

Utah's Income Tax Structure

Utah is perhaps one small step away from creating an Income tax structure that will serve them well into the foreseeable future. Currently Utahns like to claim they have a flat tax rate. However, while Utah has a nominally flat rate, that rate is effectively turned in to a very steeply progressive rate system. This is accomplished through a complicated system that turns deductions to credits and then phases out those credits very quickly as income rises.

The foundational factor in any tax structure is the tax base. A broad base is more desirable than a narrow base. As the tax base broadens, the revenue stream becomes less volatile. As the economy fluctuates, a flat or broad base will be less volatile and cause the revenue stream to flow much more evenly and predictably than when the base is narrow. Therefore, the first and most important part of any tax structure is to create the broadest tax base that is practical. The factors that weaken or narrow a tax base and make it less stable are deductions, exclusions, exemptions, etc.

Once the broad or flat tax base is established, the next step is to determine the tax rate to that base. The rate can be thought of as the valve that controls the flow of revenue from the base. The rate is much easier to set in tax policy than is the base.

I believe that most experts would agree that the most practical broad base for a state that uses the federal tax system as a starting point for individual income tax calculations is federal adjusted gross income or AGI. If AGI is used, all federal deductions that come after AGI are automatically eliminated and their weakening or narrowing effects on the base are also eliminated.

Where is Utah in this process with respect to the individual income tax? The answer, I believe, is just one small step away. The legislative and executive branches in Utah have worked hard through the years to create an excellent income tax structure. Currently we have a base that is flat for all taxpayers whose taxable incomes are at or above the phase out amount. For those whose income is less than the full phase out amount, the base becomes progressively broader or flatter as their Utah taxable incomes approach the phase out amount. Therefore, a large portion of Utah taxpayers actually have a flat income tax base of federal AGI, or they are approaching a flat base.

This legislative foresight has left Utah in a unique position to take advantage of recent federal changes and create a broad-based income tax structure that will serve Utah well for many years. The key federal change is the large increase in the federal standard deduction starting in 2018. This change has undoubtedly caused a great many Utahns to choose to use the standard deduction in lieu of itemized deductions at the federal level and therefore, also on their Utah returns.

With many more taxpayers likely using the standard deduction coupled with a large number of taxpayers who's itemized deductions are already completely or partially phased out by Utah law (Itemized deductions are phased out by means of the credit phaseout.) Utah is very close to a flat tax base based on federal AGI. The destabilizing influence of deductions from AGI are currently eliminated for all but a minority of taxpayers. The danger we face is the federal propensity to tinker with the tax law. As they tinker, they very often create volatility in Utah's revenue stream. We cannot the federal law to remain static.

I believe this task force would be remiss in not taking the opportunity to solidify Utah's individual income tax base in a manner that would serve the citizens of Utah well far into the future.

In light of the above, I propose the following: Utah should adopt federal AGI as the base to which a rate is applied for individual income taxation. Destabilizing deductions would be eliminated, and a simple rate system should be applied to the base of federal AGI. The top rate should potentially remain unchanged and that two or three brackets with graduated lesser rates be applied to those taxpayers who have not yet reached what would otherwise be the fully phased out amount under current law. I also propose that a zero rate be applied to say the first \$15,000 or \$20,000 to protect the low-income taxpayers. The final amount, as well as the graduated rate brackets and the corresponding rates would be determined based on projections using 2018 data. The last date for filing 2018 income tax returns is October 15; therefore, those projections can be made in the near future.

This change in structure will allow several things: First, it could, and should be used to offset the economic effect of restoring the sale tax on food to low income taxpayers if it is restored. Second, we should be able to make the change with a minimum of losers and a maximum of winners, especially if there is an overall tax cut. Third, Utah income taxpayers should be able to file their returns on a post card, thus easing the burden of compliance and administration.

Preliminary results using 2017 data look very promising. Results using 2018 data will give more definitive results to work with.

I urge, in the strongest way possible, the task force, the legislature, and the governor to consider this proposal. Utah has a unique opportunity to eliminate the future effects any tinkering with deductions from AGI at the federal level and provide a stable revenue stream for the long term future benefit of her citizens.

Sincerely,

A handwritten signature in blue ink, appearing to read "M. Keith Prescott". The signature is fluid and cursive, with a large loop at the end.

M. Keith Prescott CPA