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Tax Restructuring and Equalization Task Force Begins to Weighs Options, Examines Food Sales Tax and Reducing Income Tax

After eight town halls across Utah, the Tax Restructuring and Equalization Task Force began to weigh its options in August. Your Taxpayers Association attended seven of those town halls and is participating in all remaining Task Force meetings.

In its August 19 public meeting, it was obvious Task Force members were taking their work very seriously. There was almost perfect attendance and members stayed until the end after 3 hours of intense study. The Task Force released its listening tour report, and results from the more than 1,500 attendees and hundreds of comments which were somewhat mixed.

This word cloud, provided by the Tax Restructuring and Equalization Task Force, shows common comments given to the Task Force throughout the touring town hall phase.

As you can see from this word cloud produced by the Task Force, many people were opposed to taxing certain services and wanted better control of spending.

According to the report, many people mentioned that they were not convinced with the Legislature's argument that a change as dramatic as was proposed during the 2019 Session is necessary. Generally, people were opposed to an increase in taxes, which both the Legislature and the Governor have agreed to.

The report also details that many attendees and comments were strongly opposed to sales tax on services, with an emphasis on avoiding tax pyramiding. However, others were not entirely opposed to the sales tax on services, as long as it only impacts final consumption, in order to avoid business-to-business transactions. This has long been a call from your Taxpayers Association, and we continue to beat the drum to ensure that tax pyramiding is avoided at all levels.

If you're interested in learning more, you can read the report here.

The Task Force also began weighing options for tax reform, based on public comment and discussions during the 2019 Session, unveiling these eight guiding principles:

- Competitive
- Sufficient
- Sustainable
- Stable
- Flexible
- Fair
- Simple
- Transparent

Your Taxpayers Association is very encouraged by these principles, which align with ours.

The first of the possible solutions the Task Force discussed was restoring the sales tax on food. Unprepared food items are taxed at a lower state sales tax rate, currently 1.75%, as compared to the general sales tax rate of 4.85%. Your Taxpayers Association has long believed that this is a necessary change the Legislature ought to make, and are encouraged by the Task Force's discussions.

Restoring the food sales tax will not only create a stable source of sales tax revenue, but it will also ease compliance for retailers, who have to classify each item in their inventory based on certain criteria set by the Legislature.

If the Legislature were to restore the food tax to the full state rate, it would generate roughly $250 million in sales tax revenue annually, beginning in FY 2021.

The sales tax is generally seen as regressive, with lower-income people paying more of their income on food. However, the tax break on food also helps the wealthy far more than the poor. Those that spend higher dollar amounts on food are banking a significantly higher tax break than those who spend less. Restoring the full sales tax on food corrects this benefit that is largely going to higher income individuals. Also keep in mind, those on SNAP or other government benefits are exempt from the tax.

In order to protect the working poor, Utah could enact a grocery tax credit, which could be claimed through the income tax filing. Of the 7 states that have their populations pay the full sales tax rate, four provide some kind of tax relief in this way.

If this were to be enacted along with restoring the sales tax on food, that grocery tax credit would return $65 million to qualifying taxpayers, considering a single filer makes less than $30,000, and a married-filing jointly less than $60,000.

Another option the Task Force heard was the possibility of enacting an Earned Income Tax Credit (EITC). The EITC could possibly be used to offset the restoration of the sales tax on food, although EITC is generally more broadly applied. The federal government and 29 states offer varying degrees of EITC. Typically, EITC offered by a state is valued as a percentage of the federal EITC the resident qualifies for. Utah could adjust this to target only specific populations, or apply it broadly to those who are low- to moderate-income earners.

If the Legislature were to enact an EITC at 10% of the federal level, taxpayers would receive $45 million in return.

Another idea that has been building momentum over the past few years is exempting social security income from the state income tax. Utah is one of 13 states that still taxes this source of income. However, Utah does offer a retirement tax credit to those born before 1953, to help offset increasing costs and taxes.

During the 2018 Session, then Rep. John Westwood sponsored a bill to exempt social security income. While this bill did pass the House, the Senate did not vote to approve the bill. This idea was also tied into HB 441 during the 2019 Session.

If social security income were exempted from income tax, the cost to the state would be $33 million.

Finally, the Task Force examined the ramifications of lowering the income tax rate. In Utah, due to our population and job growth, the income tax has far outpaced the growth of any other tax levied by the state. All income tax revenue is constitutionally required to be spent on education.

Your Taxpayers Association has called for cutting the income tax rate, because that would provide the greatest economic boost to the state by incentivizing out-of-state business to locate here, as well as in-state business to expand and hire more employees. Lower income taxes also benefit individuals and families.

Each cut of the income tax by 0.05% would return $55 million to taxpayers.

The Task Force is not taking public comment during this phase of its work but will after it has a proposal for consideration. There will be meetings in the coming weeks to discuss more proposals and weigh options. We'll be there.

My Corner: Utah's 51st Rank in Spending Per Student – A Flawed Metric

In recent years many Utah legislators have reported on their experience at national conventions when a speaker asks whose state spends less per student on public education than any other. Legislators representing several states claim theirs is the lowest. Sometimes arguments ensue between legislators representing Idaho, Arizona, Oklahoma, Mississippi, North Carolina, Tennessee, Nevada, and even Florida and Texas. They all claim public education advocates have shown them proof that their state is dead last in K-12 spending per student.

The common factor in this discussion is that these are the ten states Governing.com reports as having the lowest public education funding per student. Education spending advocates in these states sometimes "massage" the data to include spending per student only from selected revenue sources or to include spending for capital outlay and debt service to show their state unfavorably in an effort to get policy makers to increase spending.

And in fact, spending per student has increased across the United States faster than the rest of the world and much faster than inflation, causing the United States to now spend more per student than any of the industrialized nations in the world (non-industrialized nations don't even come close). Despite the U.S. dominating international spending rankings, America's student performance is lackluster. On the most recent Programme for International Student Assessment (PISA) report card the U.S. ranked 31st overall out of 70 industrialized nations, 39th in math, 25th in science, and 24th in reading. The National Assessment of Educational Progress (NAEP) reveals that in spite of America's massive increases in spending per student, results continue to stagnate or decline. The most recent NAEP shows that two-thirds of U.S. students are not proficient in math and reading, and the scores continue to decline for all subgroups each time the NAEP is given. Washington D.C. spends $19,159 per student, more than all but New York, yet its scores on the NAEP are near the bottom of the nation. The data prove that the amount spent per student is not as important as whether it is sufficient. More than sufficient amounts tend to make little difference in student performance.

The Governing.com report shows spending per student highest in New York at $22,366, Washington DC $19,159, Connecticut $18,958, New Jersey $18,402, Vermont $17,873, Alaska $17,510, and Wyoming $16,442. The U.S. average is $11,762 and Utah comes in last place at $6,963, followed by Idaho at $7,157 and Arizona at $7,613. Interestingly, the report reveals New York's administrative spending per student at $3,707 which is nearly as high as Utah's teacher salary and benefits spending per student at $3,998!

Why Utah's 51st Ranking is Flawed

According to the most recent nationwide data from 2016, Governing.com ranks Utah's spending per student 51st in the nation. In isolation, that metric fails to tell the story of wide variations in efficiency of school spending from one state to another based on geographic and cultural factors and that significant efficiencies in Utah schools are ignored.

Surprising to many in light of Utah's rural image, the Beehive State is one of the most urban states in the nation. The only states that are clearly more urban than Utah are California, Nevada, and New Jersey with approximately 95% of their populations living in urban areas. Utah competes for fourth place with Rhode Island, Hawaii and Massachusetts at around 92% urban. The 2020 Census is expected to put Utah squarely in 4th place. (Maine is least urban at 39% which helps explain why its spending per student at $13,278 is nearly twice Utah's.)

Education financial analysts all agree the single biggest expense of public education is (and should be) teacher salaries and benefits – typically comprising 70-80% of school general fund spending. It is widely known that class size affects the amount of spending per student related to teacher salaries and benefits. Based on average teacher total compensation, a class of 12 students would require double the spending per student on teacher salaries and benefits of a class of 24 students. Most variations in per student spending have to do with class size, or student:teacher ratio. In turn, student:teacher ratios are more efficient in urban areas because of the ability of Utah urban school districts, for example, to have four classes of each grade with fairly uniform class sizes in each elementary school. That type of efficiency is impossible to accomplish in states with students scattered through rural areas and results in per student spending to be much higher in rural states.

The average student:teacher ratio in the United States during the 2018-19 school year was 16:1, according to PublicSchoolReview.com. Utah and California were highest at 23. Of the ten states lowest in spending per student, all but one were higher than or at the national average class size. Of the ten lowest spending per student states, Utah at 23 was highest followed by Nevada at 20. On the other hand, the top ten spenders per student tended to have the smallest class sizes: New York with 11, New Jersey, Vermont, Wyoming and New Hampshire with 12 and Connecticut, Vermont, Wyoming, Massachusetts with 13. There is a strong debate about whether low class sizes produce better student learning outcomes, and low student:teacher ratios are not always planned. They are sometimes a product of declining enrollments or geographic distances between students.

The High Cost of Small School Districts

Utah's efficiency in per student spending is also affected by the fact that we have fewer school districts than all but four other states and our average number of students per district is greater than all but four other states. This creates efficiencies in lower administrative and plant operational overhead and better pricing for purchased services and instructional materials. It's part of the reason Florida with 46,237 students per district, Nevada with 27,223, Utah with 14,949 and North Carolina with 12,520 – the four states with the largest average district enrollments – are all in the bottom ten states in spending per student.

On the other end of the 50 state spectrum of district size, Montana's average district size is 354 students and it spent $11,348 per student, North Dakota (587) $13,373; South Dakota (869) $9,176; and Maine (980) $13,278. Interestingly, Utah school districts of similar size to these state average sizes (under 1,000 students) spent similar amounts per student: Daggett (178) $21,137; Tintic (226) $16,727; Piute (273) $17,093; Wayne (444) $12,554; Rich (507) $14,570; and Garfield (899) $11,075.

By contrast, 86% of Utah students are attending districts of 10,000 students or more while 88% of states have average district sizes of less than 10,000. This difference has a profound impact on relative costs of providing K-12 schooling.

While Utah's Population Growth Leads the Nation, Many States Face the High Cost of Declining Enrollments

While growth creates challenges in a school system, one of the greatest challenges an elected school board can face is closing schools due to declining enrollments. In America, public schools have become centers of the community. This is true regardless of whether it is an elementary, middle, or high school. There is nothing more politically difficult than closing a community center school. Over the years, Salt Lake and Granite school districts faced such decisions in a small way as neighborhoods once teeming with children of young families are now occupied by aging populations.

Across America's Rust Belt, as out-migration occurred, school boards, wherever possible kept schools open with half or a third of the students occupying the building but with all of the costs of heating, lighting, cleaning and maintaining a building where these costs had been spread over more students but now are focused on a fraction of the students the buildings were designed to serve.

No one would suggest the higher spending per student caused by failure to efficiently utilize capital facilities is something anyone would want to emulate. Yet these are the states with which Utah school spending is compared.

While the U.S average growth in public elementary and secondary school enrollment grew 7% between fall 2000 and fall 2016, Nevada and Utah led the nation at 39% and 37% respectively, according to "The Condition of Education 2019" published by the National Center for Education Statistics. This growth explains in part why

Nevada and Utah are in the ten lowest states in spending per student. Schools are full while administrative and operational overhead costs per student are low.

Eight of the ten states lowest in spending per student have experienced growth significantly faster than the national average: Tennessee 10%, Oklahoma 11%, Florida 16%, North Carolina 20%, Idaho 21%, Arizona 28%, Utah 37% and Nevada 39%.

While the nation's population has grown 7%, 12 of the 20 states spending the most per student have actually experienced population declines between fall 2000 and fall 2016: Massachusetts and Illinois -1%, New York, Connecticut, and Pennsylvania -5%, Ohio -7%, Rhode Island -10%, Michigan -11%, and Vermont, New Hampshire and Maine -13%, No one envies the difficult decisions school boards face in paying excess per student expenses in underutilized school buildings, but no one should criticize states which spend less per student because of efficient operating environments.

Should Utah apologize for exercising economies of scale and lower administrative overhead? When anyone mentions Utah's 51st ranking in spending per student, remind them it is a false metric.

Utah's Ugly Little Secret

Next month in this column I will explain why so many in Utah's K-12 system use our 51st ranking as a red herring to draw attention from Utah's practice of discrimination against students attending schools in the wrong zip codes and the fact that these students receive only a fraction of the education resources available to students in other districts.

Second Quarter Remote Sales Tax Revenue Estimates Are In - How Are the Numbers Shaking Out?

Your Utah Taxpayers Association recently received the second quarter data from the Utah State Tax Commission for new revenue coming into the state from the collection of sales tax from remote sales. Since January 1, 2019, larger remote sellers to Utah consumers should be collecting and remitting sales tax after the United States Supreme Court decision in *South Dakota v. Wayfair*.

We discussed the first quarter revenue numbers in the June edition of The Utah Taxpayer, when they were first released. With additional data rolling in, first quarter numbers have been updated from a range of $8 million to $12 million to a higher range of $9.3 million to $14 million. The numbers are expressed in a range because it is not known precisely how many sales tax filers are remitting based on remote sales.

According to the Utah State Tax Commission, the second quarter new revenue came in at a range of $12.8 million to $19.3 million. We have examined the last five years of historical quarterly sales tax data from the Tax Commission to quantify how the various quarters differ because of seasonal purchasing patterns. Using that data, the second quarter revenue usually comes in 5.44% higher than the first quarter, the third quarter at 10.46% higher and the fourth quarter at 12.40% above the 1st quarter.

With the higher first quarter that historical trend puts the projected annualized number at $49.9 million, up from our previous estimate of $42.8 million. This does not include the "marketplace sellers", which are sellers that use a platform in order to sell products who are currently not being collected by the state. Thanks to the work of Senator Bramble during the 2019 Session, Utah will begin collecting from these sellers on October 1, 2019 and it is estimated to add an additional $20 million. Utah is also expected to receive $50 million to $70 million through the voluntary compliance program the state started a couple of years ago, with these new collections, online sales are tracking even more solidly towards $120 to $140 million annually.

As the revenue continues to grow, Utah now has another quarter of data that further bolsters the claim for the projected $200 million annually which State Tax Commission Chairman John Valentine spoke about during an interim meeting for the Revenue and Taxation Committee in 2018.

This is new, ongoing revenue coming to the Utah's coffers going forward. Your Utah Taxpayers Association is working to ensure the legislature keeps its promise to use that revenue to lower taxes and not grow government.

How Utah Can Get An "A" on the COST Sales Tax Scorecard. COST Warns Against Tax Pyramiding

Members of the Utah Legislature and Utah business leaders heard a presentation on the impact of tax pyramiding from members of the national Council on State Taxation (COST). Mr. Carl Freidan, Vice President and General Counsel, and Nikki Dobay, Senior Tax Counsel focused their presentation on four separate areas.

The Principles of a Good Consumption Tax

Their presentation outlined the principles of a good consumption tax (like the sales tax). It needs to apply to a broad base of final household consumption while exempting the critical issue of business inputs, they told the crowd. It also needs to have a uniform sales tax base.

Throughout the nation, on average, businesses pay 42% of the sales tax revenue collected by states. Utah businesses pay a slightly lower amount of the revenue collected by the state at 37%, which is a good sign of the work the legislature has done to reduce sales taxes on business inputs.

However, most states miss the mark according to COST's recent report issued in May that stated: "*Despite a complex system of exemptions intended to exclude specific categories of business input purchases from the sales tax base, most state sales tax systems fall short of the goal of taxing only household consumption because they impose significant taxes on business-to-business transactions."* Most states' sales tax structures were enacted long before the growth of services in the economy.

The Problem With Imposing Sales Tax On Business Inputs

COST explained the problem with imposing sales taxes on business inputs. They said there is broad agreement among economists that the ideal sales tax system taxes final household consumption, not business-to-business intermediate transactions**.**

The negative consequences of taxing business inputs are significant, including: inefficient tax pyramiding, a lack of transparency, higher consumer prices and reduced economic activity. As a result of sales taxes on business inputs and extensive pyramiding, states like Utah often double tax particular industries.

For example, cable TV, electric, and natural gas utilities are industries which are subject to double taxation. Further detail was given as to the amount of purchases in an industry that are subject to sales tax, with the highest being 47% of purchases in utility services (gas, electric) being taxed and information services (IT) at 36%. All these sectors would be good places to start as the legislature looks for areas of improvement.

The Difficulty of Broadening the Sales Tax Base

The COST experts also mentioned the challenge of broadening the sales tax base without exempting business inputs. Over the last three decades, states have repeatedly sought to expand their sales tax base to cover a wide range of services. They said no state has been able to pass or sustain legislation that is broadly applied. When states have tried, the most common factor has been the principled opposition from the business community. Generally, the policy objections were not to the expansion and modernization of the sales tax base to include the growing services sector, but doing so without limiting the base expansion to household purchases and exempting business inputs.

Businesses purchase a disproportionate share of many services. For example, in the area of administrative and support services, businesses purchase 97% of services, and in the data processing/internet publishing/information services sector they purchase 77% of the services. Other examples of a high ratio of business purchases over consumers are credit intermediation (67%), insurance carriers (67%), rental and leasing services (73%) and waste management (78%).

Improving Utah's Grade

Utah is currently scored at a respectable B+ on COST's most recent Sales Tax Scorecard. However, if Utah enacted broad sales tax base broadening legislation while exempting business inputs its grade would rise to an A-, joining four other states with the highest grade on the COST Scorecard. Utah would also receive national recognition as the first state to significantly modernize its sales tax by broadening the base of household purchases without extending the tax to business purchases.

COST suggested that policy decisions will be required to determine whether certain services should be wholly exempt to avoid administrative/compliance issues. Considerable consultation with industry, stakeholder groups and practitioners will be required. Time would need to be given for Tax Commission implementation of systems and extensive (and ongoing) rulemaking would be required. In addition, time will need to be given to educate taxpayers since bringing thousands of new taxpayers on the rolls would require extensive education.

Association Accomplishments During August:

- Met with the Salt Lake Chamber to discuss tax reform efforts and business to business pyramiding
- Hosted legislators and business leaders at a Utah Business Coalition breakfast on interim day
- Attended Revenue and Taxation Committee meeting on interim day
- Attended a Silicon Slopes town hall with Spencer Cox
- Met with the chairs of the Tax Reform Task Committee to discuss tax reform efforts
- Met with Wasatch and Tooele County School Boards to discuss their bond proposals