

Tax Restructuring Policy Proposal

Sponsor(s): *Sen. Karen Mayne*

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 revenue to be spent on education and would address several policy concerns.

Budgetary Impact

- Results in an overall net revenue increase of approximately \$200 million.

Policy Impact:

- Modifications of the income tax structure would increase revenue for education spending and shift the tax burden toward higher income residents
- 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 an expanded sales tax base and existing sales tax on food would be mitigated by a new Earned Income Tax Credit and an income tax credit for certain Social Security retirement income.

Policy Summary:

This proposal includes the following policy modifications:

Reductions

Income Tax

- Creating an income tax credit for certain Social Security retirement income
- Creating a state earned income tax credit

Sales Tax

- Exempting feminine hygiene products from sales tax

Expansions

Income Tax

- Implementing progressive rate structure

Sales Tax

- Restoring the full sales tax rate on soda and candy
- Expanding the sales tax base by repealing certain sales tax exemptions
 - Establishing reporting requirements for exemptions
- Expanding the sales tax base by charging sales tax on certain services

Other

- Increasing the state Motor Vehicle Rental Tax
- Increasing the state Transient Room Tax

Revenue Neutral Changes

- Removing earmark for state Transient Room Tax Revenue
- Dedicating revenue increases to education spending

Policy Description:

Create an Income Tax Credit for Social Security Income

- Non-refundable tax credit equal to total Social Security income included in Adjusted Gross Income (AGI) x State Income Tax Rate
- Amount of credit reduced by \$0.025 per dollar that modified AGI (including Social Security and all other income) exceeds:
 - \$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

- Offer a refundable income tax credit to individuals who claim the federal earned income tax credit
- Credit amount equals 5% of the federal credit amount an individual is entitled to claim

Exempt Feminine Hygiene Products from Sales Tax

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

Implement a Progressive Income Tax Rate Structure

- Income tax rates increase with state taxable income (STI)
 - First \$250,000 of STI would be taxed at the current rate of 4.95%
 - STI between \$250,001 and \$1,000,000 would be taxed at 5.25%
 - STI above \$1,000,000 would be taxed at 5.5%

Dedicate Education Spending

- Statutory language mandating that the Legislature annually appropriate funding to public education that, at a minimum, funds student growth plus a 3% inflationary factor.
 - Repeal of this statute would require a constitutional majority.
- Statutory language mandating that the Legislature annually appropriate funding to the school lunch program that, at a minimum, funds student growth plus a 3% inflationary factor.
 - Repeal of this statute would require a constitutional majority.

Restore Full State Sales Tax Rate on Soda and Candy

- The sales tax rate on soda and candy 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)
 - Construction materials for new airport in 2nd class county (material converted to real property only)
 - Electricity to ski resorts for lifts
 - Vehicles used for temporary sporting events
 - Admissions to college athletic events
 - Textbooks purchased by a student (not including a college bookstore; seller sales primarily textbooks)
 - Certain electricity produced from a new alternative energy source
 - Gold, silver, platinum (bars, coins, etc.; not legal tender; content 50%+ gold, silver, or platinum)
 - Primarily unassisted cleaning of property (coin operated laundry, etc.)
 - Use of unassisted amusement device
 - Vending machine food sold for \$1 or less under certain circumstances
 - Car wash that does not include cleaning the interior of the vehicle
 - Sales to a public transit district (includes construction materials converted to real property)
 - Fuel sold to a common carrier railroad and used in a locomotive engine
- The following exemption would be repealed in 2022:
 - Construction materials for Salt Lake International Airport (material converted to real property only)
- Reporting requirements would be established for recipients of sales tax exemptions

Broaden the Sales Tax Base by Charging Sales Tax on Certain Additional Services

- 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:
 - Installation of tangible personal property
 - Veterinary services (with agriculture exemption)
 - Taxi and limousine service
 - Peer to peer ride sharing
 - Scenic and sightseeing transportation
 - Tour operators
 - Portrait photography services
 - Photofinishing laboratories
 - Sports and recreation instruction
 - Exam preparation and tutoring
 - Fine arts schools
 - Miscellaneous schools and instruction (e.g. yoga studios, public speaking training)
 - Motor vehicle towing
 - Parking lots and garages
 - Language schools
 - Miscellaneous personal services (e.g. wedding planning, dating services)
 - Automobile driving schools
 - Software as a Service (excluding custom business software programming)
 - Streaming media
 - Shipping and handling when part of a taxable sale
- Sales or use tax would be due from the end user of these services if the end user is in Utah
- Businesses providing the services would collect and remit the tax
- Businesses collecting and remitting the tax would be eligible to retain a portion of the sales tax collected as a vendor discount to minimize the compliance burden
- Task force will consider additional policy options to minimize the compliance burden on very small businesses
- Task force will consider policy options to minimize impact on cities and counties

Increase the State Motor Vehicle Rental Tax

- Increase the state motor vehicle rental tax from 2.5% to 4.25%

Increase the State Transient Room Tax

- Increase the state transient room tax rate from 0.32% to 3.32%
- Remove the requirement that state transient room tax revenue be used for certain hospitality and outdoor recreation programs

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 FY2017 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.
- Tax incidence modeling does not account for effect on businesses. Approximately \$33 million of the tax change will be paid by businesses. Businesses will be affected by the change in income tax rates, any expansion of sales tax to services, any repeal of sales tax exemptions, increases to the transient room tax and vehicle rental taxes, and the sales tax on food items. 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.
- Based on data from the Kem C. Gardner Policy Institute, we assume that approximately 86% of the incidence of the increased Transient Room Tax will be borne by nonresidents, and so only model 13% of the incidence in the model.
- 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.