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THE UTAH TAXPAYER

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Economic Viability, Transparency Key Issues as 2017 Session Begins

With the 2017 General Session just a few weeks away, your Taxpayers Association has already begun to monitor bills that may impact taxpayers pocketbooks.

Each year, the Taxpayers Association works on a Legislative Watchlist, published each week, to educate taxpayers about issues and to inform legislators about bills they ought to support or oppose. Our Watchlist is often referenced by legislators to help gain a broader perspective of the impacts on taxpayers of the bills they are voting on.

We're getting a running start to help you understand legislation that may affect you, and whether the Association encourages support or opposition.

Continuing our success from 2016, Utah 2.0, our legislative initiative which aims to further the state's economic viability, will see a comeback in 2017.

In December, your Taxpayers Association met with Sen. Stuart Adams, who has drafted legislation for 2017 that would eliminate the sales tax inequity on business inputs that exists between manufacturers.

In 2016, Rep. Brad Wilson sponsored a similar piece of legislation. While it didn't make it all the way through the legislative process due to short-term fiscal constraints, it passed the House, but did not pass the Senate. In 2015, the reverse occurred.

Based on the discussions we've had with legislators, there is a growing willingness to *(continued on page 3)*

JOIN US: Pre-Legislative Conference on January 9, 2017

The Utah Taxpayers Association's annual Pre-Legislative Conference is on Monday, January 9, 2017 at 9 a.m. at the Little America Hotel in downtown Salt Lake City.

Seats are limited at this event.

To RVSP, please contact Bren at (801) 972-8814 or bren@utahtaxpayers.org.

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Association President
Howard Stephenson

My Corner: The Dangers of Increasing Utah's Income Tax, Other Options to Consider

In late November a new initiative was announced called Our Schools Now (OSN) to seek voter approval of an initiative for a $750 million corporate and individual income tax increase on the 2018 General Election ballot. The proposal would raise Utah's rate from the current 5% to 5.875%.

Our Schools Now (OSN) chose the income tax because Constitutionally it is earmarked for funding public and higher education in Utah. The initiative is backed by organizations such as Education First, the Salt Lake Chamber and the Utah Education Association.

OSN cites a poll that was published by UtahPolicy.com which showed that 67% of voters support an income tax increase for education. I noted in My Corner published in the December issue of this newsletter that polls for these types of issues are usually inaccurate. When individuals are asked if they would support a tax increase to benefit children they will often say yes because they fear being viewed negatively by the surveyor. However, we have seen time and time again that in the privacy of the voting booth they vote no to tax hikes, even when it's for "the children."

The Income Tax Is the Wrong Tax to Hike

In 2007, the legislature completed a two-year process of overhauling Utah's tax system. Part of that overhaul was lowering the individual and corporate income taxes from 7% to 5%. One of the driving forces behind that change was research which showed that the state's high income tax rate was a deterrent to growing Utah's economy and the location of high-paying new jobs. Governor Jon Huntsman Jr. understood that Utah needed to lower its rate to attract high paying jobs to the state and helped guide the legislature to success in lowering the tax rate. Since that time Utah has seen great economic growth. The state survived the great recession far better than other states and is constantly touted as the best state for business. Why would we do anything to harm this goose that is laying the golden egg for our state is beyond me. If we are going to increase education funding significantly, we ought to be looking at anything but the income tax.

Other Options for Education Funding Increases

There are some suggestions on what else the state can do to increase funding for education. Some have thought restoring the tax cut made on food would be one area to find funding. Utah charges a 1.75% state sales tax rate on unprepared food, while other products, including prepared food, are charged at the regular 4.75% state sales tax rate. (There are additional local sales tax rates which already apply to food.) Legislative analysts have estimated restoring the unprepared food rate to 4.75% could generate as much as $190 million annually. All or part of the new revenue could be used for K-12 education.

Another source of new education funding could be to use the statewide property tax to increase funding for Utah schools. One idea in this area is to freeze the statewide basic school property tax rate. Under Utah's property tax laws, taxing entities are only guaranteed the previous year's revenue collected from the property tax. Under Utah's Truth-in-Taxation law, each year, the property tax rate for each entity floats so to match the prior year's revenue. This eliminates cities, counties and schools from reaping property tax increases resulting from reappraisal of existing properties. However, if the statewide rate was "frozen" the state would be able to gain additional revenue for education by allowing for the property tax rate to keep up with inflation as reappraisals are done on properties by county assessors and the state tax commission. The legislature estimates this may generate about $20 million annually.

Another source of new school revenue is unused local property taxing authority. Most school districts are not taxing to the full limit allowed under state law. If there are district's that are in need of additional funding, they can increase their local rate instead of depending on taxpayers statewide to bolster their revenues.

Additional funding could also be found by ending the revenue sharing of the income tax that is currently done by the public education system and Utah's higher education institutions. In 1996, voters determined that the income tax could be used not only for public education but also for higher education.

Higher education currently now receives more than $800 million from the income tax (a similar figure to the $750 million being sought under the OSN proposal). One idea being discussed could be phasing out this revenue sharing with higher education. But K-12 schools would have to"earn" it. As public education passes certain benchmarks of improved student performance, it would then be able to claw back the money that was previously used by higher education. That would then leave the legislature and higher education with the task of figuring out how to keep higher education funded from another source but it would allow public education the opportunity to take this revenue back as improvements are made to the system.

All of these proposals, and certainly others, will be given consideration by legislators in the upcoming session. It is crucial that all options are examined and given full consideration by Utah's 104 lawmakers. OSN's proposal to increase the income tax rate by almost 20 percent simply will not be accepted either by the legislature or the voters. This will do more harm than good to Utah's economy. Your Taxpayers Association is committed to protecting taxpayers from this well intended but dangerous effort to increase funds for education. If more needs to be done for Utah's students, there are options to consider, but raising the income tax is a nuclear option that will have negative results on our state for years to come.

Economic Viability, Transparency Key Issues as 2017 Session Set to Begin (continued)

(continued from page 1) see this policy enacted this year.

Continuing with Utah 2.0, Utah still needs to work to continue to provide our students with the tools they need to enter the workforce.

One proposal that had been discussed throughout the 2016 interim session is moving to a competency-based education system. Simply put, a student moves onto the next level once (s)he has mastered the current concept.

The Education Interim Committee outlined several hurdles on all levels to competency-based education, including funding seat-time instead of student mastery, incentivizing schools, and creating an assessment protocol.

Sen. Ann Millner has drafted a bill that is addressing some of these concerns. SB 34, Competency-Based Education Funding, begins the process by addressing the funding structure for a student who graduates from the system early due to mastery-based learning. The bill would allow for a credit to be given to the student's local education agency (school district or charter school), to be redistributed to the remaining students.

This is based on the number of days the student attended classes in comparison to a full pupil, and the value of the weighted pupil unit, set by the Legislature each year.

Utah 2.0 is all about strengthening Utah's economic future and preparing a workforce that would be unmatched in the nation. With this in mind, competency-based education measures that address the hurdles listed above are a key focus of Utah 2.0.

Your Taxpayers Association is working closely with legislators to ensure that Utah 2.0 is ready for even more success in 2017.

Moving on, Rep. Jeremy Peterson's HB 23, Income Tax Credit Modifications, would phase out the income tax credit that is provided to consumers who purchase solar panels for their homes. Currently, the tax credit provides $2,000 or 25% of the cost of the system (whichever is less) to individuals who install solar panels on their homes. There are no limits or caps to the program.

In November's meeting of the Revenue and Taxation Interim Committee, Rep. Peterson presented the exponential growth of the solar industry since the tax credit was in place, and the state could end up, based on current trends, refunding approximately $50 million in income taxes.

Your Taxpayers Association supports HB 23, as it would allow an opportunity for the income tax base to be broadened, providing tax dollars to the education system and eliminating a tax inequity that alters behavior of individuals.

Next, we are working with Senator Deidre Henderson

to better clarify the true cost of a bond when voters go to the polls to decide whether or not to approve it.

As defined by statute, the first paragraph when describing a bond in voter informational pamphlets address the increase in property taxes for the upcoming years, if a bond were to be issued. Essentially, it's calculated as if the current tax effort were frozen. However, it does not take into account any bonds that may be paid off over the term of the newly approved bond, therefore minimizing the true cost to the taxpayer.

While the legislation is not yet publicly available, your Taxpayers Association will work with the Legislature to ensure this vital piece of transparency is in effect for future bond proposals.

As more bills are distributed publicly, we will continue to monitor and lobby the Legislature on behalf of taxpayers and for equitable and lower tax policy.

Keep an eye out for our weekly Legislative Watchlist as the Session nears.

Guest Commentary: The Cost of Yesterday's Pension Promises to Public Education

The Office of the State Auditor (Office) recently completed an analysis of how past, underfunded pension promises impact public education in Utah today. This analysis identified that nearly $204 million is being directed to fund these past pension promises rather than current public educational activities. This represents 3.7% of Utah's $5.5 billion in total public education expenditures in fiscal year 2015.

Background

Pensions are one approach employers have used to compensate their workforces. Total compensation includes all of the wages, health insurance premiums, retirement benefits, leave, taxes and other items of value that an employer provides to or on behalf of employees. Under sound financial practices, when a pension commitment is made, funds should be set aside that will allow the pension to pay for that future benefit. Too often, pensions were funded on a "pay-as-you-go" basis, with politicians and policymakers being rewarded for making promises of additional post-retirement compensation, but future taxpayers being burdened by the delayed cost of paying for those promises.

For many years, standards bodies and financial accountability watchdogs were concerned with the hidden cost of pensions and the fact that employers were not adequately accounting for those future costs. A couple of recent articles from The Wall Street Journal highlight these concerns, including reports such as "Does Your State Have A Pension Problem?"[1] and "California's State Pension Obligations Are Larger Than Previously Estimated."[1]

Utah State Auditor John Dougall

In 2012, the Governmental Accounting Standards Board (GASB) published new accounting standards applicable to states and local governments to improve financial reporting for public pension plans. These new accounting standards[1], require states and local governments to report, for the first time, their pension liabilities and expenses, resulting in a more faithful representation of the full impact of pension obligations.

Today, the risk of unfunded pension liabilities has become well known, and governments are being pushed to "catch up" and fund those past promises. When this happens, money is directed away from current activities. Our report[1] analyzed the impact this diversion of funding—to "prop up" the "old" pension system—has on Utah's public education funding.

Analysis

Pensions pay retirees through a combination of gains from investments and contributions from employers and workers. Currently, pension systems are regularly evaluated to determine whether they are actuarially sound — to weigh how likely the system is to meet an obligation to pay retirees in the future based on these two factors. These studies show that Utah's past contributions and investment earnings are insufficient to pay vested retirement benefits. The unfunded liability (UAAL) is the gap

between the pension's liabilities and the value of existing assets. The Utah Retirement Systems (URS) [1] computes the amount needed to pay for this unfunded liability spread (amortized) over 25 years.[1]

The Legislature has chosen to fund the UAAL by increasing employers' required pension contribution rates. In 2008, the required contribution rate for the noncontributory (pension) system for state and school employees (Tier 1)[1] was 12.72%. By 2015, this required contribution rate had escalated to 22.19%. Since this rate is applied against an employer's applicable wages, the increased rate places a greater burden on government budgets and ultimately upon the taxpayers who fund that governmental entity, with no increase in worker productivity. Currently, the rate required to cover the unfunded liability is 9.94% of applicable wages. In other words, almost half of the current required contribution rate is going to pay for those past promises which were not fully funded.

Whether or not an employee participates in the Tier 1 pension, the required UAAL rate is applied against all applicable wages when paid into the pension system. In other words, even if an employee is enrolled in the Tier 2 Defined Contribution retirement plan (i.e. the 401(k) plan), his/her employer would still pay 9.94% of the employee's wages to URS to help fund the Tier 1 pension system.

The Office's analysis shows that nearly $204 million—3.7% of Utah's fiscal year 2015 public education expenditures—was set aside in 2015 to pay for this unfunded expense.

Summary

The trade-off Utah faces for yesterday's pension promises is a decreased amount of today's funding being available to meet today's educational expenses. If yesterday's taxpayers had fully funded past pension obligations, and today's taxpayers were not required to pay for the unfunded liability, that money could have instead been allocated to:

- Reduce education expenses by 3.7%,
- Increase the Weighted Pupil Unit (WPU) by almost 7.5%,
- Increase teacher pay by 14%,
- Raise public education employee wages by approximately 8.5%,
- Double the number of teacher aides and paraprofessionals inside classrooms, or
- Operate an additional 40 elementary schools or several hundred new classrooms.

Making promises about the future is risky, especially with pensions where there is a significant incentive to make promises today for which others must pay tomorrow. As a result, past pension promises now redirect significant portions of today's budgets for work that was performed years if not decades ago. While not the ideal scenario, Utah's policymakers should continue to take steps to ensure today's expenses are paid today and not pushed onto taxpayers in the future.

Bio: John Dougall first took office as State Auditor on January 7, 2013. He was re-elected and began his second term on January 2, 2017. Mr. Dougall believes the State Auditor should provide Utah taxpayers and government officials with an independent assessment of financial operation, statutory compliance, and performance management for state and local government.

Prior to becoming State Auditor, Mr. Dougall served 10 years as a member of the Utah House of Representatives, where he was a champion of government accountability, tax reform, transparent government, performance management, and fiscal responsibility.

Mr. Dougall has a long career in the technology sector, working for large companies and small start-ups, in an array of management and technical positions.

Sources:

[1] *Interactive table:* http://graphics.wsj.com/table/Connecticut_102015

[2] http://www.wsj.com/articles/californias-state-pension-obligations-are-larger-than-previously-estimated-1458351309

[3] *GASB Statement 67 — Financial Reporting for Pension Plans and GASB Statement 68 — Accounting and Financial Reporting for Pensions*

[4] *Office of the State Auditor Report - The Cost of Yesterday's Pension Promises to Public Education,* http://financialreports.utah.gov/saoreports/2016/AR16-03EducationPensionCostsEducation,Officeof.pdf

[5] *Data from Utah Retirement Systems 2015 Comprehensive Annual Financial Report,* http://newsroom.urs.org/2015-comprehensive-annual-financial-report

[6] *Beginning in 2009.*

[7] *Currently designated the Tier 1 Public Employees Noncontributory System for State and School Employees*

Herbert Calls for Comprehensive Review of the State's Tax System as Part of his Latest Budget Proposal

Gov. Gary Herbert has asked business leaders and education stakeholders to come together on a task force to examine Utah's tax structure and make suggestions on how to better align state taxes with the Utah's economy.

Herbert made the call for the task force in his latest budget proposal, released early December 2016. In his budget, the governor also called on the state's Tax Review Commission (TRC) to study and make recommendations regarding the state's current tax structure.

Herbert made a point in his written proposal that Utah's economy is changing, leading to a misalignment of the tax structure as it fits with Utah's business climate.

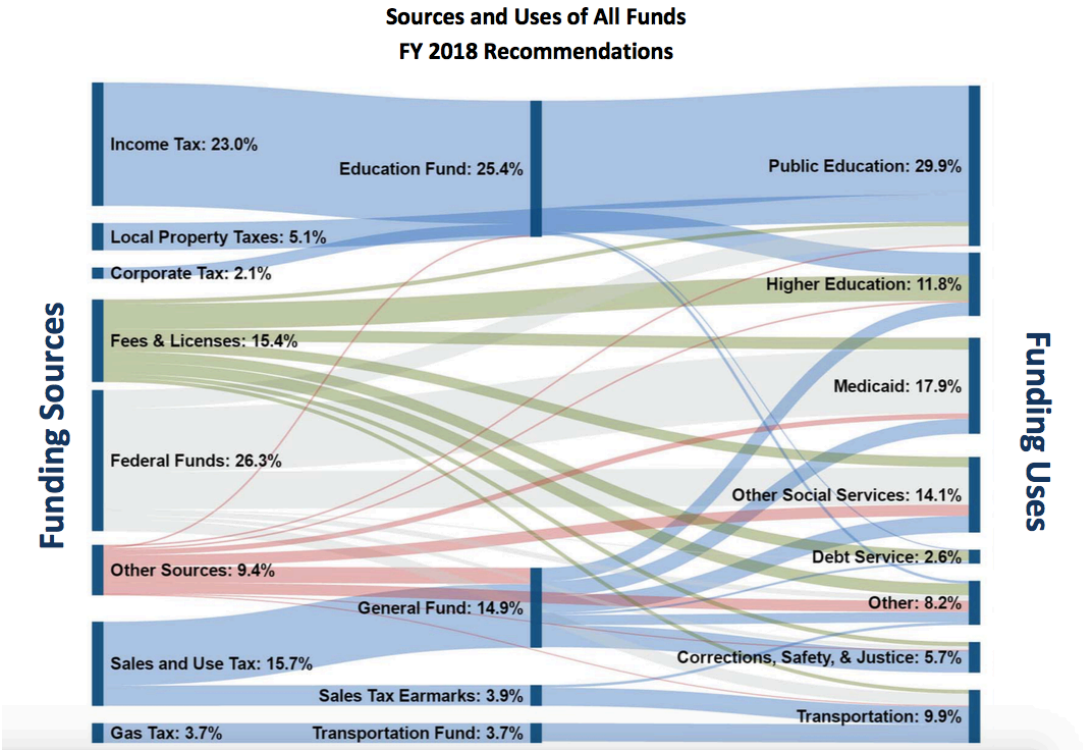
One example his office cites is the sales tax, which supplies the state's general fund, has not changed since it was first implemented in 1933. At that time, Utah's economy was mostly based off tangible products. Since then, Utah's economy has migrated from goods to become a more service-based economy. This shift has resulted in less opportunities for the sales tax to be collected.

Additionally, online sales continue to increase, which has created an inequity between sellers in tax policy. While measures have been taken in the past month to work towards solving this inequity, a more concrete legislative solution is necessary.

Herbert is asking for the proposed task force, as well as the TRC to review and determine what needs to be done to Utah's taxes to adjust for these changes.

Herbert's budget proposal also notes that Utah has a number of exemptions, exclusions, credits and reduced tax rates on specific items within the tax code. These tax breaks shrink the overall tax base forcing pressure for taxes to be increased to make up for the loss in revenue. The task force and the TRC are expected to also discuss which of the exemptions are beneficial to the state's economy and which can be eliminated.

The issue revolving around the collection of remote sales taxes was also a top issue for the governor in his budget. The governor noted that the state is potentially losing out on $200 million in sales tax revenue from the lack of collection of sales tax from out-of-state online retailers and also argued this area of the tax code is causing tax policy to pick winners and losers among retailers. He called for an aggressive pursuit of collection of the online sales taxes in the budget. On the same day that Herbert's budget was released he also announced that online mega retailer Amazon had agreed to collect and remit sales taxes to the state of Utah. It is unclear how much of an impact on Utah's sales tax this will be.



Funding Sources and Funding Use for Fiscal Year 2018
(Governor's Office of Management and Budget)

Overall, Herbert's proposal calls for no tax hikes, while spending the $287 million in new revenue collected by the state. The governor calls for 79% of new revenue to be spent on education. He also calls for more than $12 million to go towards public safety. For a helpful breakdown on what revenues pay for which government services, see the chart above.

The budget proposal does give a warning to taxpayers that more money will be needed in the future to cover the cost of providing water for Utah's growing population. It was stated that costly water projects could be postponed for decades if Utah's water resources are used more efficiently. However, if Utah remains in its current form on water and makes only minor efforts to conserve the need to increase local or state taxes to obtain water will be imminent. According to the proposal, water districts have a list of roughly $33 billion in water structure needs for the state and that state taxpayers could end up paying for $12 billion of that if the projects were found to be necessary.

The governor's budget serves only as a recommendation to the legislature, which has the responsibility of crafting the state budget, but it sends a message of what his priorities are for the

2017 Legislative Outlook Conference to Preview Top Issues from Key Policymakers

On Monday, January 9th, the Utah Taxpayers Association will host the annual Legislative Outlook Conference at the Little America Hotel in downtown Salt Lake City.

The conference, beginning at 9 a.m., will feature lawmakers, policymakers, and other tax influencers from across the state and nation discussing some of the most prominent issues that the Legislature is set to address when it convenes later this month.

Highlighting the Conference is a panel discussion in response to an initiative to raise Utah's income tax by nearly 20%. Senate Revenue and Taxation Chair Howard Stephenson will join Chair of the Public Education Appropriations Subcommittee Senator Lyle Hillyard and Dr. Richard Kendall, former deputy to the governor for education and economic development and commissioner of higher education in Utah to discuss the pros and cons of the initiative, as well as alternate funding sources for Utah's public education system.

The Conference will also feature policymakers identifying the positive impacts of Utah 2.0, the Taxpayers Association's legislative initiative to ensure economic viability well into the future.

Senator Stuart Adams will once again present on his efforts to entirely remove the taxation of business inputs on manufacturers, which has support of both houses of the Legislature. Sen. Adams has been a champion for eliminating this inequity and the Association will be working with him to progress this legislation.

Nikki Dobay from the Council of State Taxation will explain how taxation of business inputs harms Utah companies, and why Sen. Adams efforts are necessary to keep Utah moving forward.

Following, Curtis Trader, Chair of the Utah Tax Review Commission will talk about the conversations had throughout 2016 on lowering the corporate income tax burden through the expansion of the single sales factor apportionment. In 2016, the Tax Review Commission agreed that single sales factor ought to be eliminated in the state.

Other issues that are to be addressed at the conference include:

- What Utah's agreement with Amazon means for online sales tax collections,
- Increasing oversight for special service districts,
- Giving voters the whole cost on an election bond proposal, and
- Training Utah's workforce for Information Technology and advanced manufacturing.

If you would like to view the full agenda, please click here.

If you wish to attend, please call our office to RSVP at (801) 972-8814, or email bren@utahtaxpayers.org.

View our 2016 Actions and Results!

As we open a new year, your Taxpayers Association takes a look back at 2016 and what we were able to accomplish on behalf of all taxpayers across the state.

Click here to view some of the 2016 highlights.

Association Accomplishments During December:

- Met with newly elected legislators to discuss Association mission, key tax policies
- Met with state lawmakers and key business organizations to discuss and strategize for the 2017 Legislative Session
- Spoke with the National Tax Foundation and other state taxpayer advocacy groups across the nation about tax issues facing the state of Utah in 2017
- Planned the 2017 Legislative Outlook Conference
- Conducted an "end-of-year fundraising drive

In the News:

- Op-Ed on Issues and Misconceptions Facing Charter Schools
  - Solving Problems Faced by Utah Charter Schools: Salt Lake Tribune