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Cannon's Canon: Cutting the income tax rate is the right move for Utah

Association Vice President Rusty Cannon

While lots of ink has been used to opine on the ongoing tax modernization debate, a significant piece of data has gone fairly unnoticed. On a regular basis there is a report issued by the State of Utah GOMB (Governor's Office of Management and Budget) and LFA (Office of the Legislative Fiscal Analyst) known as the TC-23. It's a report that discloses the various incoming tax collections for the state and it provides a bit of a "live" look at how collections into the State coffers are going. For tax nerds like us it's like getting an update on the score of the game for your favorite team.

The April 2019 TC-23 report had some nice news for those that might be paying attention. Before I get to that however, I wanted to give a little background. As the legislative session got started in 2019, the Governor's budget called for a tax cut of $200 million. In his opening session remarks Speaker Wilson suggested a larger cut of $225 million. Both should be commended for showing bold leadership in continuing to drive Utah's rock solid economic top spot in the nation. An income tax cut is exactly what is needed whether Utah engages in tax reform or not.

Then, surprisingly, the capacity for tax cuts disappeared as the state's economists presented their "Winter Revenue Update" February 22, 2019 in an Executive Appropriations Committee. Revenue forecast was down by $222 million and calls for a tax cut immediately seemed to take a back seat in legislative budget work. In spite of the lower projections and to the Legislature's credit, they did at least set aside $75 million in the budget for a tax cut in the near future.

Now for the good news. In the April 2019 TC-23 report, the state disclosed that in recent months the trend has turned positive once again and Income Tax collections are clocking at 9% above the previous year at over $4.2 billion for the fiscal year so far. That is several hundred million above the mid range of forecasts. That might not be a surprise to some considering the upside surprise nationally in the past quarter with a GDP number of 3.2%, well above forecasts.

There's still hope for a $225 million income tax cut. Take the $75 million set aside in the budget, add what should be at least a $75 million surplus in fiscal year 2020, and another $75 million from a reasonably projected $400 million in growth the state will see in fiscal year 2021, and you get a $225 million income tax cut that could be done this next legislative session.

Shout it from the rooftops folks. It’s time for an income tax cut.

My Corner: Teacher Salary Hikes without Conditions Reveal Local School Boards’ Lack of Vision

Association President Howard Stephenson

Three of Utah’s local school boards have launched the second phase of salary wars, believing that boosting starting teacher salaries to $50,000 annually will magically vanquish mediocre student achievement. Other districts may follow.

Near the end of April, Canyons School District announced it would raise taxes to increase starting salaries to $50,000 and all existing teachers $7,665 annually for a 14.2% pay raise. A few days later Murray School District met Canyon’s $50,000 proposed a property tax hike to increase all teachers pay by nearly $7,000. Not to be left out, the lower-funded Jordan School Board announced a starting salary of $45,000 without a tax increase plus another boost to $48,875 to be funded through a proposed property tax hike.

The $50,000 does not include the more than 40% medical and retirement benefit package which brings total beginning compensation to more than $70,000 annually. The teaching contract of 186 days at $50,000 starts teachers at an hourly rate of $270 per day or $33.60 an hour. Remember this is a *starting* salary. Teachers are not poorly paid compared to other professionals for time worked. However, other professionals are not laid off for nearly a third of the work year without compensation and unable to collect Unemployment Compensation.

Put in perspective, a full work year is 260 days or 2,080 hours. Teachers are contracted to work only 186 days or 1,488 hours. However, when a new teacher’s starting daily rate of $270 is multiplied by a full work year of 260 they make the equivalent annual starting salary of $70,200. How many professionals do you know who start at $70,000 on the first day?

Higher Pay From Tax Hikes with No Planned Educational Improvement
With these increases, Canyons and Murray average teacher pay is expected to be as much as $50 an hour or $400 per day. Jordan’s wouldn’t be far behind. This daily rate multiplied by a full 260 day work year would equate to $104,000.

In the business world such increases would be tied to improved performance measures but just as with the salary wars two years ago, the pay hikes anticipate that teachers will continue to do what they are currently doing, no additional days are required and the increased pay is not tied to any type of performance improvement.

District professionals and school board members we have spoken with admit nothing additional is expected. They say the higher pay will improve the future pool of candidates for hire, help overcome the current teacher shortages and motivate good teachers to stay in the profession. It's true that higher pay over time will attract more qualified teachers to enter and stay in the profession, but unlike the business world, the poor teachers are to receive the same incentive to stay in the profession. These school boards are missing significant opportunities; failing to use the higher pay to induce improved instruction.

Everyone knows that teacher shortages do not exist in all subjects. Yet school boards granting these pay raises are doing nothing to differentiate pay to ensure they attract highly qualified personnel to fill severe shortage subjects like math, science, computer science, and special education teachers. Instead, these school boards allow the union tail to wag the dog.

One of the biggest complaints I hear from teachers as I regularly visit Utah schools is that with all the duties of managing a classroom for more than 6 hours a day, they simply don't have enough time to prepare effective instruction, time to evaluate student performance data and time to learn best practices. Yet none of the districts granting these huge pay increases are using the money to add days to the teacher contract for preparation, evaluation, and professional learning. In fact, Canyons is actually *cutting* two days out of the contract!

School board members we have met with say that the teacher union is adamant about not adding days to the contract; they just want more pay for current days. And yet the typical district union membership is only 25% to 35% of teaching staff. School boards are not required to negotiate with a bargaining unit that doesn't represent a majority of teachers, yet school board members don't have the backbone to call the union's bluff. Local school boards seem to care more about the union than the majority of teachers who chose not to belong, or the students they're supposed to serve, or the voters who elected them.

With rare exceptions, local school boards are in a crisis of leadership and utterly without the vision to improve educational outcomes. Their school performance is nothing to brag about. We are not getting great results out of Utah schools. The most recent National Assessment of Educational Progress (NAEP) showed that 59% of Utah 4th graders are not proficient in math and 54% are not proficient in reading. As students move through the grades, results get worse. A whopping 61% of Utah 8th graders are not proficient in math while 62% are not proficient in reading.

In what morally inverted world would a school board hike taxes to pay employees to do the same job they've been doing all along? It's time taxpayers speak up and demand accountability of our local school boards.

Online Remote Sales Tax Data (Wayfair) Starts To Roll In: Utah Taxpayers Association First to Quantify - $120-$140 Million Annually and Growing Toward the Original Estimate of $200 Million

At the 2019 Taxes Now Conference in May, State Tax Commission Chair John Valentine provided a new datapoint that many have been waiting to see. Those that were able to hear his remarks (you can see his slides and hear his remarks on our website HERE) might have noticed the first public comments about what "new revenue" might be coming in to the sales tax coffers of the state after the United States Supreme Court decision in *South Dakota v. Wayfair.*

Since January 1, 2019, sales tax from online purchases should be collected and remitted for purchases made in Utah. Now that the first quarter data has come in, the Tax Commission was able to provide some data on what might be happening. Commissioner Valentine gave three data points since the passage of new legislation addressing the issue. First, there have been approximately 1,420 to 1,880 new registered online sellers. Second, they have seen approximately $120 million to $170 million in new taxable sales from them. Finally, that translates to approximately $8 million to $12 million in sales tax revenue in the first quarter of 2019.

This is noteworthy data, since many policymakers have wondered how the numbers would shake out. There are a few calculations you need to make to try and arrive at future expected revenue, however a relatively accurate number can be arrived at. Mr Valentine warned that seasonality needs to be taken into account in order to accurately make a guess at what an annualized total might be. So, your Utah Taxpayers Association has examined the last five years of quarterly sales tax data from the Tax Commission to quantify how the various quarters differ.

Using historical data, on average, the second quarter revenue 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 first quarter. So, if you take the middle of the first quarter data that he shared ($8 million to $12 million) at $10 million and use those averages you arrive at an annualized number of $42.83 million.

However, you don't stop there. You have to factor in what is known as the "marketplace seller" issue. This is where even under the new legislation, sellers on platforms such as Amazon that are independent of Amazon and just using Amazon as a facilitator, are not required to collect and remit sales tax. For example, if you buy a bike from Amazon directly, they would collect and remit sales tax from you. However, if you buy the bike from "Bob's Bike Shop" that is a marketplace seller on Amazon's platform, they would not collect and remit sales tax from you. That issue has been fixed by Senate Bill 168 (Bramble) in the 2019 legislative session and goes into effect Oct 1, 2019. Once that goes into effect we should pick up the missing revenue from those marketplace sellers.

Policymakers have been operating on a consensus that approximately 40% of online sales fall into the category of "marketplace sellers". So, if we know we are missing out on 40% until Oct 1, 2019, the $42.83 million represents 60% of what should be the annual number we might expect. Doing the math gives you an annual number of approximately $71 million annually.

In addition, Utah has been collecting new sales tax revenue from online remote sellers for the last couple of years. The Tax Commission initiated a program for voluntary compliance for many online sellers that wanted to comply. That program is now bringing in an estimated $50 to $70 million in revenue annually.

Adding in that additional $50 to $70 million from voluntary compliance to the $71 million totals a figure of $120 to $140 million. That is tracking right towards the figure of $200 million annually that Chairman Valentine spoke about during an interim meeting for the Revenue and Taxation committee in 2018 as the right number to use for policy purposes. In recent conversations with your Utah Taxpayers Association, Valentine still says $200 million is the proper number to use as new revenue from online remote sellers solidifies.

So there it is folks, $120 to $140 million and growing towards the $200 million mark. This is new revenue that is rolling into the State of Utah's coffers going forward and policymakers need to remember that they made a promise to the taxpayers of Utah, when the state signed onto the Streamlined Sales Tax Project, that they would use that revenue to lower taxes and not grow government. Your Utah Taxpayers Association will be relentless in making sure that promise is kept.

“Why Must This Be Done?” Panelists Discuss Basis and Answers to State Tax Reform

During the 2019 Session, the message was told that the state of Utah has a revenue and a structural problem, which was the base for HB 441 and the argument for tax reform. After HB 441 failed to pass the Legislature, attendees at the Association’s Taxes Now Conference gathered to hear from experts and policymakers what comes next.

We asked tax experts and economists to weigh in by posing the question if Utah has a revenue problem. Our first panel included State Auditor John Dougall, Legislative Fiscal Analyst director Jonathan Ball, and Natalie Gochnour, director of the Kem C. Gardner Policy Institute. The panel was moderated by Association president Howard Stephenson.

Mr. Ball started by mentioning that with the increase of population, the pressure on the state budget is primarily on services funded by the discretionary general fund. As our economy grows, there are more demands on government.

The sales tax base has grown more slowly than personal income and Utah’s gross domestic product (GDP), with the sales tax base growing at 4.6%, as opposed to 5.3% for the other two factors, according to data from Mr. Ball. Ms. Gochnour added that the sales tax base should match economic growth, especially when you look at spending as a percent of the overall economy.

Mr. Stephenson asked whether the collection of remote sales taxes will make an impact, as revenue from these purchases have only been recently collected by the state. Mr. Ball said it was part of the solution, but will not solve Utah’s structural and revenue problem.

Ms. Gochnour noted that until 1998, the sales tax and income tax revenue were relatively equal, with some years the sales tax actually exceeding the revenue brought in by the income tax. Following that point, the income tax revenue outpaced sales tax revenue. While sales tax revenue continued to increase for most years after that, income tax revenue grew at a faster rate. Ms. Gochnour said that when you compare sales tax base and personal income, the sales tax base has dropped from 70% in 1980 to 43% today.

The panel noted that sales tax rates have been increasing as local and boutique taxes, such as zoo and parks sales taxes, have been implemented. But on the flip side, the base has narrowed due to the Legislature’s correct actions in exempting business inputs. Mr. Dougall said that it would be very negative to reverse what the Legislature has done over the past 25 years in exempting business inputs.

Mr. Dougall added that when the state has attempted tax reform in prior years, state leaders and the public understood the shared vision. In 2006 -2007 efforts when the state broadened the income tax base and cut the rate from 7% to 5%, the shared vision was to make Utah more competitive. “What is the shared version this time around” he asked.

He added that in the past, when discussing tax reform, the Legislature and other interested parties spent a great deal of time engaging with the public, business, and other groups to ensure they understood what was trying to be accomplished and to bring them along in the discussions. Utah ought to continue this model, rather than having discussions behind closed doors.

Following this discussion, policymakers were brought in to discuss possible solutions. This panel consisted of Senator Dan Hemmert, Senator Lincoln Fillmore, Representative Robert Spendlove, and Phil Dean of the Governor's Office of Management and Budget.

Sen. Fillmore began by addressing several unacceptable common complaints against tax reform he regularly hears. The first is "taxes are evil". Second, "I'm so special that the tax and regulatory burden should fall more heavily on other taxpayers." Sen. Fillmore said that special interests try to get themselves exempted out of additional taxes, which shifts burdens to everyone else, and defeats the purpose of updating the tax system. Third, "the current system is unfair in my favor". He said that no one is willing to admit that they benefit from the current system, and would rather stay in the status quo.

Rep. Spendlove said that he's been viewing the issue of tax reform by asking three questions. First, "why must this be done"? He said that the state has a structural imbalance that needs to be adjusted, as well as significant changes to the economy, as society moves from a goods-based to service-based economy. In addition, the transportation fund is not providing enough revenue to cover necessary infrastructure.

The second question he asked is "why now"? Primarily, Utah no longer has the ability to move money between the general and education funds. Rep. Spendlove says Utah is in between a rock and a hard place considering there is not the flexibility we once had to fund government services.

Finally, he asked what Utah ought to do about it. There are four broad solutions, which can be used as a standalone or in a combination, Spendlove argued. First, broadening the base, which could include services, as was done in HB 441. Second, raise rates, which is politically unpopular. Third, amend the Utah Constitution to allow for income tax to be used more flexibly, rather than just for education. Finally, Spendlove said Utah could tighten its belt. He said that Utah does not have a revenue problem. He said legislators often perceive that the public is demanding or expecting additional government services as the population increases. Given these four options, the task force has an opportunity to make the call.

Aligning usage of infrastructure and services must closely match to the person who uses it, and this ought to be a central point of tax reform efforts, argued Mr. Dean. He said that $1 billion in sales taxes goes to transportation, but that is still not enough. As the gas tax has less buying power, Utah needs to be inventive in order to provide the service while charging the user of that service or infrastructure.

Cost of doing business should be entirely exempt from sales taxes, said Sen. Hemmert. The tax pyramiding issues in HB 441 creates a hidden tax on the system. A tax on a tax is inappropriate, and will ultimately hurt the economy.

Taxes Now Conference Attendees Told to "Act Boldly and Implement Slowly" When Considering State Tax Reform

Former Majority Leader of the Indiana State Senate, Brandt Hershman, spoke as the keynote of the Utah Taxes Now Conference about Indiana's efforts on tax reform over the last several years. This has lead to Indiana's economic outlook ranking skyrocketing from 24th place to 3rd place in ALEC's (American Legislative Exchange Council) annual Rich States, Poor States. Utah, by the way, has ranked #1 for all of the 12 years the report has been published.

Indiana has made significant changes in tax policy, regulatory environment, and workforce development and is reaping benefits from those efforts.

In 2010, Indiana's legislature decided to act boldly. They saw an economy that was reliant on the stagnant auto industry where revenues were tenuous, and decided they needed to make some major changes. They slashed their individual income tax rate to a flat rate of 3.23%, cut their corporate tax rate from 8% to 4.9%, raised their sales tax rate, put a cap on property taxes, cut regulatory burdens and cut government spending. They also passed right to work legislation and got rid of minimum wage laws in the state.

The results have been astounding. Forbes now ranks Indiana as the #1 state for regulatory environment in the entire nation. They are seeing over $3 billion in new investment this year alone, and 55 companies have moved from Illinois to Indiana since the changes were made. Boeing, Saab, Rolls Royce Aviation, Subaru, Honda, Toyota, Salesforce.com and GM have all expanded or invested more in the state since the changes. They have seen $5 billion in new telecom investment and have the most 5G wireless deployments in the United States.

While Indiana is catching up, Utah has a chance to continue as a leader among states as we debate our tax reform efforts.

Mr. Hershman told the attendees that Indiana has a "gift that keeps on giving" just like Utah does. Utah's continual gift is California, as population, year after year, flees its high tax rates and burdensome regulatory environment. For the very same reasons Indiana has Illinois, as their state lawmakers double down on failed policies that drive businesses and individuals out of the state and right into the lap of its next door neighbor, Indiana.

Senator Hershman finished by giving several pieces of advice for Utah policymakers. Most importantly, Utah policymakers need to have a solid, long term plan as any changes are made. He told the attendees Utah should not make changes just for the sake of change. Tax policy is inherently complicated and hard to explain, and so it is easily demagogued.

Mr. Hershman said that Utah ought to communicate better on tax policy and take pains to properly explain the issues and problems Utah is facing or expect significant opposition. Business decisions are made over time, but revenue change from tax cuts is immediate. Therefore phasing in changes or matching cuts with spending reductions is always the wisest path to take.

Finally, he urged Utah to "act boldly and implement slowly". That is solid advice for Utah policymakers to follow as they look to modernize the tax system for future generations.

Association Accomplishments During May:

- Held the 2019 Taxes Now Conference at the Grand America Hotel
- Attended various Salt Lake Chamber meetings to discuss sales tax reform
- Attended the first meeting of the State Task Force on sales tax reform
- Met with the Canyons School District about their property tax increase
- Met with Jordan School District about their proposed property tax increase
- Continued planning the 2019 *Teed off on Taxes* golf tournament

In the News

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