

## Overview

Following the economic fluctuations of the past ten years and the impact of those fluctuations on state revenues, Utah's legislative and executive branches undertook a comprehensive study of the state's tax system. Topics examined include the income tax, sales and use tax, property tax, local government taxes, and other taxes. Heading into the 2006 General Session, tax reform appears to be one of the major issues likely to be considered by the Legislature and Governor. Depending on which proposals are ultimately enacted into law, the tax reform effort could result in a major impact on individuals, businesses, and state and local governments.

## 2005 Summary

### Background

The remarkable economic upsurge in the 1980s and 1990s was followed by a dramatic economic downturn in the early 2000s. This caused major fiscal impacts for the states and the federal government. Years of slower revenue growth and even revenue decreases forced state governments nationwide to grapple with difficult spending and tax decisions. These difficult decisions prompted states to examine the outcomes of tax and budget policies over the economic cycle.

Although Utah fared well compared to many states, elected officials were still required to make many difficult fiscal decisions when revenues did not meet expectations. As the state started to emerge from the economic downturn, many people began closely examining the state's tax policies, and the extent to which adjustments to those policies could better help the state meet its goals and challenges in the 21st century.

In 2004, the Utah State Legislature established a task force to study the individual income tax and the corporate franchise and income taxes. In November 2004, Governor Olene Walker issued a report highlighting problems with the state's existing revenue portfolio and made 16 recommendations to address a declining tax base. As part of his campaign, Governor Huntsman highlighted tax reform as a way to improve the state's overall economic climate and to attract higher wage industries to the state.

### Tax Reform Task Force

In the 2005 General Session, the Legislature and Governor Huntsman established a task force to study tax reform and make recommendations based on its study. The task force was comprised of four senators, nine representatives, and two gubernatorial appointees. In May 2005, it began examining the major components of Utah's tax structure in order to make recommendations to the Revenue and Taxation Interim Committee of the Legislature by November 2005. The task force began by adopting a set of guiding principles, which included treating taxpayers in similar situations similarly, establishing the amount of revenue to be generated by taxes, and creating a simple, stable, broad-based, and responsive tax system for the state. To facilitate a more in-depth review of the tax system, the task force divided itself into four working groups: income tax, sales and use tax, property tax, and RDA/other taxes. These working groups studied issues with existing tax policies in their respective areas and made recommendations to the full task force. After initial deliberations, the task force held public hearings in Logan, Salt Lake, Provo, Vernal, Price, Cedar City, and St. George to receive citizen feedback. Including the public hearings and working group meetings, the task force held over 50 meetings in its comprehensive review of the state's tax system.

## Significant Issues

### Income Tax

- Individual income tax - Major proposals considered: a flat tax; low-income exemptions; family size exemptions; retirement exemptions; deductions or credits for mortgage interest and charitable contributions; sales tax refund credits; expanding tax brackets; adjusting tax rates.
- Corporate franchise and income and gross receipts taxes - Major proposals considered: elimination of the corporate franchise and income tax; apportionment formula adjustments such as a single sales factor; repeal and reduction of a gross receipts tax on electrical utilities; a minimum filing threshold; adjusting tax rates.
- Earmarking of income taxes for education - A major proposal considered would eliminate the constitutional earmarking of income taxes for education.

### Sales and Use Tax

- Major sales and use tax issues considered: modifying the sales and use tax on food; expansion of the tax base to include consumer services; tax exemptions for business inputs; a uniform statewide rate; changes to local government sales and use taxes; existing tax exemptions; including the motor fuel exemption; various confusing inconsistent tax issues.

### Property Tax

- Major property tax issues considered: taxation of personal property; property tax rebates for elderly individuals with lower income; changes to truth in taxation processes; including advertisements and property tax inflation adjustments; property tax exemptions, including the 45% primary residential exemption.

### Local Government and Other Taxes

- Major local government and other taxes issues considered: redevelopment agency reform; changes to local government sales and use taxes; including distribution methods and a shift from sales and use taxes to the property tax; modifying insurance premium taxes; decreasing taxes on cable companies and airlines.

### Final Recommendations

The task force adopted 16 draft bills and six conceptual proposals. The following is a summary of the final recommendations.

### Income Tax

- Individual income tax - Establish a tax based on federal adjusted gross income with a rate of 5.0% or less with non-refundable credits based on filing status, family size, charitable contributions, and mortgage interest.
- Corporate franchise and income tax - Allow electable single sales factor.
- Gross receipts tax on electrical corporations - Repeal and reduce tax rates commensurately.

### Sales and Use Tax

- Sales and use tax on food - Eliminate the sales and use tax on unprepared food (i.e., groceries).
- Business input exemptions - Expand the existing manufacturing exemption, revise the existing semiconductor industry exemption, exempt certain telecommunication inputs with a one year life or greater, and exempt certain mining, computer system design, and biotech inputs with a three year life or greater.
- 1% local option sales and use tax - Phase out "hold harmless" provision.
- Uniform statewide rate - Adopt a uniform statewide sales and use tax rate of 6.4%.
- Confusing and inconsistent sales and use tax issues - Address various confusing and inconsistent issues, including (a) isolated and occasional sales, (b) car washes, laundry facilities, and amusement devices, (c) transportation exemptions, and (d) certain agricultural product sales.

Further information on the task force, including audio recordings of meetings, can be accessed on the legislature's website <http://www.le.utah.gov>

### Property Tax

- Circuit breaker - Increase eligibility and benefit amounts for property tax credits for elderly individuals with low income.
- Personal property taxation - Propose constitutional amendment providing legislative discretion on how to impose the property tax on personal property.
- Truth in taxation - Clarify truth in taxation newspaper advertisements and provide a four year newspaper advertisement exemption for certain school district levies approved by citizen vote.
- Commercial aviation - replace the current ad valorem property tax with a uniform fee for certain commercial airlines with headquarters in the state.

### Local Government and Other Taxes

- Redevelopment agencies - Restructure redevelopment agency processes into three tracks, with separate conditions and requirements.
- Insurance premium tax - Reduce the tax on certain insurance premiums.
- Cable tax credit - Provide a credit for cable providers against a state tax to offset local franchise fees imposed on cable providers.

The task force also recommended that various local government tax issues be studied further in 2006.

Tax reform will be one of the major issues to be considered by the Legislature and the Governor during the 2006 General Session. Many of the proposals, if enacted, would have a significant impact on the level and types of taxes paid by individuals and businesses, and the revenues available to the state and local governments to provide services.