MINUTES OF THE
TAX REVIEW COMMISSION

Friday, October 12, 2001 – 1:00 p.m. – Room 405 State Capitol

Members Present:
Mr. Gary Cornia, Chair
Mr. Keith Prescott, Co-Chair
Sen. Lyle W. Hillyard
Sen. Millie M. Peterson
Rep. Judy Ann Buffmire
Rep. Greg J. Curtis
Mr. Larry Barusch
Mr. Mark K. Buchi
Mr. David Crapo
Ms. Kathleen Howell
Mr. Bruce Jones
Ms. Dorothy P. Owen

Members Absent:
Anne Clark
Commissioner Bruce Johnson

Staff Present:
Mr. Bryant Howe, Research Analyst
Mr. O. William Asplund, Assistant Director
Ms. Rebecca L. Rockwell, Associate General Counsel
Ms. Sandra Wissa, Legislative Secretary

Note: A list of others present and a copy of materials can be found at http://www.image.le.state.ut.us/imaging/history.asp or contact the Office of Legislative Research and General Counsel.

1. TRC (Tax Review Commission) Business

Chair Cornia called the meeting to order at 1:08 p.m. and introduced the two new members: Ms. Kathleen Howell and Mr. Mark Buchi. Chair Cornia also noted that Commission Palmer DePaulis from the Tax Commission (Utah State Tax Commission) was sitting in for Commission Bruce Johnson.

Chair Cornia presented recognition award to former TRC members James B. Lee, Robert Graham, and Bonnie Miller.

MOTION: Mr. Bruce Jones moved to approve the minutes of the September 14, 2001 meeting. The motion passed unanimously.

2. Review of Proposed Amendments to the Tax Article of the Utah Constitution

Mr. Robert Rees, Associate General Counsel, OLRGC (Office of Legislative Research and General Counsel), distributed and explained the additional changes, which are underlined, to the handout "Article XIII, Revenue and Taxation." He also distributed the handout "Letter from the District Attorney David Yocom's Office to Alan L. Sullivan, Chairman, Utah Constitutional Revision Commission."

Chair Cornia asked for the TRC members to review this revised article and bring it back to the next meeting. Mr. Rees stated that the tax article would be incorporated into legislative style for the next meeting.

3. Individual Income Tax Reform

The Chair was turned over to Co-chair Prescott.

Ms. Rebecca L. Rockwell, Associate General Counsel, OLRGC, distributed and reviewed draft legislation "Individual Income Tax - State Earned Income Tax Credit," "Individual Income Tax - Bracket Adjustments," and "Individual Income Tax Personal Retirement Exemption and Deduction for Retirement Income - Eliminating Marriage Tax Penalties." Ms. Rockwell reminded TRC that at its last meeting, the TRC adopted a motion by Sen. Hillyard that the TRC review these three bills as a package. Ms. Rockwell briefly reviewed each bill and explained issues associated with each bill.

She stated that the draft legislation "Individual Income Tax - State Earned Income Tax Credit" provides for a state earned income tax credit equal to 5 percent of the federal earned income tax credit except that a person earning $25,000 or more would not be eligible for the credit. The credit would be funded through the General Fund rather than resulting in a revenue loss to the Uniform School Fund. The credit may not be carried forward or carried back.

Ms. Rockwell reviewed with the TRC a handout "Examples of Potential Issues Relating to Individual Income Tax - State Earned Income Tax Credit." One issue deals with the non-refundability of the state earned income tax credit. As the bill is currently drafted, an individual becomes eligible for the state earned income tax credit at levels at which the federal credit has already started to phase out.

Mr. Thomas Williams, Senior Economist, Tax Commission, distributed and reviewed a handout and chart showing the effects of the proposed state income tax credit in relation to the federal earned income tax credit for a married taxpayer with two children. Mr. Williams emphasized that because the credit is non-refundable, taxpayers would only receive a refund if the amount of the credit exceeds the amount of state income tax liability. He also questioned whether the $25,000 adjusted gross income limit, which is imposed regardless of filing status, would lead to a "marriage penalty" in the administration of the credit.

Ms. Rockwell also reviewed the issues of whether the credit should be allowed to be carried forward or carried back and the process for funding the credit from General Fund revenues.

Ms. Rockwell reviewed draft legislation "Individual Income Tax - Bracket Adjustments." She explained that the Legislature has considered adjusting the individual income tax brackets for inflation in the past. During its 2001 General Session, the Legislature approved a one-time adjustment in the brackets but did not provided for annual adjustments for inflation. The current individual income tax has two sets of brackets: one for single taxpayers and the other for all other filing statuses. Ms. Rockwell explained that the legislation provides that beginning on January 1, 2002, the Tax Commission will first adjust the second set of brackets for inflation or deflation. After making these adjustments, the Tax Commission will establish the single brackets at 50 percent of the married brackets. Finally, the brackets will be rounded for the nearest $100. The legislation also provides that the Tax Commission may adjust the dollar amounts in each bracket and that the Tax Commission will use the Consumer Price Index as the basis for adjusting the brackets.

Mr. Barusch asked whether the fiscal note estimating revenue loss also considered the loss of buying power due to the effects of inflation. Mr. Williams replied that the revenue loss estimate only considers the loss of actual individual income tax revenue due to adjusting the brackets, not the loss of purchasing power. Mr. Barusch said that the fiscal note may be overstating the actual cost to the state.

Ms. Rockwell reviewed draft legislation entitled "Individual Income Tax Personal Retirement Exemption and Deduction for Retirement Income - Eliminating Marriage Penalties. She explained that a marriage penalty occurs when two married individuals have a greater tax liability than two similarly situated single individuals having the same income. There are two areas related to Utah law where a marriage penalty arises and this legislation would address these two areas. Utah law allows a deduction for amounts received as retirement income with a cap of $4,800 for a person who is under 65 years of age. A second provision allows an individual retirement exemption of $7,500 for a person who is 65 years of age or older. Both of these provisions provide that at certain incomes, the exemption or deduction begins to phase out. Under currently law, for married taxpayers, heads of household, and surviving spouses the exemption or credit is reduced by 50 cents for each $1 of adjusted gross income over $32,000. For married taxpayers filing separately, the deduction or exemption phases out beginning at $16,000 of adjusted gross income. For single taxpayers, the phase out begins at adjusted gross incomes over $25,000, effectively providing a "marriage penalty" for married taxpayers. The proposed legislation eliminates the marriage penalty by establishing the deduction and exemption phase out for married taxpayers at twice the amount for single taxpayers.

Mr. Barusch asked Sen. Hillyard why this was an issue in the Legislature. Sen. Hillyard said that it is an attractive political issue on the national level and there is a desire to tie in Utah. However, due to the large revenue loss, the bill has never been enacted. Mr. Barusch said that at the national level marriage is most often felt by certain taxpayers whom, if they chose to marry, would pay more in taxes than they would if they were not married. But for Utah, this is about a retirement deduction and exemption. The taxpayers are already married and so the tax code is not influencing a person's behavior regarding whether to marry. The reason for the current phase out in the code is that two persons living together as husband and wife benefit from certain economies of scale that a single person does not. Under this proposal, taxes would go up when one spouse dies. Sen. Hillyard said that some members of the Legislature do not understand the proposal, other than they do understand the nomenclature of a "marriage penalty." Mr. Barusch said that with regards to both the earned income tax credit proposal and the marriage penalty proposal, even though it may make sense to enact certain policies at the federal level, it may not always be a good idea to enact that same policy at the state level.

Sen. Hillyard said that the advantage of having all three of these bills before the TRC is to discuss what group you want to help rather than simply talking about a tax cut.

Ms. Janice Stubno, Tax Analyst, Utah Issues, stated that Utah Issues would like the TRC to reconsider the refundable portion of the EITC (Earned Income Tax Credit). She said that the refundable provision of the federal EITC is the most effective tool to address the regressive nature of the payroll tax and to reduce the poverty level among certain working families. Ms. Stubno also addressed the TRC concerns regarding non-compliance in the federal EITC program. Based on her research, she noted that the residency test for children is an area of concern nationally. This is where both a custodial and non-custodial parent claim the same child for the federal EITC. To remedy this problem, she suggested that the credit only be available to those parents who have their children living with them on a full-time basis. Finally, the problem of non-residency of children may not be as large of a problem in Utah as it is in the rest of the country due to Utah's comparatively low number of single parent households.

Rep. Buffmire said that one of the concerns at the last meeting was the reported high rate of non-compliance in the federal EITC program. To remedy this problem it is being proposed to require the children to live with parents on a full-time basis in order to be eligible for the state credit. Ms. Stubno said that she would be willing to do additional research on the non-compliance issue. Rep. Buffmire said that in most divorce cases one parent would have full-time custody of the children. However, the other parent would have visitation rights, including extended visitation periods in the summer. But even with these extended visitation periods, the custodial parent should be the one who is eligible for the credit. If for the first years of the state credit you only allowed parents who have children on a full-time basis it might lower the fiscal note and to see if the non-compliance problems at the federal level could be avoided here.

Sen. Hillyard said that it depends on how you define "full-time." Most divorce decrees today provide for joint legal custody with physical custody granted to one parent. There are usually four to six weeks granted in the summer. If a child lives with the non-custodial parent for six weeks of the year, is that child still considered to be living "full-time" with the custodial parent? Sometimes the tax benefits are split between the two parents with one parent being allowed to claim the EITC on behalf the child and the other parent claiming the child as a dependent.

Ms. Owen said that the two issues for the TRC to decide are whether to have a refundable credit and to develop a definition of residency that will ameliorate non-compliance problems. Sen. Hillyard said that merely saying that a child must live "full-time" with a parent does not really solve the problem. It just creates new challenges with definitions.

Mr. Buchi asked what is known about non-compliance with the federal EITC program. Ms. Stubno said that one issue is the residency of children. Another issue is that for all taxpayers, 50 percent of returns are prepared by paid tax preparers. But in the EITC program, 62 percent of all returns are prepared by paid preparers. Ms. Stubno also said that federal officials believe that there are incentives for paid tax preparers to find ways to qualify the taxpayer for a large refund because this is how a paid tax preparer is compensated.

Mr. Prescott noted that as the legislation shifts away from simply adopting the federal EITC requirements, you add new eligibility and auditing requirements on the Tax Commission. Also, there may be taxpayers who deserve the credit but who cannot meet a full-year residency requirement.

Sen. Hillyard commented that many legislators will be reluctant to approve tax cuts when budgets must be reduced. Any kind of income tax would have to be promoted as an economic development tool.

Ms. Owen said that at the last meeting, she proposed making the credit non-refundable. But many Utahns are facing tough economic times and it is important to make the credit refundable so that money can be spent to stimulate the economy. In addition, the EITC should be refundable to address some of the income inequities embedded in the current state individual income tax system. There will be a time when the Legislature adopts a tax cut. Any tax cut should improve the equity of the current tax system.

MOTION: Sen. Hillyard moved: (1) that the TRC not take a position on any of these three bills; and (2) if any of these bills, or any other individual income tax bill, are considered by a legislative committee that a member of the TRC executive committee appear before that legislative committee and explain what, in the TRC's view, are some of the positive and negative aspects of the bill.

Sen. Hillyard said that the TRC has the credibility with the Legislature to help them understand broad tax system issues and how a particular bill affects system issues. The TRC can give the Legislature the background and information regarding the policy issues that are involved.

Ms. Owen stated the TRC has already gone on record in favor of indexing for inflation the individual income tax brackets. Ms. Rockwell said that this position was adopted last year by the TRC. Sen. Hillyard said that the final bill enacted by the Legislature was a one-time adjustment only.

Sen. Hillyard said that rather than advocating any single policy position, the TRC would be more helpful by providing background and information and explaining pros and cons of any proposal.

Bruce Jones said that he supports what Sen. Hillyard says as long as there is no consensus among the TRC members on any of these bills. However, if there is a consensus, the TRC should make a recommendation.

Sen. Hillyard said that it would be possible for the TRC to meet during the session if any of these bills are introduced.

SUBSTITUTE MOTION: Sen. Peterson moved to endorse the: (1) State Earned Income Credit legislation with a nine-month residency requirement; and (2) the Individual Income Tax – Bracket Adjustments legislation.

Mr. Buchi said that when the TRC first started, it divided the process into phases knowing that it would be very difficult to make substantive changes to the tax structure. Prior efforts were never successful. The TRC has always tried to make recommendations based on what is good tax policy regardless of the revenue cost and whether they were political feasible. These policies would essentially be a beacon for the Legislature to look on what is good tax policy. The TRC should not pass tax policies based solely on whether they will be enacted by the Legislature.

Rep. Buffmire said that the TRC should adopt good tax policy. The positions adopted by the TRC should reflect the adopted tax policies recommend by the TRC and adopted by the Legislature.

Sen. Hillyard spoke in opposition to the substitute motion. Under the original motion, the TRC executive committee would make a presentation in support of each one of the bills and explain why each bill should be enacted. But these bills all have other sponsors outside of the TRC and will be introduced regardless of the TRC's action. With any tax cut bill, including these bills, the Legislature will need to prioritize and make the tough choices. The information that the TRC can provide is more important than its endorsement of any one bill.

Mr. Barusch spoke in favor of the original motion. The TRC should only recommend bills that are revenue neutral. If the TRC is interested in making the tax system more progressive, then it should also recommend how to pay for it. The TRC should work in the long-term to make sure the recommendations are good tax policy and improve the overall system but are also revenue neutral.

Rep. Buffmire said that each year the TRC should send a brief report to the Governor and to Legislative leadership explaining what the TRC has studied, what are the strength and weaknesses of the various bills it has considered. But the report should also emphasize the Legislature on what constitutes good tax policy. And then the TRC should offer to appear before any legislative committee to discuss tax policy matters. This is how we keep good policy and the broad view in front of the Legislature as it considered various proposals promoted by special interests.

Mr. Buchi asked Sen. Hillyard if the TRC speaks in favor of the three bills, would the EITC bill include a refundable credit? Sen. Hillyard replied that the TRC presentation would be to express both the positive and negative aspects of the bill. For example, with regards to the EITC bill, the TRC could explain the difference between refundable and non-refundable and the pros and cons associated with each option.

Sen. Peterson said that if you don't endorse the bill you don't endorse the concept behind the bill. She explained that a non-refundable EITC is more likely to pass the Legislature because of the lower fiscal note. It is important to emphasize that the EITC supports people who are working. It also indirectly provides relief to other programs and agencies that serve the working poor. Regardless of the positive things that the TRC can say about any of the bills, it will be outweighed by the negative message sent by failure to formally endorse the bills.

Mr. Jones spoke in favor of the original motion. Perhaps the primary purpose of the TRC is to educate. If it is unlikely that any of these bills will pass, then the TRC can play an important role by educating members of the Legislature.

The substitute motion failed with Sen. Peterson voting in favor. Mr. Cornia and Mr. Crapo were absent for the vote.

SUBSTITUTE MOTION: Rep. Buffmire moved to adopt the original motion with the following exceptions: (1) send a written report, to be reviewed by the TRC at a future meeting, to the Legislature outlining what constitutes good tax policy; and (3) endorse the concepts contained in "Individual Income Tax - State Earned Income Tax Credit" and "Individual Income Tax – Bracket Adjustments."

Sen. Hillyard expressed concern that another written report sent to the Legislature would probably not be noticed. Rep. Buffmire said that some legislators might read the report and that it would be helpful.

Sen. Peterson suggested that the written reports be given to legislators only as they consider the proposed legislation.

Mr. Barusch said that these are very important issues. He suggested rather than voting on the motions at this time to direct staff to, under the direction of the sponsors, put the two motions in writing. If a consensus between the two sponsors cannot be found, then both alternatives would be considered by the

TRC at its next meeting. But perhaps in the process of writing the motions it might be possible to resolve the remaining issues.

Sen. Hillyard agreed that the motions should be placed in writing for consideration at the next meeting. Ms. Rockwell clarified that staff would put the two motions in writing. Sen. Hillyard requested that a letter to the Legislature explaining the tax policy behind the two bills also be drafted for consideration at the next meeting.

Rep. Buffmire withdrew the substitute motion.

Sen. Hillyard withdrew the original motion.

4. Western States Tax Burden Study

Mr. Doug Macdonald, Chief Economist, Tax Commission, presented "Utah Household Falling: But Still #1 in the West." He explained that the Tax Commission conducts this study every two years that compare the state and local tax burden in Utah with those in other states. The study examines the tax burden on both households and businesses. In Utah, household taxes as a percent of personal income dropped from 8.5% in FY 1998 to 8.3% in FY 2000. This 0.2% decline saved households $99 million. Mr. Macdonald explained that Utah families' propensity to have large families results in higher demand for education and other government services. However, when comparing per capita household tax burdens, Utah ranks in the middle of seven western states.

Mr. Macdonald stated Utah ranks in the middle of seven western states (Oregon, Colorado, California, Idaho, Utah, Arizona, and Washington) in the tax burden that is placed on businesses. The Utah tax burden on business dropped from 2.9% of GSP (gross state product) in FY 1998 to 2.7% of GSP in FY2000. This saved businesses about $120 million. When comparing business tax burden as a percent of personal income, Utah still ranks in the middle of the seven western states used in the comparison.

5. Process to Review Proposed New Exemptions to the Sales and Use Tax

Due to the lack of time, this item was postponed until a future meeting.

6. Other Business

Co-chair Prescott announced that the next meeting of the TRC will be held on November 9, 2001.

Co-chair Prescott adjourned the meeting at 4:26 p.m.