January 2019

Volume 44 Issue 1

THE UTAH TAXPAYER

A PUBLICATION OF THE UTAH TAXPAYERS ASSOCIATION

Following 2018 Successes, Utah 2.0 Moves into the Next Phase

In 2018, your Taxpayers Association gained major success for our legislative initiative, Utah 2.0, including eliminating the three-year sales tax penalty and the expansion of single sales factor.

As a reminder, the expansion of single sales factor, accomplished in House Bill 293, moves key industries in Utah to single factor apportionment when calculating corporate income taxes. This is a key element of Utah 2.0, the Association's legislative initiative to boost economic output for decades to come.

The calculation increases the emphasis on sales within the state while decreasing the emphasis on property and payroll when determining a business's income tax. This method incentivizes companies to invest their payroll and property in Utah and produce products that sell nationwide. This calculation method is expected to be a $27.8 million tax cut when fully phased in.

Meanwhile, in July, the elimination of the three-year life sales tax penalty was funded in its entirety, via SB 2001. This legislation was a result of the Wayfair Inc. vs. South Dakota ruling the Supreme Court issued in June of 2018 dealing with remote sales taxes. The bill put a structure in place for Utah to begin requiring out-of-state online retailers to collect and remit sales taxes to the state of Utah.

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JOIN US for the
2019 Legislative Outlook Conference on
January 7, 2019

The annual Utah Taxpayers Association's Legislative Outlook Conference will be held on January 7, 2019. The event will begin at 8:30 a.m. at the Little America Hotel, located at 500 S Main St., Salt Lake City.

Hear from Utah Governor Gary Herbert on his tax modernization proposal, legislative leaders will discuss tax issues, and other tax experts on what you can expect during the 2019 General Session.

Sponsorship opportunities are available.

To RVSP, please contact Bren at (801) 972- 8814, bren@utahtaxpayers.org or head to our website, www.utahtaxpayers.org.

JANUARY 2018
VOLUME 43

My Corner: Will the Legislature Allow Automatic Yearly Property Tax Hikes?

Association President
Howard Stephenson

The 2018 General Session of the Utah Legislature yielded a compromise between promoters of the Our Schools Now (OSN) initiative and the Legislature which may have resulted in annual property tax hikes for Utah taxpayers. OSN had initially proposed raising the sales and income tax to the tune of an additional $700 million for public education.

The hike on the ballot which would have produced $125 million annually in taxes for highways, freeing up that amount in General Fund sales taxes previously earmarked for roads to be earmarked instead for schools.

Voters rejected the gas tax for schools by a two to one margin. It is unclear if the original initiative calling for a $700 million combination of sales and income tax hikes would have fared better, and it is equally unclear whether the overwhelming rejection of the gas tax for schools failed from lack of support for education or disbelief that the funds would have actually made their way into the schools.

Automatic Property Tax Hikes

Despite voter rejection of the gas tax portion of the OSN compromise, there is a separate property tax hike component of the compromise which lives on and could haunt legislators and taxpayers for decades to come.

House Bill 293 – Tax Rebalancing Revisions accomplished a freezing of the statewide basic property tax rate for education at .0016 to provide $125 million by FY 2023.

These revenues would fund greater property tax equalization for school districts with low assessed valuations per student. Prior to this amendment the statewide school tax rate would drop annually to ensure that reappraisals of existing properties would not generate net higher tax revenues.

WPU Value Index = Property Tax Hikes

Another element of HB 293 is the Weighted Pupil Unit (WPU) Value Index which requires additional property tax hikes to maintain a ratio of 85% income taxes to 15% property taxes in funding the WPU. This means that for every 1% (or $32 million) increase in the WPU would require a hike in statewide property taxes of $4.7 million (15% of $32 million).

However, legislators can minimize these automatic property tax hikes by putting more education funding in ways that don't increase the value of the WPU. Instead, the number of WPUs could deliver more money to education without increasing property taxes. This could be accomplished several ways including putting more funding into flexible allocation, equalizing voted and board property tax levies, funding student enrollment growth, funding targeted programs which increase the numbers of WPUs for high needs students.

Voted Levy property tax caps for eleven of Utah's 41 school districts were also raised in HB 293 from .0018 to .0025 per dollar of taxable value which is the current cap for 30 districts. This means that over the years ahead taxpayers in these districts could experience voter approved tax hikes which previously were not possible.

The Good Part of HB 293

As its title suggests, HB 293 – Tax Rebalancing Revisions did more than increase property taxes for public education. The one very positive feature of the bill was the completion of single sales factor weighting of corporate income taxes. This is intended to encourage job growth by ensuring employers who bring their payroll and capital investments to Utah and sell most of what they make out of state they would pay virtually no income taxes.

We will be fighting in 2019 to disconnect WPU increases to use funding in additional ways in order to prevent automatic property tax hikes.

Following 2018 Successes, Utah 2.0 Moves into the Next Phase (continued)

The legislation also changes the effective date for the manufacturing sales tax exemption, nicknamed the 3-year-life bill around the Capitol. In March of 2018, your Taxpayers Association passed legislation to trigger the sales tax exemption based on when the state collects $55 million in online sales taxes (our hope was the Supreme Court would rule the way it did to allow states to collect the taxes).

Thanks to the work of former Senate President Niederhauser, that trigger was amended and passed in the special session. Now starting at the beginning of this year, the manufacturing sales tax exemption will go into full effect.

But our work is not done. We have identified more work to do during the 2019 Session, and have incorporated them into the new Utah 2.0 proposal.

Elimination of the Double Taxation on Personal Property Tax

Utah small businesses have faced a heavy burden in accounting for all tangible personal property used during the process of creating a final, consumable product. Businesses are required to account for, then pay property tax on those items, which can range from gears used by manufacturers to silverware in restaurants. In addition, small businesses must pay the sales tax on the purchase of the personal property and then pay property taxes for years into the future.

Businesses have to account for every item in their possession, then match them to find what "class" they belong to. There are 17 classes of items that the Utah State Tax Commission identifies.

Following this, the business owner must then calculate the depreciation of each item, as outlined by the Tax Commission. For example, office furniture has an 8% depreciation if purchased in 2018.

After the owner classifies and calculates depreciation, then the property tax must be paid on the item. Tangible personal property is exempt if the property has a total aggregate fair market value of $10,300 or less.

Many of our members have told us that this is an extremely burdensome tax, and have asked us to push for elimination of it. Throughout the summer, your Taxpayers Association has been explaining the issue to legislators, and are pleased to report that the Revenue and Taxation Interim Committee unanimously passed a proposal for the total elimination of personal property taxes on small businesses.

Lowering the Income Tax Rate

Following action taken in 2018, the statewide income and corporate franchise tax was lowered to 4.95%. Your Taxpayers Association continues to call on the legislature to lower the statewide income and corporate tax as it is a significant factor in decisions that companies make when looking to expand or relocate.

The call becomes more urgent, however, as ideas are raised to expand the base of the sales tax to include services. These services can range from a landscaping service or a haircut to legal and health care professions.

While there isn't a target number of newly generated revenue due to a lack of specificity in the proposal, we strongly believe the legislature, if they are to expand the sales tax base, should cut the income tax by an equivalent amount. This prevents growth in government, which the legislature has generally agreed to, including following the collection of remote sales taxes.

Expanding the sales tax base should not increase net tax revenues, but should be used to stabilize the sales tax base and insulate it from economic peaks and valleys.

Even if the Legislature does not make the move to expand the sales tax base, Utah's income tax rate should be lowered following increased property and sales taxes from the past few legislative sessions.

Keeping the Promise

The Legislature is expected to keep its promise, made in 2013, to ensure that $200 million in new tax revenue from the U.S. Supreme Court decision on Wayfair, Inc. will be used to cut taxes dollar for dollar.

In 2013, Sen. Harper's sponsored legislation that would force the legislature to keep the promise, and in 2016's SB 68, canonized the legislature's agreement that when the new revenues flow from collecting from remote sellers, Utah would not use the estimated $200 million to grow government but would instead reduce taxes correspondingly. It was clear that the Utah Legislature would not have passed the legislation without the promise that it would not result in a net tax increase. Senator Harper said that in the special session the legislature cut taxes by $85 million through family income tax reductions and elimination of the three-year life sales tax penalty on manufacturing and mining. "We're part way there," he said, "we still have a cut of $115 million to make in the next General Session."

The 2018 Legislature has already cut $85 million of the $200 million and is expected to lower other taxes to fulfill the remaining $115 million promise. $55 million was from the elimination of the three-year life sales tax penalty, while an additional $30 million was to offset a tax increase on larger families, following federal tax reform passed in December of 2017.

Aligning Utah's Workforce to the Needs of Utah's Employers

Utah taxpayers and students are paying more than $2.3 billion annually for state funded higher education.

Unfortunately, more than half of that goes for non-completions and of those who do complete, more than half cannot get a job in their field of study. Your Taxpayers Association will be lobbying for greater alignment of higher education spending with Utah workforce demands.

Because Utah's System of Higher Education and Utah Technical Colleges are not supplying sufficient numbers of trained workers, Silicon Slopes and other high-technology industry employers simply don't have the supply of trained workers they need. This results in companies recruiting from their neighbors.

Your Taxpayers Association is working with the Utah Technical Colleges in supporting their request for a $7 million appropriation to handle bottlenecks in high wage, high demand technical certificates. We will be working with legislative leaders and the Higher Education Appropriations Subcommittee to advocate for greater accountability for the immense resources currently going into the system.

We will also be supporting legislation by Senator Ann Millner which would ensure college students receive credit for competencies students bring with them rather than being forced to sit through classes for which they already have expertise. Her stackable credentials legislation is already providing students with the on and off ramps they need to easily move back and forth between employment and education.

Moving Forward into the 2019 General Session

Over the past few weeks, your Taxpayers Association has brought these issues to light with each of the new Revenue and Taxation standing committee chairs and vice chairs, as well as various members of both House and Senate leadership, and the governor's office.

We had very productive discussions with each of them and are encouraged by their willingness to listen to our ideas and to participate in the solutions.

You can hear from each of these standing committee chairs, as well as the governor and legislative leadership on these issues at our Legislative Outlook Conference on January 7, 2019. Register by emailing bren@utahtaxpayers.org.

Expanding the Sales Tax Base: Whose Ox Gets Gored?

Governor Herbert's Fiscal Year 2020 Budget proposal was released in December of 2018. It contained major structural changes to Utah's sales tax code and some significant suggestions in dealing with taxation in Utah.

The boldest suggestion would broaden the sales tax base while lowering tax rates. While we have concerns regarding some of the specifics, his proposal strongly correlates with the Taxpayers Association's principles of sound tax policy. Our immediate priority is lowering the income tax rate to offset any broadening of the sales tax base. The governor's proposal advocates lowering the sales tax rate to offset the broadening of the base, however we feel strongly that lowering the income tax rate is a much better alternative. Cutting the income tax rate spurs economic growth for all taxpayers, and simply cutting the sales tax rate does not.

A report, released by the Kem C. Gardner Policy Institute went into detail on what Utah is facing regarding the erosion of the sales tax base, the risks it poses to Utah and reviewed possible solutions. The report can be found here.

The study documents the sales tax base as a percentage of personal income has eroded from 62% in 1980, to 42% today, with a forecasted drop to 35% by fiscal year 2027. This is in line with the national drop in spending on goods versus services. For example, in 1960, 53% of expenditures were on goods and 47% on services. Today, those statistics have flipped to approximately 31% on goods and 69% on services. We simply don't buy as many taxable goods and buy much more in services. That is a significant problem for the state's budgeting and taxation system which is heavily dependent on balancing the three-legged stool of income tax, property tax and sales tax.

The solution proposed in this report is threefold. First, reduce or limit government expenditures that are funded by sales taxes. Second, lower sales tax rates, and third, broaden the sales tax base. The report recommends a mix of all three. The Utah Taxpayers Association strongly recommends reducing the income tax rate as a far better alternative to reducing the sales tax rate to offset the taxation of services.

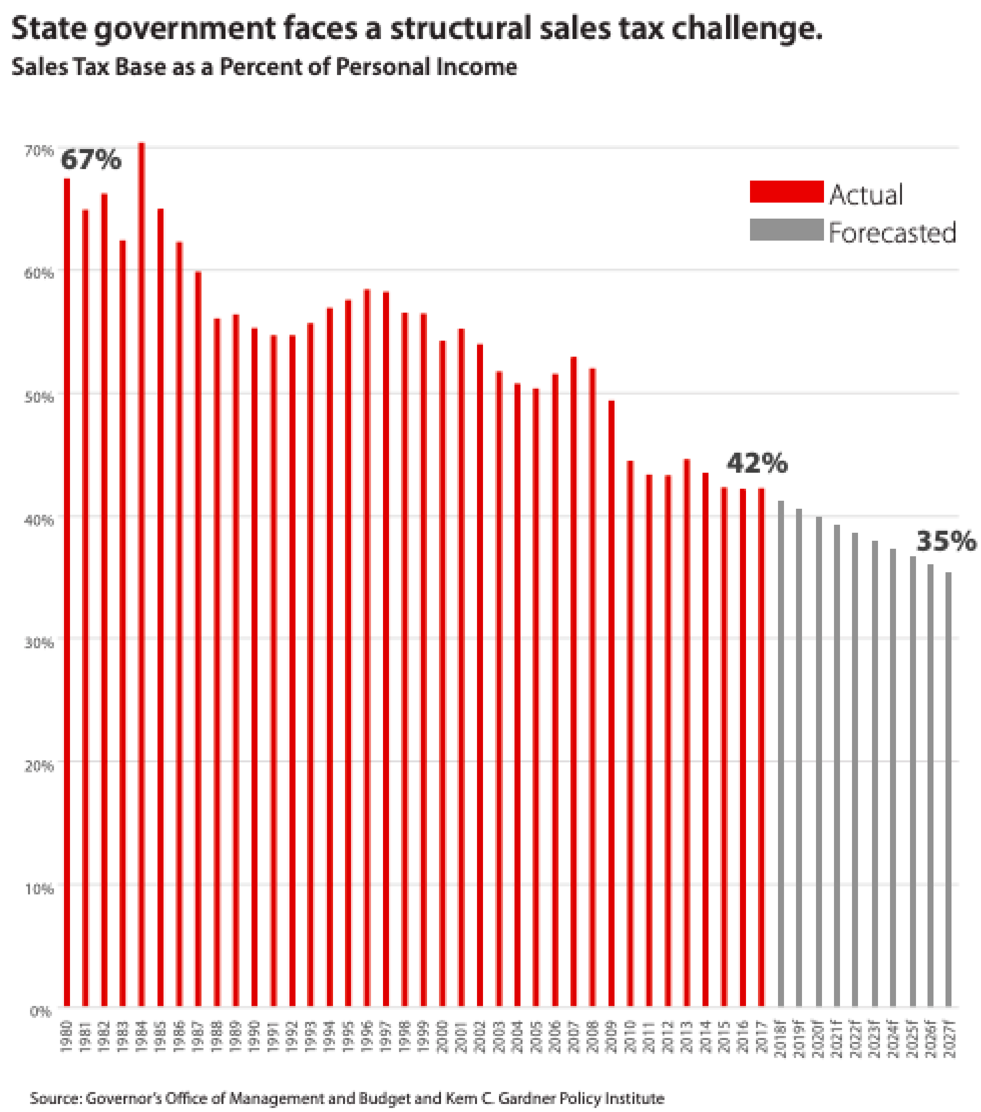
The real battle in this debate would be - Which services will make the list of taxable services? Utah is about in the middle of the pack when it comes to how many services we levy a sales tax on compared to other states, charging sales tax on 64 services.

We haven't found any information from any source as to what specific services might be put into the mix, which could include health care, accounting, and legal services. However, the report did mention several categories as "major areas of the economy that are excluded from the sales tax base. They listed the following:

- Prescription drugs and medical equipment/devices
- Health care services
- Legal services
- Accounting services
- Construction and real estate services
- Personal care services (haircuts, massage, tanning, etc.)
- Property services (landscaping, cleaning, repair, etc.)
- Transportation services

Some of these services are large parts of Utah's economic engine and one would have to ask which services would generate enough tax revenue to move the needle on broadening the base.

Your Utah Taxpayers Association is actively engaged in this debate and will be focusing our main priorities this session on making sure that any broadening of the base is offset by a dollar for dollar reduction in tax burden so this effort does not turn into a chance to grow government once again.



Cannon's Canon: Recession Coming? Always Listen to Jonathan Ball and Bond Traders

Legislative Fiscal Analyst, Jonathan Ball, made some very prophetic comments during budget discussions in November. He noted that the signs we are seeing now in the economy and in state revenues are eerily similar to what occurred before the 2008 economic downturn. For example, state revenue spiking and a revenue growth rate of 10%, double the 5% growth rate of the state economy. He also noted that ¾ of the spike in revenue is coming from income taxes. Typically, the growth rate of income and sales taxes are more similar. Ball counseled Legislators to not count on the revenue spike being sustainable and suggested that significant portions of the revenue be used for one time purposes such as paying down debt and paying cash instead of bonding for state building projects, including the new state prison.

After hearing about the very prophetic comments by Jonathan Ball, I remembered a lesson I learned about a decade ago that I try to never forget. Back in 2007, while I was working in the investment advisory world, I one day found myself paired with a bond trader at a golf event at a conference in Florida. At the time, the economy was still firing on all cylinders and only the slightest of hints from various markets would have given you any idea that a recession was coming. At one point, I mentioned to him that I used to work for Merrill Lynch. He immediately shot back with- "Merrill is going to go bankrupt."

I couldn't believe what I was hearing. Merrill Lynch at that point was the largest and most powerful brokerage firm in the United States. How in the world could anybody make such a brash and confident prediction about an economic juggernaut like Merrill Lynch? After gathering myself I asked him what led him to say that. As it turned out, he not only traded bonds, he was a rare breed. He traded complicated and often misunderstood mortgage bonds. The market had been flooded with them over the previous several years as the housing bubble went on and on. He traded for another firm but dealt with all of the major firms every day. He proceeded to describe the massive levels of leverage Merrill had used to get up to its eyeballs in massive mortgage bets that were totally toxic in his opinion and "when the music stops on those, it's game over".

Much to my dismay I completely ignored his warning. I went along with the rest of the world and merrily whistled my way into the buzzsaw of 2008 along with everyone else. In the not too distant future from there, along with many other financial institutions, Merrill Lynch essentially went bankrupt in the fall of 2008. It was technically saved from doing so only when Bank of America bought it for a pittance on death's doorstep.

So why do I tell that story? Hearing what Jonathan Ball said the other day, I remembered the valuable lesson I learned that day back in 2007 – "ALWAYS LISTEN TO THE BOND GUYS".

The bond markets are made up of the most brilliant minds on the planet because the amounts of money that are at stake are astounding and the result of getting things wrong can be catastrophic for financial institutions and even governments.

One of the indicators on what the bond markets are thinking is something called the "yield curve". Simply put, it is the various yields on short term bonds all the way to long term bonds graphed on a curve. Typically, you earn a low amount of interest on short term bonds and a higher amount of interest on long term bonds. So, when you plot those yields on a chart, the slope of that line should be upward as you move out from short term to long term. However, from time to time that curve "inverts", where some longer-term bond yields become lower than short term bonds.

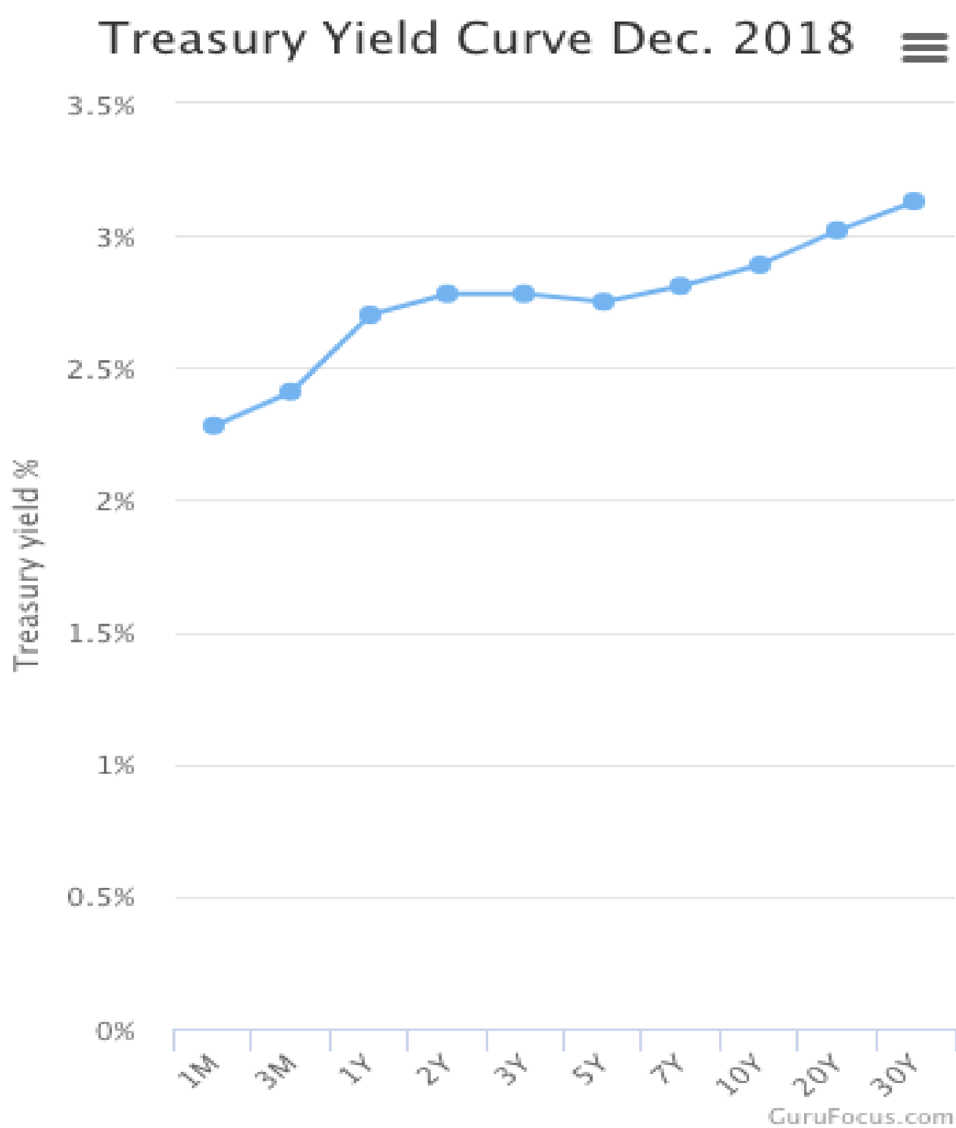
The yield curve inverting has typically been a reliable indicator that an economic slowdown is coming. In fact, the yield curve has inverted before every one of the last seven recessions. The recession typically comes much later however (the last recession came more than two years after inversion- inversion was first in December of 2005).

There is no perfect economic indicator, and there are many other factors to consider. For example, the spot on the yield curve that is inverted is different than what has been typically looked at and the yield curve has been slowly moving towards inversion for the last several years.

Nevertheless, it is inverted.

Also, some recessions have been brief, some long, some with soft landings, and of course the most recent one in

2008, where things got really bad really fast. Before you run for the hills, you might want to also consider another Wall Street saying that could be applicable now as well: "The market can stay wrong a lot longer than you can stay solvent". However, if you follow the lesson I learned years ago, you might want to pay attention to what the bond market is telling us and pay attention to what Jonathan Ball prophetically observed: a slowdown could be coming.



Association Accomplishments During December:

- Met with Senate President Adams to outline 2019 tax priorities
- Discussed with new Revenue and Taxation chairs and vice chair about Utah 2.0 (2019)
- Planned the 2019 Legislative Outlook Conference
- Meet with Utah County Commissioners regarding a proposed property tax increase
- Stopped the Utah County proposed property tax increase

In the News

- Governor Herbert Releases His 2019 Proposed Budget
  - Governor's 2019 Proposed Budget Calls for Taxation Modernization Deseret News
- Utah County Proposes Property Tax Hike
  - Utah County Commissioners Meet to Discuss Property Tax Hike KUTV