

Task Force Tax Restructuring Policy Proposal

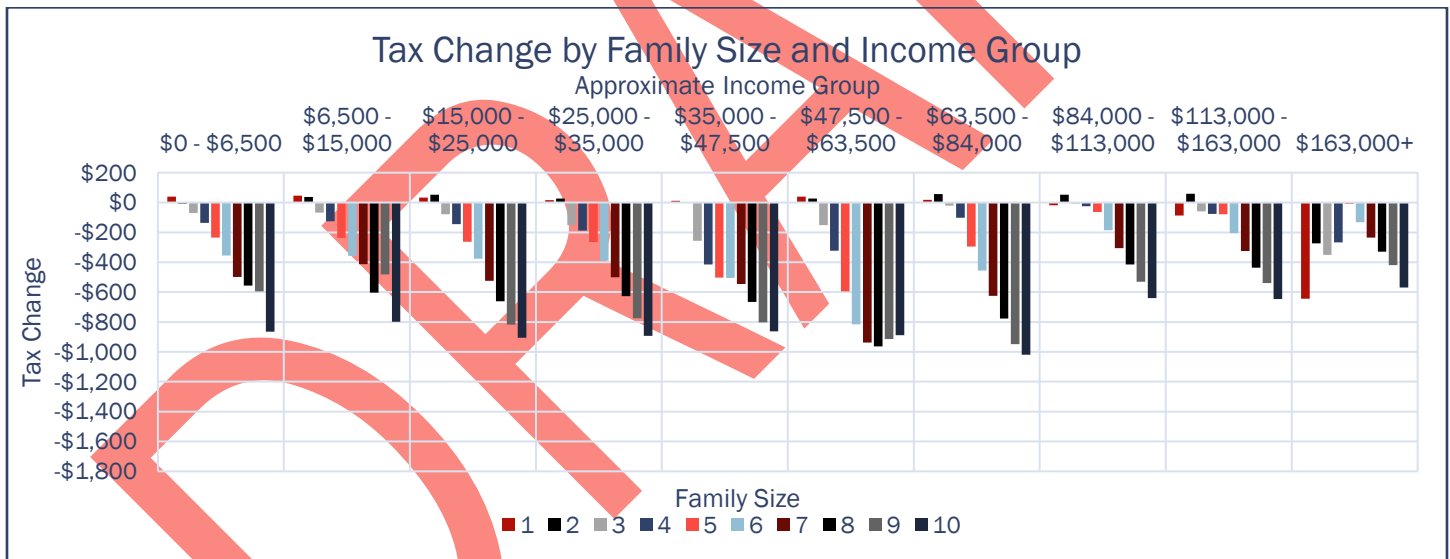
Executive Summary:

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

- Addresses structural imbalance by increasing sales tax revenue by approximately \$570 million and decreasing income tax revenue by \$650 million
 - Results in an overall net tax reduction of approximately \$80 million.
 - A family of four making \$60,000 per year would see an estimated average total tax reduction of more than \$320 per year
- Restores funding of Higher Education to the sales tax-backed General Fund, holding Public Education harmless.
- Increases portion of transportation funding paid for by transportation user fee type taxes and reduces sales tax earmarks for transportation.
- 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, an Earned Income Tax Credit, 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 (Lines 373 & 584)
- Expanding the “Utah Dependent Exemption” provision of the taxpayer tax credit (Line 812)
- Creating an income tax credit for certain Social Security retirement income (Line 1221)
- Establishing a state earned income tax credit (Line 1363)
- Creating a “Grocery Tax Credit” for low-to-middle-income residents (Line 1315)

Sales Tax

- Exempting feminine hygiene products from sales tax (Lines 1919 & 3772)

Expansions

Sales Tax

- Restoring the full sales tax rate on unprepared food (Line 3304)
- Expanding the sales tax base by repealing certain sales tax exemptions (Lines 3677-4496)
- Expanding the sales tax base by repealing the sales tax exemption for motor and some special fuels (Lines 3680, 4906-4988)
- Creating new excise tax on diesel rather than repealing sales tax exemption (Lines 5131-5145)
- Transitioning to direct user fees for transportation costs (Lines 5194, 5303, 5459)
- Reducing sales tax earmarks for transportation (Lines 3562-3675)
- Expanding the sales tax base by charging sales tax on certain services (Lines 3174-3279)

Other

- Increasing the state Motor Vehicle Rental Tax (Line 4992)

Budget 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 (Line 247)

Policy Description:

Reduce Individual and Corporate Income Tax Rates (Lines 373 & 584)

- Reduce the state income tax rate to 4.58%

Expand the Utah Dependent Exemption (Line 812)

- 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 (Line 1221)

- Non-refundable tax credit equal to total Social Security income included in Adjusted Gross Income (AGI) x State Income Tax Rate (Line 1241)
- Amount of credit reduced by \$0.025 per dollar that modified AGI (including Social Security and all other income) exceeds: (Line 1251)
 - \$24,000 for married filers filing separately
 - \$30,000 for single filers
 - \$48,000 for head of household or joint filers

Create a State Earned Income Tax Credit (Line 1363)

- Refundable income tax credit to individuals identified by the Department of Workforce Services as experiencing intergenerational poverty and who claim the federal earned income tax credit (Line 347)
- Credit amount equals 10% of the federal credit amount an individual is entitled to claim (Line 1373)

Create a “Grocery Tax Credit” for Low-to-Middle-Income Residents (Line 1315)

- \$125 refundable income tax credit per household member (Line 1339)
- Phaseout rate of credit is 0.0035% of the credit per dollar above 138% of the federal poverty limit (Line 1326)
 - For households with more than five members, the phaseout begins at 138% of the federal poverty limit for five member households (Line 1355)
- For example, a family of four with a household income of up to \$35,535 per year would qualify for the full grocery credit amount (4x\$125 = \$500). That amount would be reduced for each dollar the family makes over \$35,535, with the credit phasing out entirely at \$64,106.
- 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 (Line 1342)
 - File a completed form with the Tax Commission
- A separate form will be created for claimants who do not file income taxes (Line 1358)

Exempt Feminine Hygiene Products from Sales Tax (Lines 1919 & 3772)

- The current 4.85% sales tax on feminine hygiene products would no longer be charged

Restore Full State Sales Tax Rate on Food (Line 3304)

- 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) **(Line 4378)**
 - Electricity to ski resorts for lifts **(Line 4031)**
 - Vehicles used for temporary sporting events **(Line 4079)**
 - Admissions to college athletic events **(Line 4064)**
 - Textbooks purchased by a student (not including a college bookstore; seller sales primarily textbooks) **(Line 4369)**
 - Certain electricity produced from a new alternative energy source **(Line 4082)**
 - Primarily unassisted cleaning of property (coin operated laundry, etc.) **(Line 3743)**
 - Use of unassisted amusement device **(Line 4043)**
 - Vending machine food sold for \$1 or less under certain circumstances **(Line 3696)**
 - Car wash that does not include cleaning the interior of the vehicle **(Line 4458)**
 - Sales to a public transit district (includes construction materials converted to real property) **(Line 4324)**
 - Fuel sold to a common carrier railroad and used in a locomotive engine **(Line 4356)**
 - Newspapers or newspaper subscriptions **(Line 3894)**
- Reporting requirements would be established for recipients of sales tax exemptions

Repeal the Sales Tax Exemption on Motor and Special Fuel **(Lines 3680, 4906-4988)**

- Remove existing sales tax exemption on motor and some special fuels (does not include diesel or 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 state 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
 - UDOT will begin studying transition immediately **(Lines 5194, 5303, 5459)**

Create New Excise Tax on Diesel **(Lines 5131-5145)**

- Rather than repeal existing sales tax exemption on diesel, create a new excise tax on diesel of \$0.10 per gallon

Broaden the Sales Tax Base by Charging Sales Tax on Certain Additional Services **(Lines 3174-3279)**

- 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)
 - Services performed as part of a capital improvement excluded from sales tax **(Lines 1696-1702)**
 - All other maintenance and repair services subject to sales tax **(Lines 2668-2673, 3261)**
 - Installation of tangible personal property **(Lines 2037-2047, 2595)**
 - Veterinary services (with agriculture exemption)
 - Non-emergent veterinary services subject to sales tax **(Lines 2250-2260, 3268)**
 - Pet boarding services **(Line 3269)**
 - Taxi and limousine service **(Lines 2360-2367, 3262)**
 - Includes all intrastate motor vehicle transportation services except for services provided by governmental entities
 - Peer to peer ride sharing **(Lines 2360-2367, 3262)**
 - Scenic and sightseeing transportation **(Line 3263)**
 - Motor vehicle towing **(Line 3267)**
 - Parking lots and garages **(Line 3266)**
 - Miscellaneous personal services **(Lines 1915-1918, 2261-2286, 2354-2359 3270-3279)**
 - e.g. esthetics services, tanning services, body piercing, dating services
 - Streaming media **(Lines 3246-3256)**
 - Shipping and handling when part of a taxable sale **(Lines 1773-1787, 2594)**
 - Storage of tangible personal property **(Line 3264)**
- Include clarifying language to codify existing practice regarding software as a service **(Lines 2809-2812, 3257-3259)**
- 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
- All businesses will be able to retain 100% of first \$2,500 of sales taxes collected as a vendor discount **(Lines 4877-4904)**
 - Vendor discount will be 1.2% of sales tax collected between \$2,501 and \$400,000.
- Task force will consider policy options to minimize impact on cities and counties

Increase the State Motor Vehicle Rental Tax **(Line 4992)**

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

Fund Public Education School Lunch Program from Education Fund **(Line 247)**

- 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
- Restore funding of Higher Education to the sales tax-backed General Fund, holding Public Education harmless.

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 FY2018 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 some special fuels assumes a wholesale price of between \$2.20 and \$2.30 per gallon for gasoline; the analysis applies the new sales tax rate before adding the federal and state excise taxes.
- 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.
- All fiscal estimates are preliminary based on existing forecasts and are subject to change as forecasts are updated and models refined. Final fiscal impact will be determined on the fiscal note for a numbered bill.

11/7/19 Update - Fiscal Impact:

Options*	Est. Total Impact FY21	Est. Ind. Impact FY21	Est. Bus. Impact FY21
Income Tax			
Reduce income tax rate (4.56%)	(\$407,000,000)	(\$364,000,000)	(\$43,000,000)
Expand Utah Dependent Personal Exemption	(\$95,000,000)	(\$95,000,000)	
Create Social Security credit	(\$18,000,000)	(\$18,000,000)	
Create Earned Income Tax Credit	(\$6,000,000)	(\$6,000,000)	
Create Grocery credit	(\$125,000,000)	(\$125,000,000)	
Total	(\$651,000,000)	(\$608,000,000)	(\$43,000,000)
Sales/Other Tax			
Exempt feminine hygiene products from sales tax	(\$1,500,000)	(\$1,500,000)	
Restore full sales tax on food	\$250,000,000	\$250,000,000	
Repeal certain exemptions	\$13,000,000		\$13,000,000
Sales tax on motor fuel/excise tax on diesel	\$215,000,000	\$148,000,000	\$67,000,000
Tax certain services	\$75,000,000	\$75,000,000	
Increase motor vehicle rental tax	\$4,500,000	\$4,500,000	
Modified vendor discount	\$15,000,000		\$15,000,000
Total	\$571,000,000	\$476,000,000	\$95,000,000
Budget Shifts			
Fund school lunch from Education Fund (\$55M shift)			
Net fiscal impact	(\$80,000,000)	(\$132,000,000)	\$52,000,000

*Proposal also includes a constitutional amendment to remove spending restrictions for income tax revenue.