Language schools
 - Miscellaneous personal services (e.g. wedding planning, dating services)
 - Automobile driving schools
 - Software as a Service (excluding custom business software programming)
 - Streaming media
 - Shipping and handling when part of a taxable sale
- Sales or use tax would be due from the end user of these services if the end user is in Utah
- Businesses (whether in-state or out-of-state) providing the services would collect and remit the tax
- Businesses collecting and remitting the tax would be eligible to retain a portion of the sales tax collected as a vendor discount to minimize the compliance burden
- Task force will consider additional policy options to minimize the compliance burden on very small businesses
- Task force will consider policy options to minimize impact on cities and counties

Increase the State Motor Vehicle Rental Tax

- Increase the state motor vehicle rental tax from 2.5% to 4.0%

Fund Public Education School Lunch Program from Education Fund

- Deposit the current funding source for school lunch, a portion of liquor markup profits, into the General Fund

Establish Meaningful Funding Security for Public Education and Remove the Constitutional Restriction on Income Tax

- Amend the Utah Constitution to allow for needed flexibility for funding all of state government
- Continue to fund public education at its current level and create an alternative, more stable, funding mechanism for public education
- Fund more of higher education from the General Fund

Fiscal Assumptions:

Estimated revenue impacts for FY2021 are based on the most direct data accessible assuming a certain set of assumptions. Data sources include the Utah State Tax Commission, the U.S. Economic Census, the Bureau of Labor Statistics' Consumer Expenditure Survey, and information collected and analyzed by the Office of the Legislative Fiscal Analyst.

Assumptions include the following:

- Estimates for the value of tax exemptions are based on a variety of direct and indirect data sources compiled by the Utah State Tax Commission and the Office of the Legislative Fiscal Analyst. Amounts were originally calculated in FY2017 and were escalated to estimates for FY2021 using 4.6% assumed growth.
- Estimates for the revenue from services are based on the 2012 U.S. Economic Census, grown forward to FY2021 using 4.6% assumed growth.
- Tax incidence modeling assumes percent of individual income spent on certain goods and services based on data from the Consumer Expenditure Survey.
- The value of the exemption on motor and special fuel assumes a pump price of \$2.85 per gallon for gasoline and \$3.50 for diesel; the analysis removes the federal and state gas taxes before applying the sales tax rate.
- Tax incidence modeling does not account for effect on businesses. Approximately \$50 million of the tax change will be paid by businesses. Businesses will be affected by the lower income tax rate, the sales tax on gas, a portion of the expansion of sales tax to services, a portion of the repeal of sales tax exemptions, and the restored sales tax on food. Businesses account for approximately 31% of purchased gasoline; we do not have reliable data on the percentage of food or certain services purchased by businesses. Change in business tax incidence may affect consumers if businesses raise or lower their prices due to tax changes.
- The average decrease in total tax incidence may be slightly inflated due to the exclusion of non-resident filers in the average calculations of the Grocery Tax Credit.
- The average decrease in household tax incidence is a sum of each individual component, independent of the other components of the proposal. A simultaneous model, including interaction between the components, may slightly change household tax incidence