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UTAH LEGISLATURE

TAX RELIEF & REFORM

What Does It Mean for Taxpayers?

Office of Legislative Research and General Counsel

HIGHLIGHTS

- In 2006 and 2007, the Legislature enacted about $400 million in ongoing tax reductions.
- Major tax changes include:
  (1) a new individual income tax[1] system ($190 million state reduction);
  (2) significant reductions in the sales tax on food[1] ($120 million state reduction, $20 million local reduction); and
  (3) a general sales tax rate reduction ($40 million state reduction).
- Various other smaller tax cuts for businesses and individuals in specific areas were also enacted ($50 million state reduction).
- Potentially offsetting the state tax reductions for taxpayers, the Legislature authorized counties to impose a new sales tax to improve transportation infrastructure and authorized certain local governments to increase sales tax rates to mitigate revenue losses related to sales tax on food reductions.
- The combination of sales and income tax reductions for individuals spreads the tax cut among taxpayers at all income levels. About 98% of resident taxpayers are expected to receive a net tax cut. Upon full implementation of the state changes, single taxpayers are estimated to receive a reduction generally between $50 and $200 and married taxpayers a reduction generally between $100 and $400.
- The state decreases could be offset by local sales tax increases for transportation. In counties that impose the new sales tax for transportation, increase amounts are generally estimated to be between $25 to $50 for single taxpayers and $25 to $100 for married taxpayers.
- Businesses receive tax reductions from the general sales tax rate reduction, new and expanded sales and use tax exemptions, the reduction of certain gross receipts taxes, the expansion of certain business income tax credits, as well as other changes.

MAJOR TAX CHANGES ENACTED IN 2006 & 2007

In 2006 and 2007, the Legislature enacted a series of significant income and sales tax changes.

Major Changes Enacted in 2006. During the 2006 General Session, the Legislature reduced the state sales tax on food (HB 109) and made various tax changes in other bills (see page 6).

During the 4th Special Session in 2006, the Legislature made two major tax changes by:

- enacting the initial version of the single rate individual income tax system (SB 4001), and
- authorizing counties to impose a new sales tax for transportation (HB 4001).

The 2006 reductions decrease state taxes by about $180 million (about $80 million individual income tax, $80 million in sales tax, and $20 million business and other reductions). These state reductions may be offset by new county sales taxes for transportation (if imposed by all counties, nearly $120 million).

Major Changes Enacted in 2007. In the 2007 General Session, the Legislature enacted SB 223, an omnibus tax bill which:

- revamps the individual income tax system,
- further reduces the state sales tax on food,
- eliminates certain local option sales taxes on food,
- reduces the state general sales tax rate, and
- makes various other tax changes.

SB 223 also allows some local governments to increase certain local option sales tax rates to offset revenue decreases related to removing food from the sales tax base for certain local option sales taxes. The Legislature also enacted several other tax changes in other bills (see page 6).

The 2007 changes reduce state taxes by approximately $220 million, including individual income tax reform ($110 million), sales tax on food reductions ($40 million), a general sales tax rate reduction ($40 million), and business and other tax changes ($30 million). In addition, certain local option sales taxes on food are eliminated (about $20 million) and certain local sales tax rates may increase (up to about $20 million).

Income Tax

What Are the Individual Income Tax Changes?

The individual income tax changes enacted in SB 223 during the 2007 General Session establish a single-rate one track system, effective in tax year 2008. For tax year 2007, the state will have a dual track system, with a choice between the traditional bracket system and a 5.35% flat tax based on federal adjusted gross income (AGI).

Flat Tax Before Credits

As outlined in Table 1 below, the new system effective in tax year 2008 will apply a single tax rate of 5.0% after making certain additions to and subtractions from AGI.

Table 1

New Income Tax Calculation - Base Adjustments & Tax Rate
Tax Year 2008

(1) Start at Federal Adjusted Gross Income (AGI)	
(2) Make the Following Adjustments:	
Additions to AGI	**Subtractions from AGI**
Certain medical savings account withdrawals and penalties deducted on state individual income tax return	Deductions required by federal law, treaty, or case law (US interest, certain American Indian income, railroad retirement income)
Certain income tax amounts deducted from AGI by an estate or trust	Uintah-Ouray reservation income
Certain lump sum distributions	State tax refund included in AGI
Child's income reported on a parent's return but not included in AGI	
Educational savings plan withdrawals that were deducted on a state individual income tax return but not used for qualified higher education purposes	
Other states' bond interest, under certain conditions	
Certain trust distributions received by a resident beneficiary	
Certain adoption expenses deducted on a state or federal individual income tax return	
(3) Multiply by 5.0% rate	

New Taxpayer Credits

Other than the initial adjustments to AGI, the system moves from a deduction-based system to a credit-based system. Rather than claiming deductions to arrive at taxable income and then applying various tax rates to different brackets of income, the bill allows certain tax credits which reduce tax liability on a dollar-for-dollar basis.

After calculating the initial flat tax amount, the taxpayer may be able reduce that initial tax amount through credits. Allowable credits provide a benefit for the federal standard deduction or itemized deductions (such as charitable contributions, mortgage interest, certain medical expenses, and certain state and local taxes), personal exemptions, and retiree status.

As income surpasses certain thresholds, the taxpayer credits phase out so that those taxpayers with incomes above the phaseout range (about 9% of resident taxpayers) pay an AGI-based flat tax.

The taxpayer credits are non-refundable, meaning a taxpayer does not receive a refund if the credit exceeds the amount of tax due.

Although the move from the traditional deduction and bracket system with which taxpayers are accustomed may be new for taxpayers, using a credit-based system may provide greater transparency because a credit more clearly identifies to the taxpayer the amount of benefit received from the rewarded behavior or status.

Other Tax Credits and Checkoff Contributions

In addition to the taxpayer and retiree credits, refundable and non-refundable tax credits previously available under the old bracket system remain. SB 223 also expands tax credits for renewable energy and research and development and HB 36 (2007) establishes a new tax credit which modifies and replaces a deduction for certain higher education savings plans.

Voluntary "checkoff" contributions for various programs (such as programs for the homeless, non-game wildlife, and public education) also remain.

How Do the New Income Tax Credits Work?

Standard Taxpayer Credit (Non-Refundable)

A taxpayer calculates the standard taxpayer credit by (a) adding the federal standard or itemized deductions other than state income tax and 75% of the federal personal exemption and (b) multiplying this amount by 6%. Above certain income levels, the credits phase out at 1.3 cents for each dollar increase in modified AGI. The phaseout beginning points ($12,000 single, $18,000 head of household, $24,000 married) are indexed for inflation beginning in tax year 2009.

Table 2 below provides three examples that illustrate how the standard taxpayer credit works at different income levels for married filers who claim four personal exemptions and the standard deduction. For a taxpayer who claims itemized deductions, the amount of itemized deductions other than state income tax would replace the standard deduction amount in the calculation.

Retiree Credit (Non-Refundable)

In addition to the standard taxpayer credit, retirees receive an additional tax benefit. For those age 65 and older, a retiree credit of $450 is provided. For those under age 65 with certain types of pension or other specified retirement income, a retiree credit of $288 is provided. These credit amounts equal 6% of the prior system's retirement deduction amounts. The retiree credit functions similar to the standard taxpayer credit in that it phases out above certain income levels ($25,000 single, $32,000 married and head of household) at a rate of 2.5 cents for each dollar increase in income. The retiree credit may only be claimed by taxpayers born before 1953.

Table 2

New Income Tax Calculation - Married Non-Retiree

Estimates for Tax Year 2008 - Standard Deduction, Family Size of 4

		Example 1	Example 2	Example 3
	Tax Before Credits			
1	Modified Adjusted Gross Income (MAGI)	$20,000	$50,000	$150,000
2	**Flat Tax Before Credits (5% x MAGI)**	**$1,000**	**$2,500**	**$7,500**
	Credit Calculation			
3	Federal Standard Deduction or Itemized Deductions Other Than State Income Tax	$11,000	$11,000	$11,000
4	75% of Federal Personal Exemptions (75% x $3,500 x 4)	$10,500	$10,500	$10,500
	Deduction Subtotal	$21,500	$21,500	$21,500
5	**Credit Before Phaseout (Deduction Subtotal x 6%)**	**$1,290**	**$1,290**	**$1,290**
6	Credit Phaseout Beginning Point ($12,000 single, $18,000 head of household, $24,000 married)	$24,000	$24,000	$24,000
7	Income Above Phaseout Beginning Point (subtract Line 6 from Line 1, 0 if less than 0)	$0	$26,000	$126,000
8	**Credit Reduction Amount (Multiply line 7 by .013)**	**$0**	**$338**	**$1,638**
9	**Credit After Phaseout (Subtract line 8 from line 5, 0 if less than 0)**	**$1,290**	**$952**	**$0**
	Tax After Credits			
10	**Tax Liability After Credit (Subtract Line 9 from Line 2, 0 if less than 0)**	**$0**	**$1,548**	**$7,500**

What Are the Income Tax Change Effects?

Based on tax year 2005 income tax returns[2], it is estimated that under the new system taking effect in tax year 2008, about 95% of resident filers will receive a reduction or pay the same amount of income tax as under the system in place in tax year 2005. When compared to the tax law changes effective for tax year 2007 (SB 4001), it is estimated that nearly 90% will pay the same or less.

An estimated 30,000 generally lower-income filers who had a tax liability under the old system will have no tax liability under the new system, because of the extra benefit provided through the credit calculation.[3]

Charts 1 and 2 on page 7 show the estimated total tax paid and effective income tax rates for resident returns in tax year 2005 and under the new income tax system taking effect in tax year 2008.

The more detailed analysis in Charts 3 through 8 utilize three methods to show changes in tax liability:
(1) dollar change, (2) percent change in liability, and (3) effective rate change. Dollar change is the estimated amount of the tax change. Percent reduction in liability is the dollar change as a percent of the prior income tax liability. Effective rate reduction is the dollar change as a percent of AGI. Each of these three measures examines tax changes in a different way. Taken together, the three measures provide a good sense of the overall effect of the tax changes.

For each method of analysis, scatterplot charts are provided in which each tax return is represented by a single dot. Large groups of dots together highlight significant trends. However, in interpreting the charts it should be noted that in instances where a very large number of similar taxpayers are affected similarly by the changes, many dots are essentially stacked on top of each other.

Charts 3 and 4 on page 8 show the estimated dollar effects of the income tax changes by filing status, compared to amounts on tax year 2005 tax returns. As shown in these charts, single and head of household filers generally receive a tax reduction ranging up to $150. Most married filers generally receive a tax reduction up to $300. Of the filers with increases, most are $150 or less.

Charts 5 and 6 on page 9 show the estimated percent change in liability by filing status, compared to amounts on tax year 2005 tax returns. As shown in these charts, many lower income filers (single, head of household, and married) receive a percentage reduction ranging from 5 to 15% or greater. This reduction percentage tends to decrease somewhat as income increases. Of the filers with increases, most have increases of 5% or less.

Charts 7 and 8 on page 10 show the estimated effective rate change by filing status, compared to effective rates from tax year 2005 tax returns. As shown in these charts, effective rate reductions generally range from 0% to 0.4%. Of those with increases, most are 0.2% or less of AGI.

The total income tax reform changes will provide about $190 million in tax relief to Utah taxpayers ($80 million for SB 4001 and $110 million for SB 223).

Sales Tax

What Are the Major Sales Tax Changes?

Significant changes have also taken place in the sales tax over the past two years. Most notable is the significant reduction in the sales tax on food purchases. Other major changes include a reduction in the general state sales tax rate, authorization for local sales tax increases for transportation and to offset local revenue reductions related to sales tax on food reductions, and the enactment and expansion of sales tax exemptions for business inputs.

Table 3 on page 5 summarizes the major changes in state and local sales tax rates.

What Has Happened With Sales Tax on Food?

Major sales tax on food reductions have come at the state level. The state sales tax on food has been reduced by nearly two-thirds, from 4.75% to 2.75% effective January 1, 2007, and then further reduced to 1.75% effective January 1, 2008. These reductions are estimated to reduce state sales tax collections by approximately $120 million.

In addition, due to several local sales tax changes enacted by the Legislature in 2007, sales of food will be taxed at a 3.0% uniform statewide rate effective January 1, 2008. This 3.0% rate is composed of the 1.75% state rate, 1.00% local option rate, and 0.25% county option rate[4].

Reducing the sales tax on food primarily benefits resident individuals. While some food purchases are already exempt (food purchased with food stamps or WIC vouchers), the reduction benefits taxpayers in all income ranges because nearly all taxpayers are likely to make at least some taxable food purchases.

What Are Other Major Sales Tax Changes?

General Rate Reduction

Effective January 1, 2008, the general state sales and use tax will decrease from 4.75% to 4.65%. While the sales tax on food reduction primarily benefits resident individuals (with some minor business and non-resident benefits), the general sales tax rate reduction benefits both resident individuals and businesses, which pay a sales tax on many purchases. To a lesser extent, non-residents who make taxable purchases may also benefit.

Local Sales Tax Changes for Transportation

HB 4001 enacted in the 2006 4th Special Session authorizes counties to impose a new sales tax rate of 0.25% to fund certain transportation activities, including fixed guideway systems, such as light rail and commuter rail, and highway corridor preservation. This rate is in addition to previously authorized local transportation sales taxes. To date, only Salt Lake County has voted to impose the new transportation sales tax (effective April 1, 2007).

Other Local Sales Tax Changes

SB 223 removes food from the sales tax base for all local option sales taxes other than the 1.00% local option rate and the 0.25% county rate. To replace some of the resulting revenue losses for local governments, the bill authorizes certain rate increases on transportation and resort community sales taxes. SB 223 also appropriates state General Fund monies to replace lost revenue related to rural and municipal hospital sales taxes.

Table 3

Sales Tax on Food Rates

	2006	2007	2008
State Rate	4.75%	2.75%	1.75%
Local Option Rate	1.00%	1.00%	1.00%
County Option Rate	0% - 0.25%	0% - 0.25%	0.25%
Other Local Rates	0% - 2.10%	0% - 2.35%	0.00%

General Sales Tax Rates

	2006	2007	2008
State Rate	4.75%	4.75%	4.65%
Local Option Rate	1.00%	1.00%	1.00%
County Option Rate	0% - 0.25%	0% - 0.25%	0.25%
Other Local Rates	0% - 2.10%	0% - 2.35%	0% - 2.50%

Exemptions for Selected Business Inputs

The Legislature also made changes related to sales tax exemptions for business input purchases. New or expanded exemptions include manufacturing equipment and replacement parts, telecommunications and mining equipment and machinery, and dental prostheses.

What Are the Sales Tax Change Effects?

Table 4 on page 6 shows estimated tax reductions from the state sales tax on food and general rate reductions by income and family size, extrapolated from federal consumer expenditure survey data.[5]

Potentially offsetting the sales tax reductions are local sales tax increases, which may vary throughout the state depending upon the actions of local governments. Table 5 on page 6 provides estimated local sales tax increase amounts by income and family size in counties that impose the new transportation sales tax.[5]

What Are the Combined Effects of Sales Tax and Income Tax Reductions?

When considering both state income and sales tax changes enacted in 2006 and 2007, it is estimated that about 98% of taxpayers will experience a net decrease in taxes. Charts 9 and 10 on page 11 combine the state sales tax reduction estimates from Table 4 with income and family size data on income tax returns to show the estimated combined dollar changes that correspond to major sales and income tax changes enacted by the Legislature in 2006 and 2007. Potential increases from Table 5 are not included in the charts because only Salt Lake County has imposed the tax to date. In general, it appears that most single filers will receive a net tax reduction of between $50 and $200 and most married filers a reduction of between $100 and $400.

Table 4

State Sales Tax Reduction Estimated Effects

3.0 Sales Tax on Food and 0.1 General Sales Tax Rate

	Family size				
Income	1	2	3	4	5+
$0-20K	-$50	-$80	-$105	-$125	-$135
$20-30K	-$55	-$85	-$110	-$135	-$140
$30-40K	-$65	-$95	-$115	-$140	-$145
$40-50K	-$70	-$100	-$120	-$150	-$155
$50-60K	-$75	-$115	-$145	-$160	-$175
$60-70K	-$80	-$120	-$150	-$165	-$185
$70-80K	-$85	-$125	-$155	-$175	-$200
$80-100K	-$90	-$130	-$160	-$180	-$205
$100-120K	-$105	-$150	-$185	-$210	-$225
$120-150K	-$110	-$160	-$195	-$215	-$245
$150K+	-$125	-$180	-$220	-$245	-$280

Table 5

Local Sales Tax Increase Estimated Effects

0.25 General Sales Tax Rate in Counties Imposing New Transportation Tax

	Family size				
Income	1	2	3	4	5+
$0-20K	$15	$20	$ 20	$25	$ 25
$20-30K	$20	$30	$ 30	$30	$ 30
$30-40K	$25	$35	$ 35	$35	$ 40
$40-50K	$30	$40	$ 40	$40	$ 45
$50-60K	$40	$50	$ 50	$50	$ 55
$60-70K	$45	$55	$ 55	$60	$ 65
$70-80K	$55	$65	$ 70	$80	$ 85
$80-100K	$65	$70	$ 80	$90	$100
$100-120K	$75	$85	$100	$110	$115
$120-150K	$80	$85	$100	$110	$115
$150K+	$100	$115	$130	$140	$145

What Are Some Other Notable Tax Changes?

The Legislature also adopted a number of smaller tax changes in 2006 and 2007, including changes to the property tax "circuit breaker" program for low-income seniors, sales tax exemptions, business personal property taxes, transient room and other tourism taxes, and others. Below is a non-exhaustive list of other enacted tax changes, along with the year enacted and bill number. Additional information for each bill (such as the bill text and fiscal note) is available at the Legislature's website (www.le.utah.gov).

Other Notable Tax Changes

- Circuit breaker expansion (2006 - HB 55)
- Business personal property tax (2006 - H.J.R. 1 and HB 338 & 2007 - HB 25 and HB 111)
- Property tax - intangible property (2006 - SB 198 and 2007 - SB 260)
- Transient room and tourism taxes (2006 - HB 371 & 2007 - HB 38)
- Corporate and individual income tax - research and development credit & renewable energy systems credit (2007 - SB 223)
- Income taxation of estates and trusts (2006 - SB 37 and SB 38)
- Sales tax exemptions related to: amusement devices and cleaning or washing of tangible personal property (2006 - HB 51), transportation (2006 - HB 52), certain agricultural products (2006 - HB 54), isolated or occasional sales (2006 - SB 28), telecommunications equipment, machinery, or software (2006 - SB 29), semiconductor fabricating, processing, research or development materials (2006 - SB 30), manufacturing (2006 - SB 31), certain mining equipment (2007 - SB 223), and dental prostheses (2007 - SB 223)
- Local sales tax distribution (2006 - SB 35)
- Streamlined sales tax (2006 - SB 233)
- Multi-channel video or audio service tax - county or municipality franchise fee tax credit (2007 - SB 223)
- Gross receipts tax (2006 - SB 34)
- Insurance premium tax (2006 - SB 136)
- Severance tax revenues (2007 - SB 18)
- Various other tax changes

Conclusion

The Legislature made significant tax changes in 2006 and 2007, including both significant tax reductions and reform. Major changes include the adoption of a single rate individual income tax system, a sizable reduction in the sales tax on food, a general sales tax rate reduction, as well as various business and other tax changes. Counties were also authorized to impose a new sales tax for transportation.

Chart 1
State Income Tax Amounts

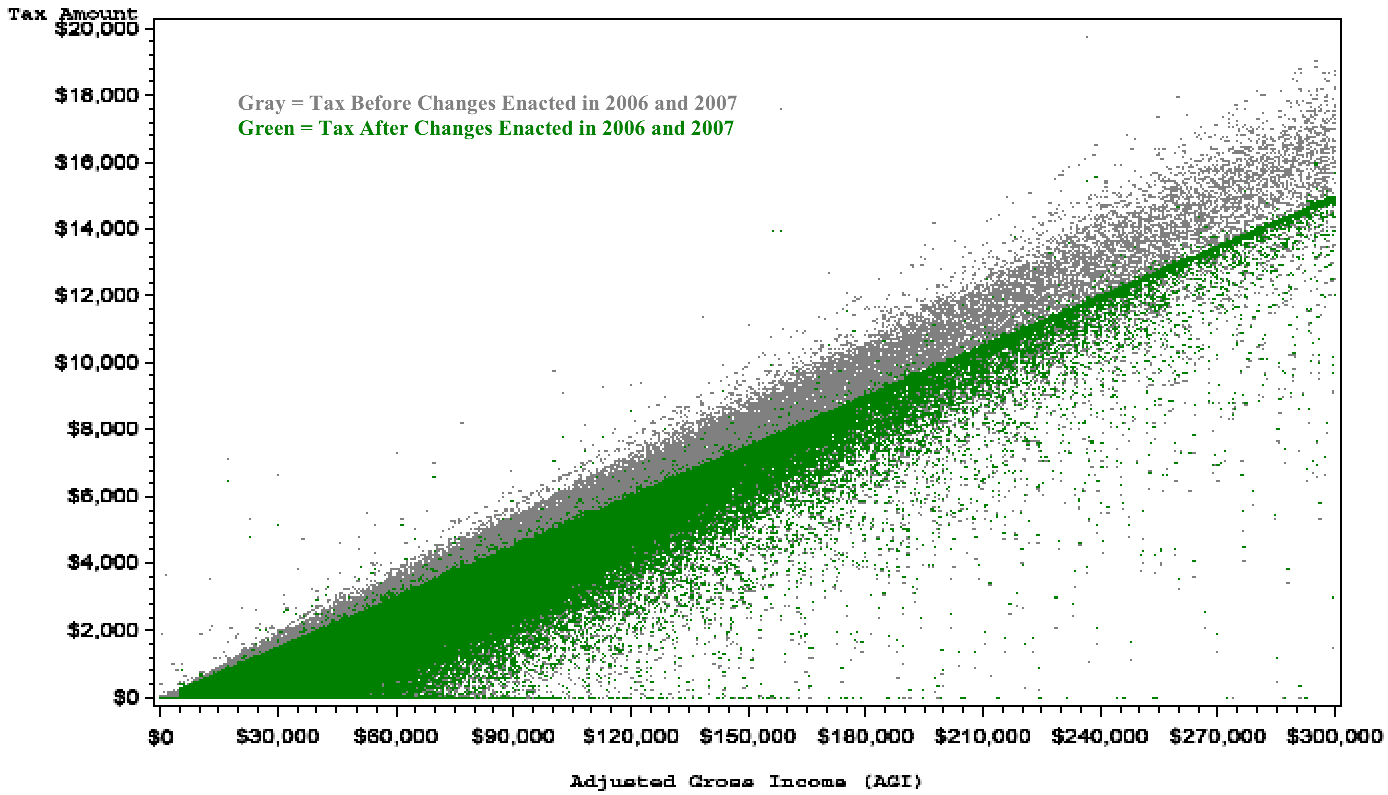


Chart 2
Effective Income Tax Rates (Tax Amount / AGI)

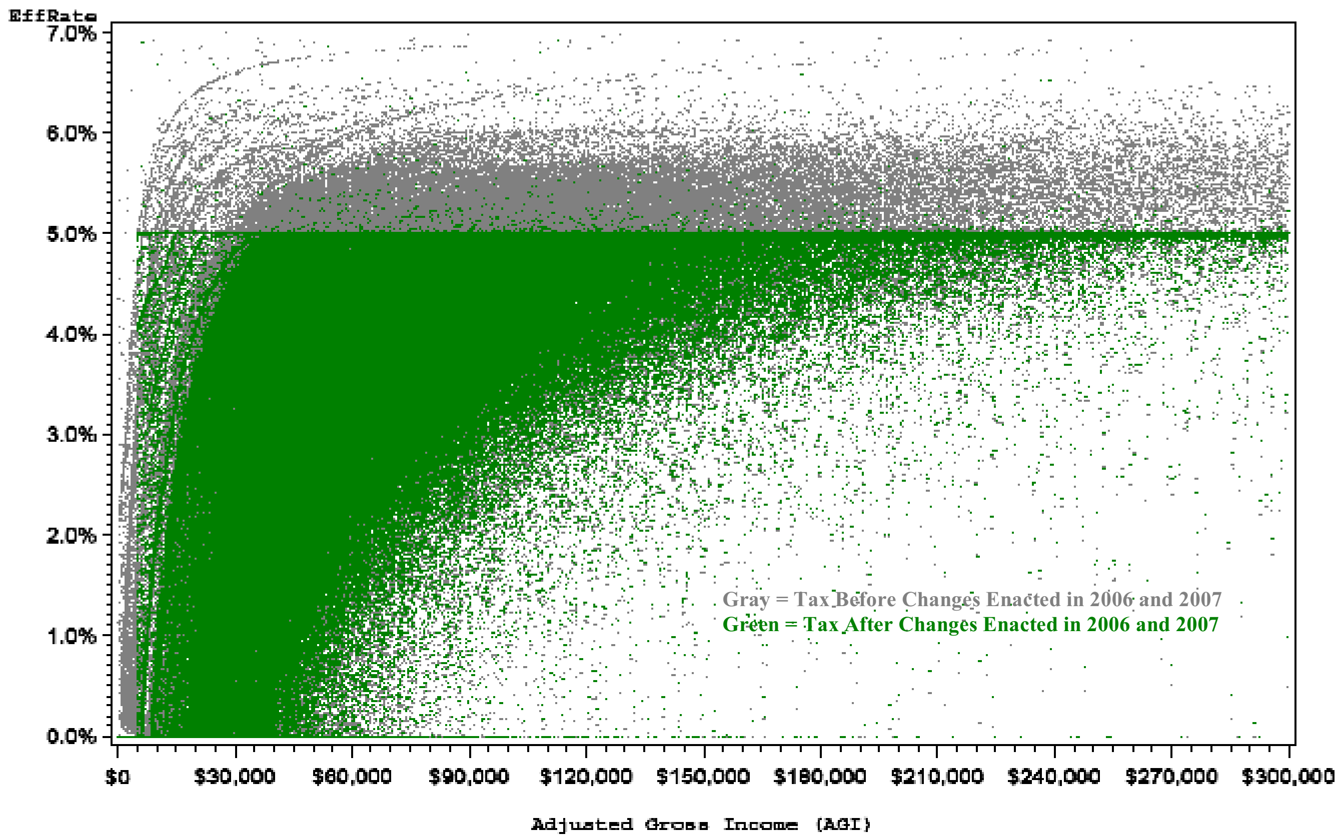


Chart 3

Estimated Dollar Change in Income Tax - Single, Head of Household, Married Filing Separately

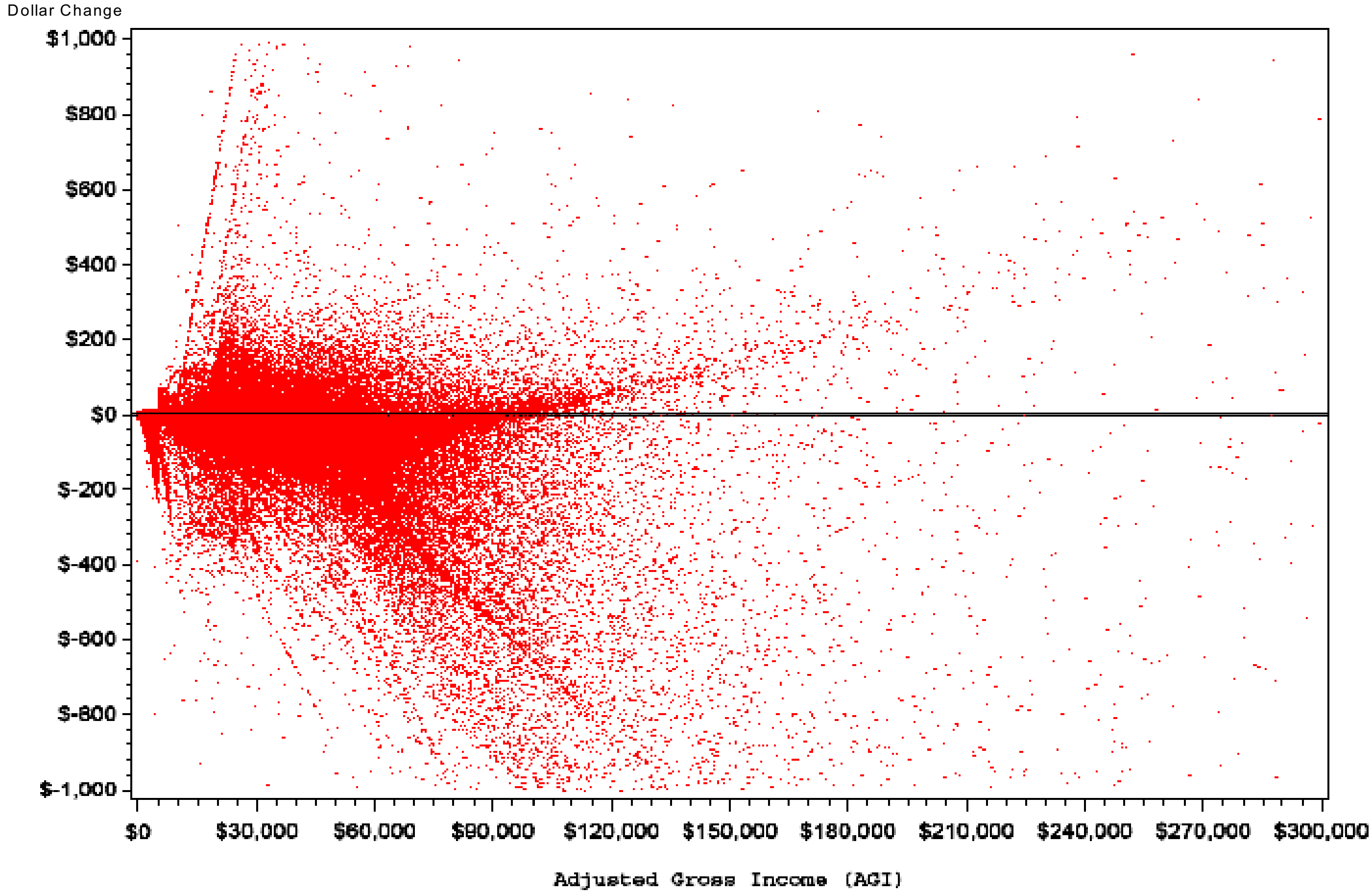


Chart 4

Estimated Dollar Change in Income Tax - Married

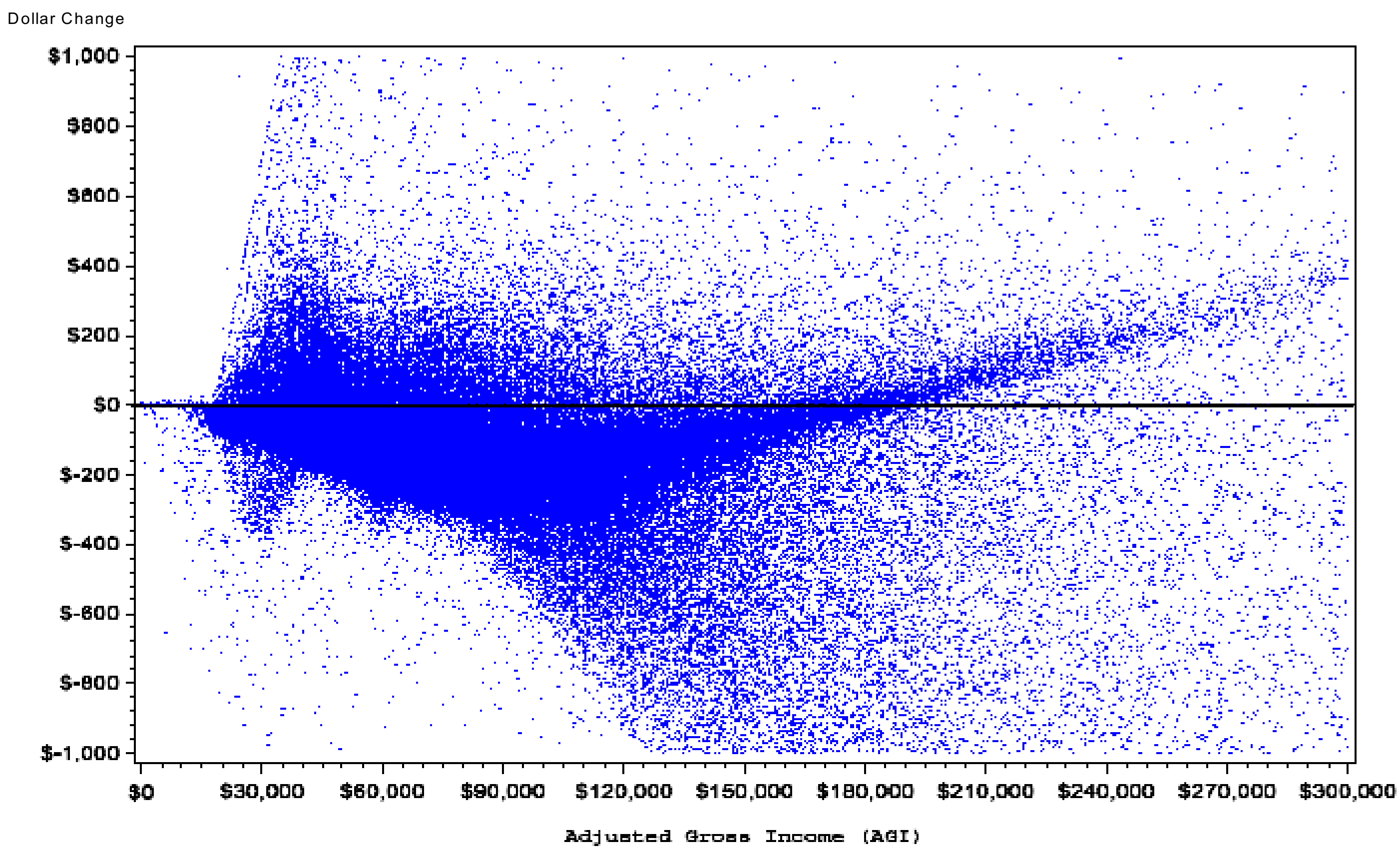


Chart 5

Estimated Percent Change in Income Tax - Single, Head of Household, Married Filing Separately

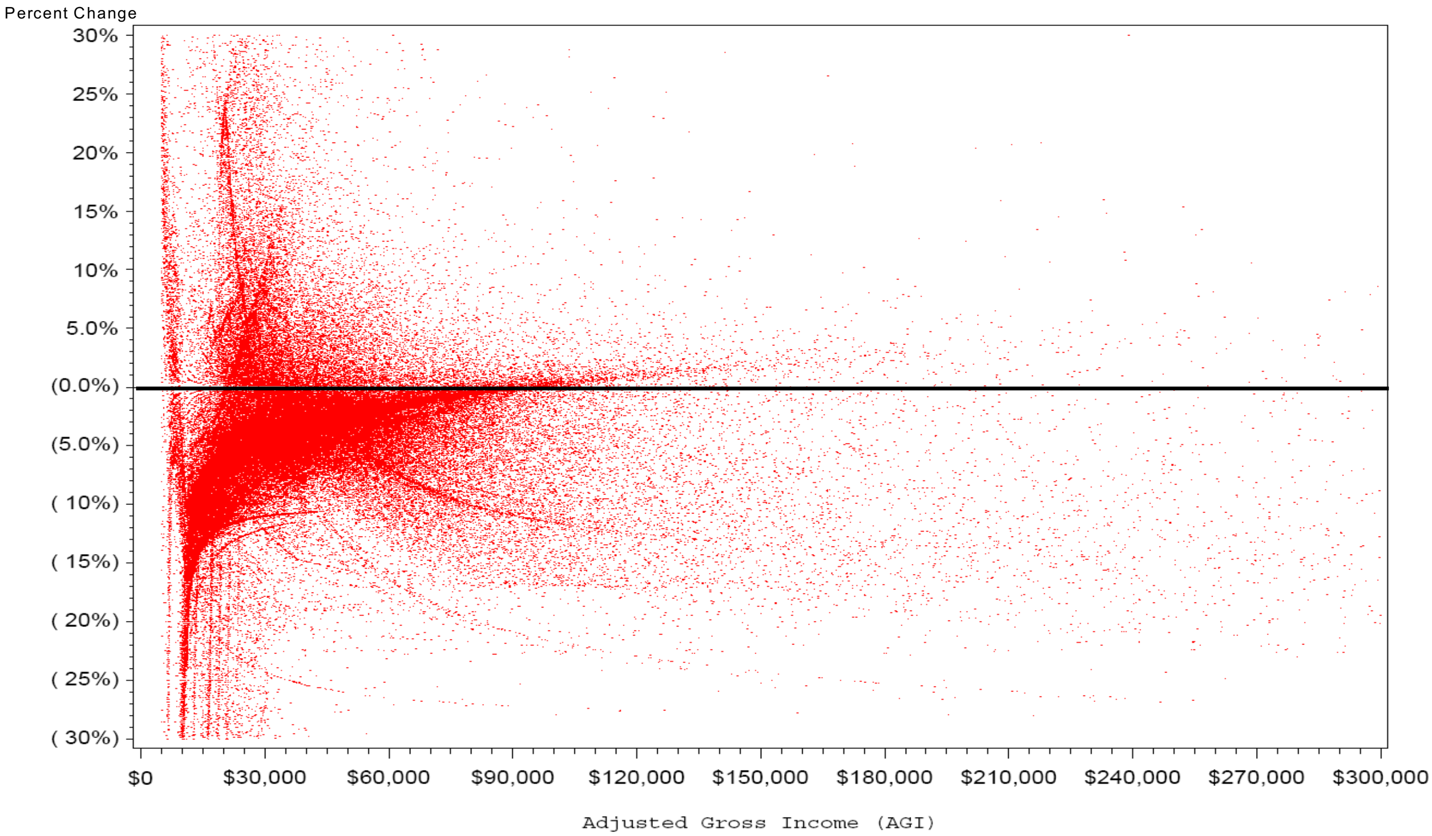


Chart 6

Estimated Percent Change in Income Tax - Married

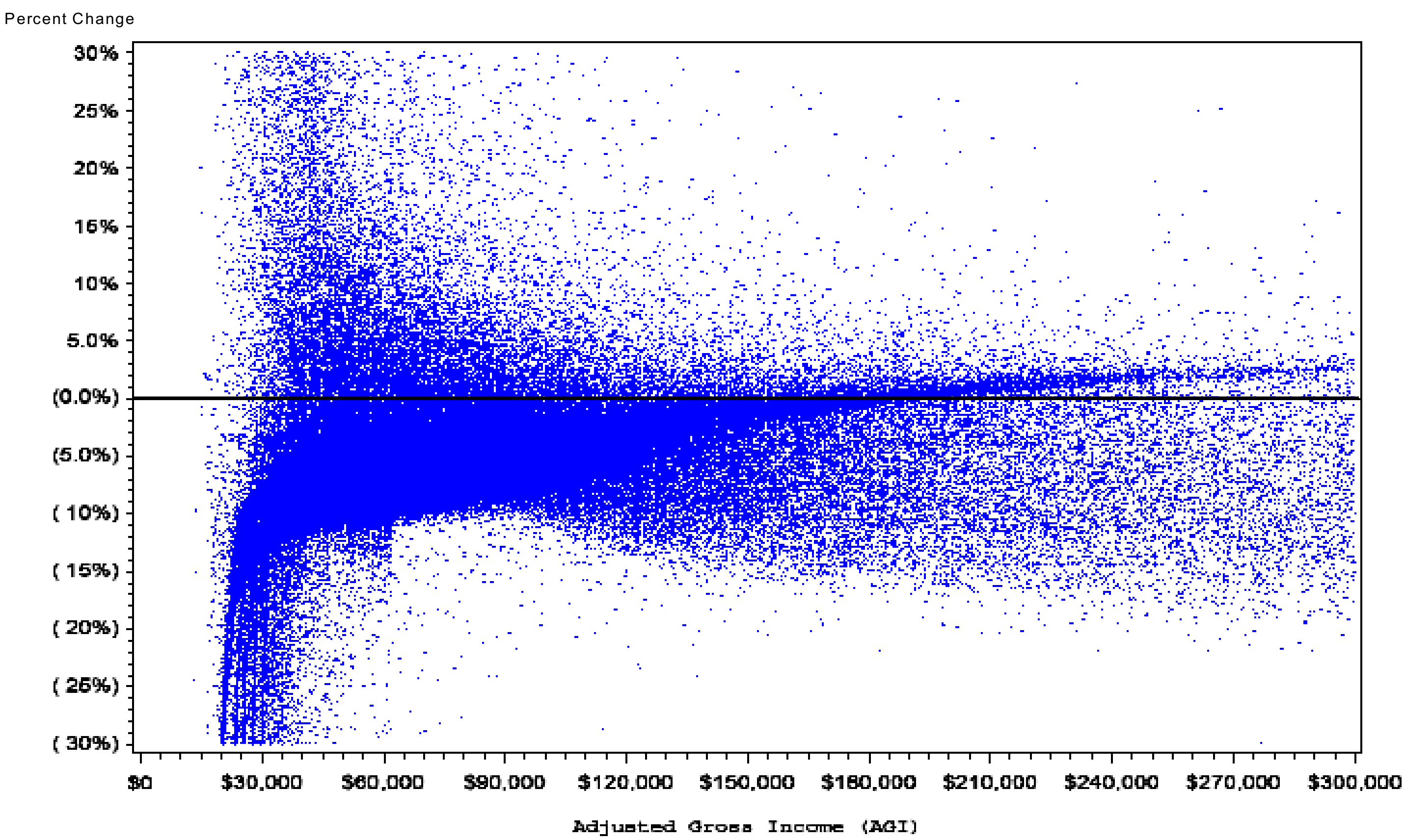


Chart 7

Estimated Effective Rate Change in Income Tax - Single, Head of Household, Married Filing Separately

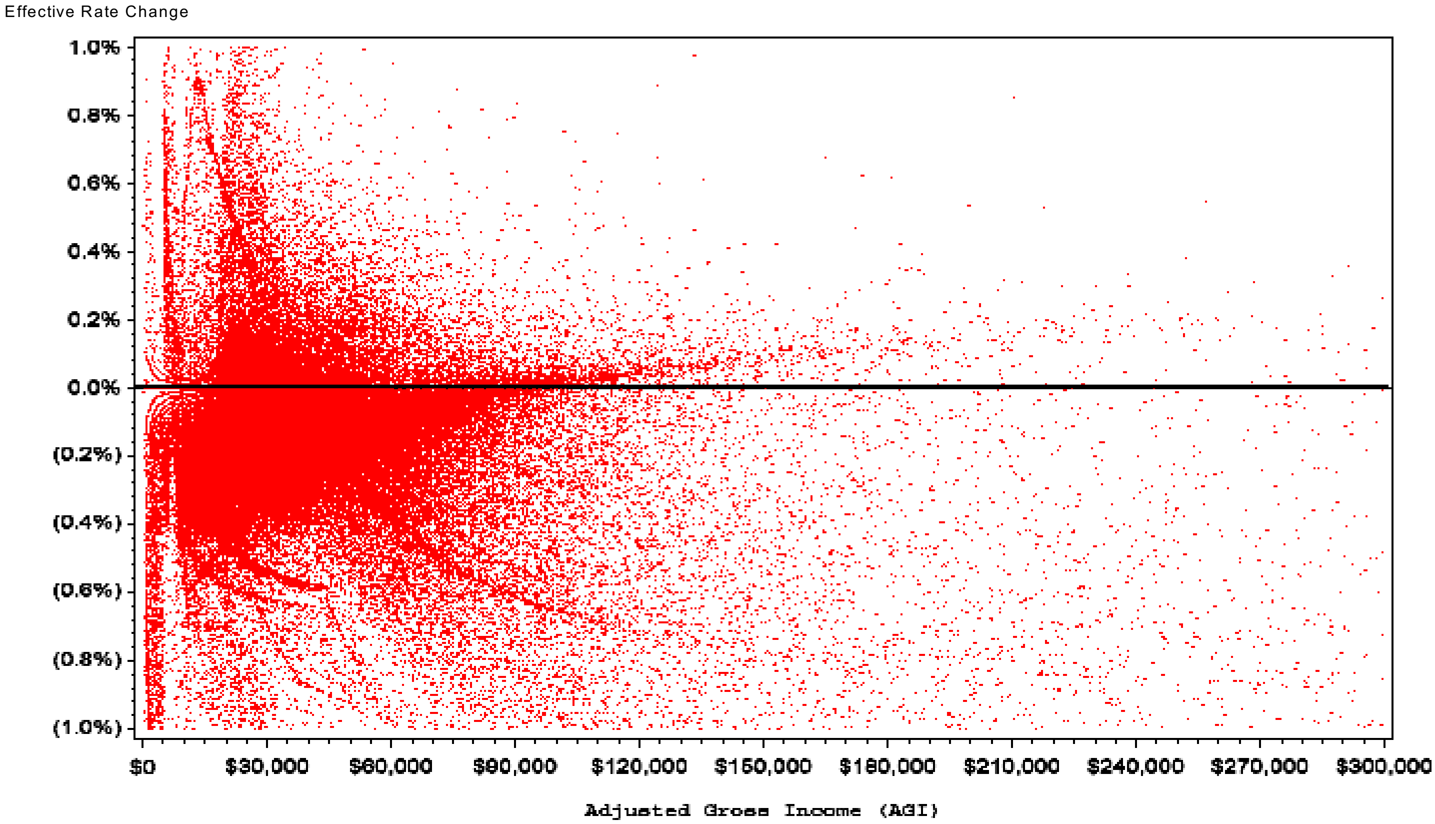


Chart 8

Estimated Effective Rate Change in Income Tax - Married

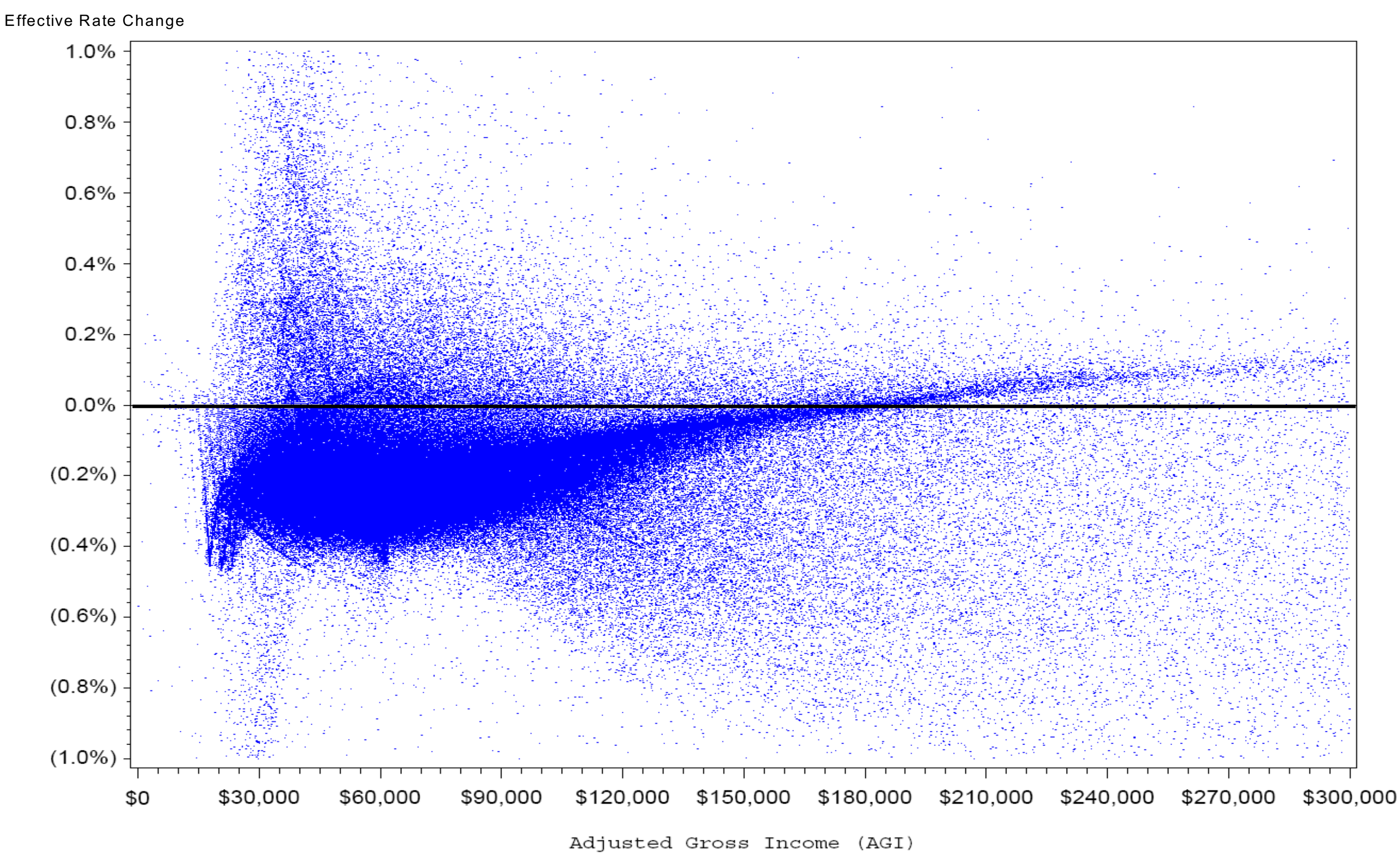


Chart 9

Estimated Dollar Change from Income and Sales Tax Changes - Single, Head of Household, Married Filing Separately

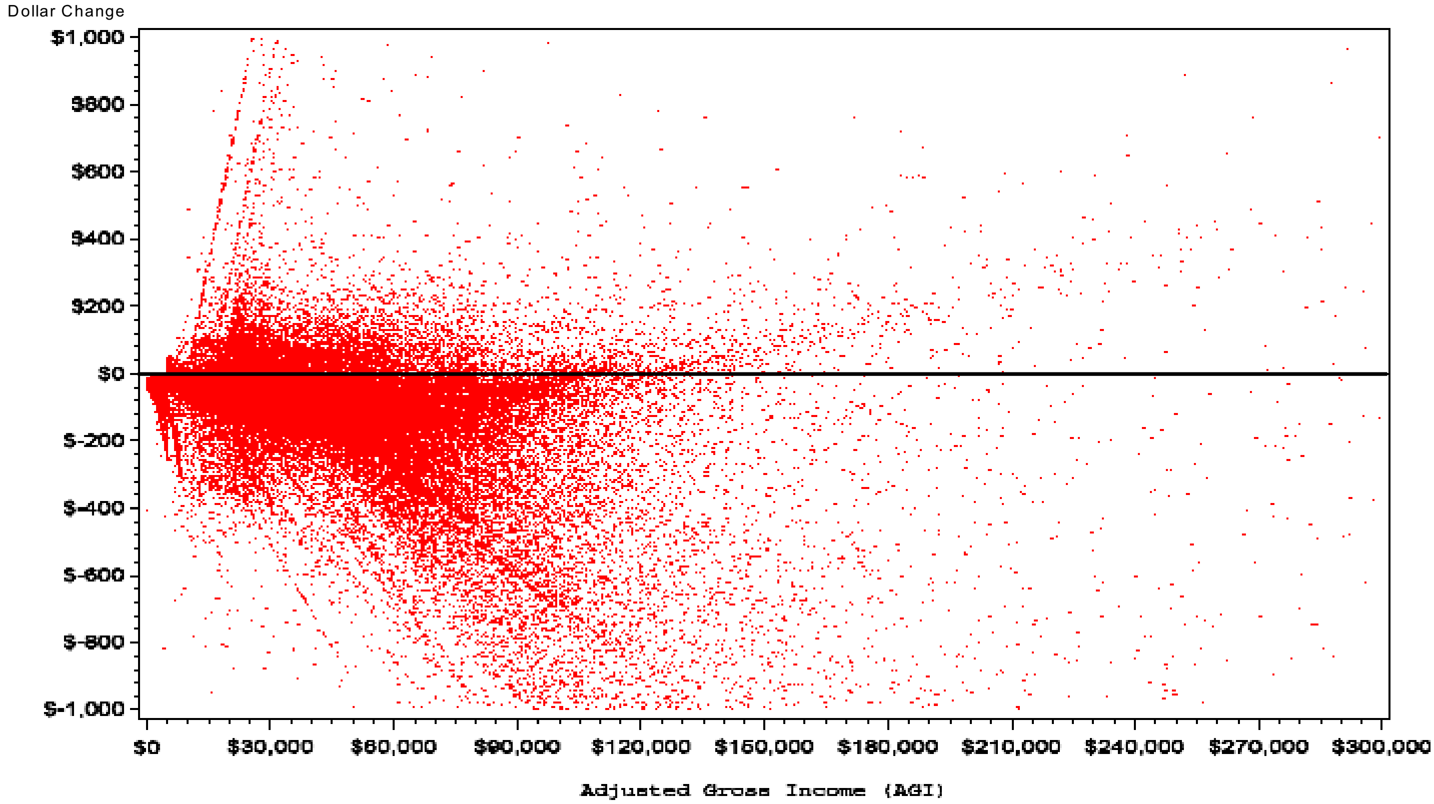
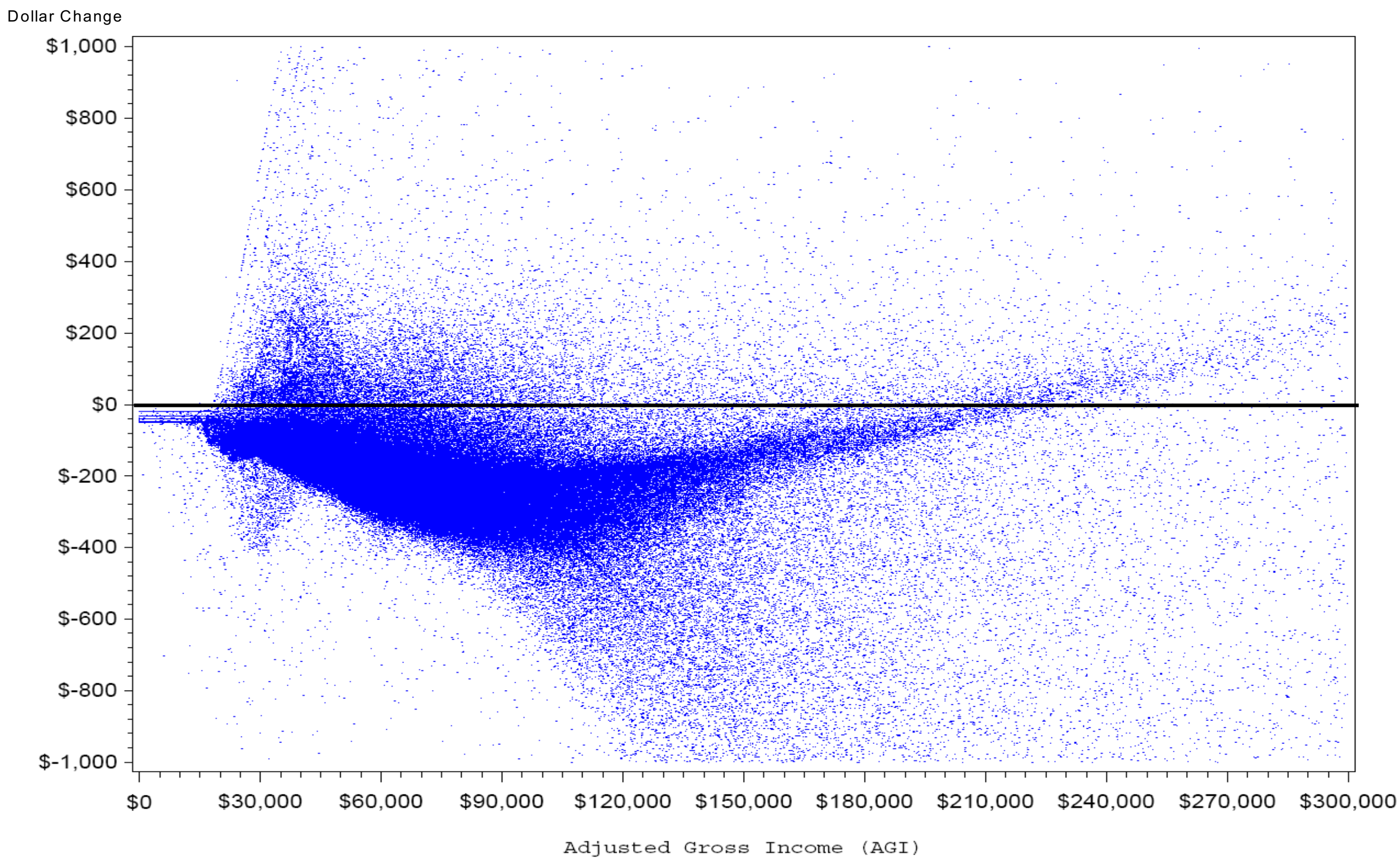


Chart 10

Estimated Dollar Change from Income and Sales Tax Changes - Married



NOTES

1. In this Briefing Paper, the generic terms "sales tax" refers to both the sales and use tax, "income tax" to the individual income tax, and "sales tax on food" to food and food ingredients, each of which are as defined in Title 59 of the Utah Code.

2. This analysis applies the enacted changes in tax law scheduled to take place in tax years 2007 and 2008 to tax year 2005 returns. No analysis of tax year 2005 returns can state precisely what will happen in the future when the enacted changes take place. Changes in income, deductions, credits, and tax for each individual return are likely, due to changes in personal circumstances and federal tax law. However, the general trends are likely to be similar between tax year 2005 and tax years 2007 and 2008 (when the enacted changes take place).

3. The standard taxpayer credit is calculated at 6% of the traditional system deductions, compared to a rate of only 5%. For some filers, this equates to a 20% increase in the value of deductions, with the extra benefit gradually decreasing for those in phaseout range. Some filers do not receive any extra benefit from this 20% increase because they pay no tax under the prior system. But some filers (generally those at lower income levels) are removed from the tax rolls under the new system because of the 6% credit calculation.

4. The state imposes the 0.25% rate in counties that do not impose this tax.

5. The federal consumer expenditure survey published by the Bureau of Labor Statistics likely provides a reasonable estimate of consumption based on income and family size, from which these tax estimates are derived. The estimates, however, should be viewed as ballpark rather than precise estimates for a variety of reasons, including possible differences in Utah and national expenditure patterns, survey sampling error, and different definitions of income and food.