

TAX MODERNIZATION

The Goal

A modern state and local revenue system that is sustainable long term, fair to taxpayers and minimizes the impact of taxes on the economy.

Key Message

The state needs to modernize Utah's sales tax in the 2019 General Session.

Background

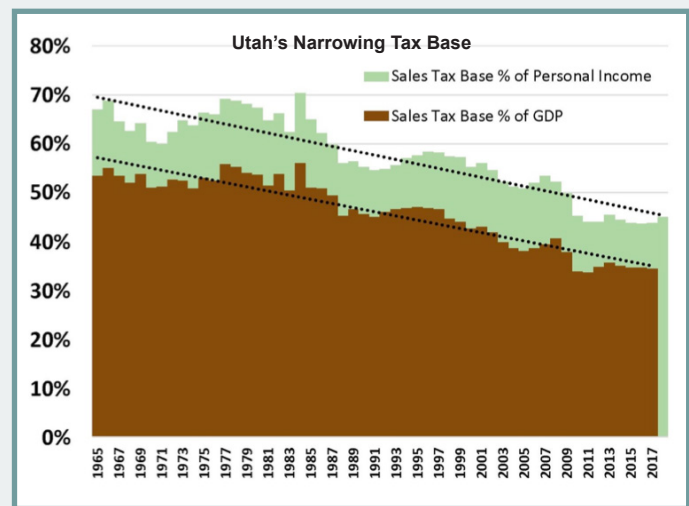
Sales tax is how most general state and local government services besides education are funded. The sales tax pays for essential services like roads, police, courts, health services and universities.

Utah's Narrowing Sales Tax Structure Puts the State on an Unsustainable Fiscal Path

The sales tax base, defined as the set of economic transactions subject to sales tax, is narrowing due to both economic changes and legislated exemptions.

Why is the sales tax base narrowing?

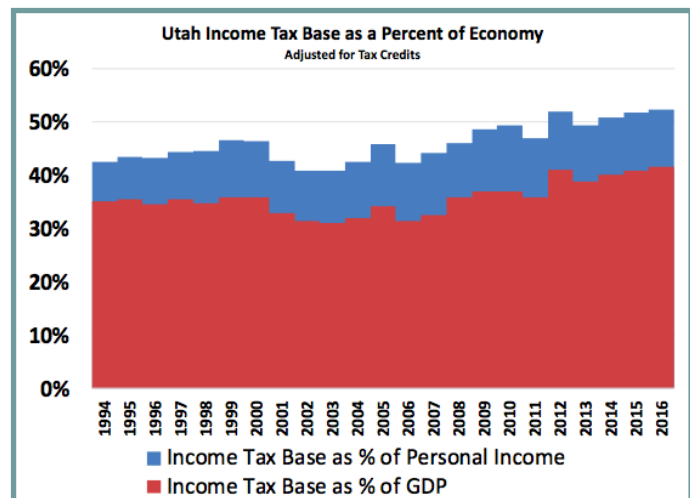
- Economic transactions covered by the sales tax constituted 70% of the economy as measured by personal income in the 1980s, but has fallen to a little over 40% today.
- The sales tax was adopted in the 1930s, when the economy was largely goods based. Today's economy is much more service based. While some services are taxed, many are not.
- In addition to economic changes, significant growth in sales tax exemptions have shrunk the sales tax base.



How Have the State of Utah and its Local Governments Responded to the Narrowing Base?

At the state level, the sales tax has historically been used to fund higher education, but the narrowing sales tax base has resulted in a funding gap. The state's practice over the past few decades to fill the gap has been to move income tax money that previously went to K-12 education to pay for higher education costs.

- The narrowing sales tax base together with a 1996 constitutional amendment allowing income taxes to be spent on higher education has impacted K-12 education by about \$800 million.



- If this shift hadn't occurred, sales taxes would have to be about \$800 million higher than they are now to support current services.

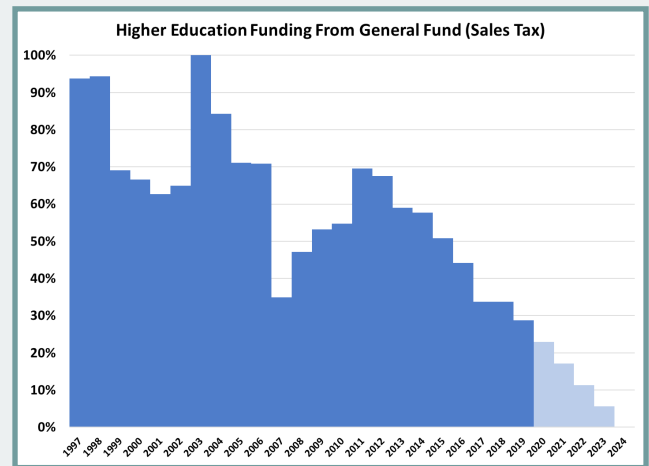
At the local level, the state continues to authorize local sales tax rate increases, primarily for transportation. Sales tax is one of the most regressive taxes. That is, middle- and low- income taxpayers pay a higher percentage of their income in sales taxes than higher-income households do. So, increasing sales tax rates pushes more of the tax burden onto middle- and low-income households.

State Fiscal Cliff

The state's ability to shift funds to cover this narrowing sales tax base will end in five to eight years at the current pace.

When this happens, the state will hit a fiscal cliff.

- Once higher education is fully funded through income taxes, the state's budget flexibility will be seriously impacted, likely resulting in future tax increases.
- On top of these sales tax challenges, the gas tax's long-term viability is highly questionable as electric cars become more common and gas cars become more fuel efficient.
- If not addressed, these changing economic dynamics in the state's tax structure could have dramatic negative effects on the state's ability to fund core services needed for a vibrant economy and high quality of life, including infrastructure, public safety and education.



Narrowing Sales Tax Base Is Unfair and Distorts Market Outcomes

- The sales tax becomes increasingly unfair as a narrowing portion of the economy increasingly bears the burden of paying for general state and local government costs. Rather than adopting the public finance standard of a broad base and low rate, the sales tax trend is for a narrowing base and higher rates.
- Utah's state and local tax system is somewhat regressive overall. This means that middle and low income households pay a higher percentage of their income in state and local taxes. Much of this regressivity of the state and local tax system as a whole is driven by the sales tax. While a moderately progressive income tax offsets some of the regressivity of the sales tax, this overall regressivity remains.
- Government intervention in the economy through sales taxes distorts market prices, and those who buy goods and services subject to the sales tax bear more of a burden than those who buy untaxed goods and services. While sales taxes are necessary, they should be broadly applied to the economy at low tax rates.

PROPOSED SOLUTION

Lower sales tax rate while broadening the sales tax base to better reflect the modern economy.