The Way We Tax: Utah’s State and Local Tax System

Prepared for:

Utah Legislature
“Bagels and Briefings”

February 12, 2013
Presentation Outline

• Tax Policy Overview
• Utah’s Comparative State & Local Tax Burden
• Income Taxes
• Sales & Use Taxes
• Property Tax
• Fuel Taxes
Tax Policy:
Why Does it Matter?
Tax Policy – Why Does it Matter?

- It’s not only the amount of revenue that matters, but also how you get it
- Sound tax policy is concerned with how taxes:
  - Are designed and administered
  - Affect the taxpayer
  - Affect the economy
- Tax policy affects every citizen of Utah
- Tax policy provides revenue that funds state and local public services
Elements of an Optimum Tax System

• Reliable
  – Sufficient
  – Stable
  – Certain
• Equitable
  – Vertical Equity
  – Horizontal Equity
• Simple
  – For taxpayers to pay
  – For tax collectors to collect
• Responsive to interstate and international competition
• Economically neutral
• Accountable and transparent

Taxation 101

Base * Rate = Revenue
Utah Tax Base & Effective Tax Rates

Source: Utah State Tax Commission
Utah’s Three Major State and Local Taxes: Income, Property, and Sales & Use Tax Revenues FY 2012

- Individual Income: $2.5B (29%)
- State and Local Sales/Use: $2.8B (33%)
- Property: $2.7B (32%)
- Corporate Income: $0.3B (3%)
- Fuel: $0.4B (4%)
- Other state: $0.4B (4%)
- Other local: $0.1B (2%)

Source: Utah State Tax Commission
State and Local Sales & Use, Individual Income, and Property Tax Revenues
FY 1970 to FY 2012

Source: Utah State Tax Commission
Real Per Capita State and Local Sales & Use, Individual Income, and Property Tax Revenues
FY 1970 to FY 2012

Source: Utah State Tax Commission
Utah’s State and Local Tax Burden: How Does It Compare?
State and Local *Taxes* as a Percent of Personal Income

FY 2010

Utah ranks 38th highest

Source: U.S. Department of Commerce, U.S. Census Bureau
State and Local *Total Own Source Revenue* as a Percent of Personal Income

FY 2010

Utah ranks 22nd highest

Source: U.S. Department of Commerce, U.S. Census Bureau
State and Local Taxes as a Percent of Personal Income

Utah: FY 1993 to FY 2010

Source: U.S. Department of Commerce, U.S. Census Bureau
State and Local **Total Own Source Revenue** as a Percent of Personal Income

Utah: FY 1993 to FY 2010

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent of Personal Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>16.57%</td>
</tr>
<tr>
<td>1994</td>
<td>16.74%</td>
</tr>
<tr>
<td>1995</td>
<td>16.83%</td>
</tr>
<tr>
<td>1996</td>
<td>16.55%</td>
</tr>
<tr>
<td>1997</td>
<td>16.54%</td>
</tr>
<tr>
<td>1998</td>
<td>16.81%</td>
</tr>
<tr>
<td>1999</td>
<td>16.95%</td>
</tr>
<tr>
<td>2000</td>
<td>17.11%</td>
</tr>
<tr>
<td>2001</td>
<td>16.69%</td>
</tr>
<tr>
<td>2002</td>
<td>16.81%</td>
</tr>
<tr>
<td>2003</td>
<td>17.29%</td>
</tr>
<tr>
<td>2004</td>
<td>17.66%</td>
</tr>
<tr>
<td>2005</td>
<td>17.69%</td>
</tr>
<tr>
<td>2006</td>
<td>17.90%</td>
</tr>
<tr>
<td>2007</td>
<td>17.90%</td>
</tr>
<tr>
<td>2008</td>
<td>17.06%</td>
</tr>
<tr>
<td>2009</td>
<td>16.15%</td>
</tr>
<tr>
<td>2010</td>
<td>16.05%</td>
</tr>
</tbody>
</table>

Source: U.S. Department of Commerce, U.S. Census Bureau
State and Local *Property Taxes* as a Percent of Personal Income

**FY 2010**

Utah ranks 40th highest

Source: U.S. Department of Commerce, U.S. Census Bureau
State and Local General Sales Taxes as a Percent of Personal Income

FY 2010

Utah ranks 21st highest

Source: U.S. Department of Commerce, U.S. Census Bureau
State and Local *Income Taxes* as a Percent of Personal Income

FY 2010

Utah ranks 22nd highest

Source: U.S. Department of Commerce, U.S. Census Bureau
State and Local *Fuel Taxes* as a Percent of Personal Income

**FY 2010**

Utah ranks 19th highest

Source: U.S. Department of Commerce, U.S. Census Bureau
How Utah Compares

Utah Taxes and Own Source Revenue as a Percent of Personal Income: FY 2010

<table>
<thead>
<tr>
<th>Rank</th>
<th>Total Own Source Revenue</th>
<th>Taxes</th>
<th>Property Taxes</th>
<th>General Sales Taxes</th>
<th>Income Taxes</th>
<th>Fuel Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>22</td>
<td>40</td>
<td>38</td>
<td>40</td>
<td>21</td>
<td>22</td>
<td>19</td>
</tr>
</tbody>
</table>

Source: U.S. Department of Commerce, U.S. Census Bureau
Income Taxes
Utah’s Single Rate Individual Income Tax

• New system took effect tax year 2008
• Single statutory tax rate of 5% applied to state taxable income
  – Start at federal adjusted gross income (AGI) with certain additions and subtractions
• Several tax credits that phase out as income increases
  – Taxpayer tax credit – phaseout 1.3%
  – Retirement tax credit – phaseout 2.5%
Effect of Recent Income Tax Changes

- Despite “flat tax” moniker, overall the new system is moderately progressive with respect to AGI
  - Basic Tax Formula
    - \( (\text{Tax base} \times \text{tax rate[s]}) - \text{tax credit} = \text{tax liability} \)
  - Old system – progressive through \text{tax base and tax rates}
  - New system – progressive through \text{tax credits}
- Briefing papers available summarizing major tax changes and impacts (visit le.utah.gov)
- Withholding changes altered the timing of income tax collections
Utah’s Income Tax System Remains Progressive

[Graph showing the effective tax rate as a percent of adjusted economic income across different deciles of adjusted economic income.]
## Distribution of Returns, AGI, and Utah Tax

**Tax Year 2010**

<table>
<thead>
<tr>
<th>Income Range</th>
<th>% of Returns</th>
<th>% of Exemptions</th>
<th>% of Income (AGI)</th>
<th>% of Utah Income Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>less than $40K</td>
<td>55%</td>
<td>43%</td>
<td>14%</td>
<td>8%</td>
</tr>
<tr>
<td>$40-80K</td>
<td>27%</td>
<td>32%</td>
<td>29%</td>
<td>26%</td>
</tr>
<tr>
<td>$80-125K</td>
<td>12%</td>
<td>16%</td>
<td>23%</td>
<td>25%</td>
</tr>
<tr>
<td>$125-250K</td>
<td>5%</td>
<td>7%</td>
<td>16%</td>
<td>19%</td>
</tr>
<tr>
<td>$250K-$1M</td>
<td>1.3%</td>
<td>1.8%</td>
<td>10%</td>
<td>12%</td>
</tr>
<tr>
<td>$1M+</td>
<td>0.1%</td>
<td>0.2%</td>
<td>8%</td>
<td>9%</td>
</tr>
</tbody>
</table>

100% 100% 100% 100%
Individual Income Taxes by AGI Class
Tax Year 2010 Full Year Residents

Returns
- Under $40K, 55%
- $40-80K, 27%
- $80-125K, 12%
- $125-250K, 5%
- $250K-$1M, 1.3%
- $1M+, 0.1%

Exemptions
- Under $40K, 43%
- $40-80K, 32%
- $80-125K, 16%
- $125-250K, 7%
- $250K-$1M, 1.8%
- $1M+, 0.2%

Income (AGI)
- Under $40K, 14%
- $40-80K, 29%
- $80-125K, 23%
- $125-250K, 16%
- $250K-$1M, 10.0%
- $1M+, 7.8%

State Income Tax
- Under $40K, 8%
- $40-80K, 26%
- $80-125K, 25%
- $125-250K, 19%
- $250K-$1M, 8.9%
- $1M+, 12.1%
Why Does the Individual Income Tax Matter?

• Constitutionally earmarked revenue for public education and higher education
• Greatest ability to adjust for current ability to pay and offset regressivity of other taxes
• Most detailed information on taxpayers
• Visible
  – $ withheld from paychecks
  – Annual tax return
• Tax on Income
  – Individuals
  – “Pass-through” business entities
  – Trusts and estates
Corporate Franchise & Income Tax Revenues
FY 1970 to FY 2012

Millions
Corporate Franchise & Income Tax Revenue by Utah Net Taxable Income, Tax Year 2010

- Under $100K, 2%
- $100-500K, 4%
- $500K-$1M, 4%
- $1M-5M, 15%
- $5-10M, 12%
- $10M+, 63%
Corporate Franchise & Income Tax Revenue by % of Business in Utah, Tax Year 2010

- Less than 1%, 31%
- 1-5%, 29%
- 5-25%, 15%
- 25-50%, 16%
- 50-99%, 5%
- 100%, 5%
Why Does the Corporate Franchise & Income Tax Matter?

- Constitutionally earmarked revenue for public education and higher education
- Volatile revenues
- Tax on income
  - Generally C-corporations
Sales & Use Taxes
The Utah Sales and Use Tax Base: What Do We Tax?

Key transactions subject to tax include:

- Retail sales of tangible personal property
- Sales of certain telecommunication services, utility services, or passenger service (reduced rate may apply)
- Sales of food (reduced rate may apply)
- Certain admissions, such as movie tickets
- Certain services, such as cleaning and repair of tangible personal property
- Certain hotel or motel charges
- Products transferred electronically
- “Use tax”
Some transactions are not specifically exempt from sales and use taxes but are not part of the tax base, such as professional services or personal care services.

Other transactions are specifically exempt from sales and use taxes:
- Currently 74 exemptions
- Estimated FY 2011 state revenue effect: $343 Million
The Utah Sales and Use Tax Base: What Don’t We Tax?

Some examples of major sales and use tax exemptions include:

<table>
<thead>
<tr>
<th>Exemption</th>
<th>FY 2011 State Impacts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motor, special, aviation fuels</td>
<td>$ 98 M</td>
</tr>
<tr>
<td>Manufacturing machinery &amp; equipment</td>
<td>$ 91 M</td>
</tr>
<tr>
<td>Prescription drugs</td>
<td>$ 46 M</td>
</tr>
<tr>
<td>Resale property / component parts</td>
<td>$ 19 M</td>
</tr>
<tr>
<td>Sale of natural gas, electricity, coal, etc. for industrial use</td>
<td>$ 19 M</td>
</tr>
<tr>
<td>Food stamps &amp; WIC</td>
<td>$  7 M</td>
</tr>
<tr>
<td>Certain religious / charitable sales &amp; purchases</td>
<td>$  6 M</td>
</tr>
<tr>
<td>Farm machinery &amp; equipment</td>
<td>$  6 M</td>
</tr>
</tbody>
</table>

Source: Utah State Tax Commission
State and Local Option Sales and Use Tax Rates

State tax rate +
Sum of local option tax rates where transaction occurs
Total tax rate imposed on a transaction

- The state tax rate depends on what is being taxed

For example:
- General state tax rate (includes prepared food) 4.70%
- Residential fuels tax rate 2.00%
- Food and food ingredients tax rate 1.75%
Local Option Sales and Use Tax Rates

- Counties, cities, and towns are allowed to impose a variety of local option sales and use taxes
- Most local option sales and use taxes tax the same transactions taxed at the state level
- Some local option sales and use taxes may be used for general fund purposes

For example:
- Local sales and use tax: 1.00%
- County option sales and use tax: 0.25%
Local Option Sales and Use Tax Rates

- Other local option sales and use taxes may only be used for purposes specified in statute
  For example:
  Public transit tax (funds system for public transit) up to 0.30%
  County “ZAP” tax (“zoo, arts, and parks tax”) 0.10%

- Some local option sales and use taxes are imposed only on certain transactions, such as vehicle rentals, hotel or motel charges, or prepared food
  For example:
  County transient room tax on hotel / motel charges up to 4.25%
  County tax on food sold by restaurants (“TRCC tax”) up to 1.00%
Sales & Use Tax Base
Gross Taxable Sales as a % of Personal Income

Over the long term, the sales and use tax base is gradually declining relative to the economy as a whole.

Source: Utah State Tax Commission & 2009 Economic Report to the Governor
The Sales & Use Tax Base: Why is It Declining Over the Long Term?

- Changing purchasing patterns
  - Movement to more of a service-based economy
  - Many services excluded from sales & use tax base
- Cross-border shopping
  - Internet, phone, and catalogue purchases
- Technological change
  - Digitization of goods (software, books, music)
- Legislated exemptions

Sales and Use Tax Revenue - Where Does the Money Go?
FY 2012

- State not earmarked: 57%
- State earmarked: 13%
- General local option: 16%
- Local transportation: 8%
- General county option: 4%
- Other local (ZAP/RAP, rural hospital, resort community, etc.): 2%
Real Per-Capita Sales and Use Tax Revenues Over Time

- General Fund State Sales Tax
- Earmarked State Sales Tax
- General Purpose Local Sales Tax
- Earmarked Local Sales Tax
Year-Over Percent Change in Utah’s Sales & Use Tax Base
FY 1978Q4 to FY 2012Q2

Source: Utah State Tax Commission
Why Does the Sales and Use Tax Matter?

- Most significant source of revenue to state government and state higher education system
- Significant source of revenue to local governments, Utah Transit Authority, and other public transit districts
- Tax on consumption
- Politically more popular less unpopular than other taxes
- Impacts zoning decisions
Property Tax
General Rule

– All tangible property shall be:
  • Assessed at a uniform and equal rate in proportion to its fair market value; and
  • Taxed at a uniform and equal rate

Exceptions to General Rule

Property Tax Exemptions
The Legislature may by statute:

- Provide for agricultural land to be assessed based on its value for agricultural purposes
- Determine the manner and extent of taxing livestock
- Determine the manner and extent of taxing or exempting intangible property
- Exempt tangible personal property required to be registered for use on a public highway, waterway, or land or in the air
- Provide for the remission or abatement of the taxes of the poor

Exceptions to the General Rule
Constitutionally Mandated Exemptions

- Government owned property
- Nonprofit entity-owned property used for religious, charitable, or educational purposes
- Burial places
- Farm equipment and machinery
- Water rights and facilities used to irrigate land owned by the owner of the water rights and facilities
- Nonprofit entity-owned water rights and facilities used to irrigate land, provide domestic water, or provide water to a public water supplier
Selected Discretionary Property Tax Exemptions

- Inventory
- Up to 45% of residential property value
- Household furnishings, furniture, and equipment
- Tangible personal property that generates an inconsequential amount of revenue
- Property owned by a disabled veteran or unmarried surviving spouse or orphan
Property Taxes
Where Does the Money Come From?
2011 Tax Year

Primary Residential 55%
Commercial 26%
Other Real 12%
Local Districts 14%

Source: Utah State Tax Commission
Property Taxes
Where Does the Money Go?
2011 Tax Year

Source: Utah State Tax Commission
Why Does the Property Tax Matter?

• Tax on wealth and capital
• Source of revenue for schools and other local government entities
• Oldest state and local tax
• Stability
• Transparent
• Unpopular tax
• Provides political accountability
Motor & Special Fuel Taxes
Combined Motor and Special Fuel Tax Revenue
FY 1976 to FY 2011

Indicates a tax rate increase

Source: Utah Department of Transportation Annual Statistical Surveys; Utah State Tax Commission
Where Does the Money Go?

- Constitutionally earmarked for highway purposes (construction and maintenance)
- 70% to UDOT
- 30% to cities and counties (B&C Road Fund)
  - Used under the direction of UDOT
  - Distributed based on road length and pavement type
Why Do Motor and Special Fuel Taxes Matter?

• Significant source of revenue for maintaining state highway system
• Politically unpopular
• Somewhat like to a user fee - taxes use of public highways
• Taxed on a per-unit basis, so adjusts with consumption amount, not price
Please feel free to contact us with any questions at (801) 538-1032

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