Utah FOUNDATION Executive Summary

Report Number 666, May 2004

UTAH'S TAX SITUATION

Although Utah's tax system is fairly typical in relying on a balance of property, income and sales taxes, Utah does have some unique tax policies that set it apart from many states. Most notable is Utah's earmarking of 100% of income tax revenues for education funding. Another important feature of Utah's tax system is the "truth in taxation" law that has resulted in a low property tax burden. Most recently, the sales tax is undergoing significant changes designed to make it easier to collect tax on mail-order and internet sales.

These three main taxes, property, personal income, and sales, produce 82% of Utah's total state and local tax revenue. The combination of three major taxes, along with several minor ones, provides a more stable income source for government than a system that relies heavily on any one tax. Figure 2 shows the sources of state and local tax revenue for 2002, during which sales, property, and personal income tax generated about $5 billion.

TAX BURDEN COMPARED TO OTHER STATES

Utah's overall state and local tax burden is high, ranking 11th highest in the nation and third highest among the Mountain States, as shown in Figure 1. This is largely the result of high income and sales taxes. However, Utah's property tax is quite low compared to other states, and the property tax is a major local government revenue. This results in a very low local government tax burden (40th in the nation) and a high state tax burden (8th highest).

Figure 1: Total Taxes & Fees Per $1,000 Personal Income

Mountain States	State & Local Taxes & Fees	National Rank	Federal Taxes	National Rank	State, Local & Federal Combined	National Rank
1. Wyoming	$154.80	8	$275.13	3	$429.93	1
2. Nevada	128.51	37	260.33	9	388.85	13
3. New Mexico	156.28	4	229.60	33	385.88	14
4. Colorado	126.62	40	257.42	11	384.04	16
5. Utah	**150.62**	**11**	**221.99**	**40**	**372.60**	**28**
6. Montana	141.79	20	227.74	36	369.53	30
7. Idaho	144.64	19	223.54	38	368.18	32
8. Arizona	126.04	43	240.54	21	366.58	34

Source: Bureau of the Census, Bureau of Economic Analysis (BEA), Tax Foundation; Calculations by Utah Foundation

This high tax burden is partly the result of funding Utah's immense education system. Utah's average family size is the largest in the nation, and this results in a large student population and heavy demands on the tax system to fund the education system. Utah's student-age population (aged 5-17) is 20% larger than would be expected for an average state, and Utah's state and local tax and fee burden is about 11% higher than the national average.

It is also instructive to review the federal tax burden on Utahns to understand the overall burden on a typical Utah household. Figure 1 shows that Utah's federal tax burden is 40th highest in the nation. It is probably low because of Utah's relatively low incomes, high charitable contributions, and the large amount of tax deductions for children living at home. When the federal tax burden is added to the state and local figures, Utah's overall tax burden is about average, ranking 28th highest in the nation.

PROPERTY TAX

In 2002, property tax generated 29% of taxes raised by Utah state and local governments. Property taxes are levied on all residential and commercial property not exempted by law. Primary home owners in Utah enjoy a significant exemption on their property taxes. In 1982, voters authorized the exemption of up to 45% of the value of primary residences. The exemption began at 25% (75% taxable) and gradually expanded to the full 45% (55% taxable), where it remains today. Figure 4 details the timeline of this exemption.

For the complete report on this topic and other reports, please visit our website at www.utahpriorities.net or www.utahfoundation.org

Figure 2: Utah State & Local Taxes, 2002 (in Thousands)

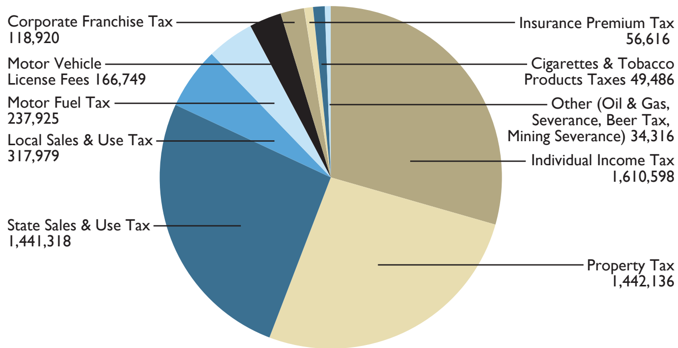

Figure 3: State & Local Tax Burden

Local Taxes & Fees

Mountain States	Per $1,000 Personal Income	National Rank
1. Wyoming	$76.28	3
2. Colorado	64.92	6
3. Nevada	58.97	15
4. Arizona	55.72	24
5. Montana	54.53	28
6. Idaho	54.07	32
7. Utah	**51.12**	**40**
8. New Mexico	41.30	46

State Taxes & Fees

Mountain States	Per $1,000 Personal Income	National Rank
1. New Mexico	$114.98	3
2. Utah	**99.50**	**8**
3. Idaho	90.57	16
4. Montana	87.26	18
5. Wyoming	78.51	29
6. Arizona	70.32	38
7. Nevada	69.54	39
8. Colorado	61.70	47

Source: Census, BEA; Calculations by Utah Foundation

Figure 4: Timeline of Utah's Primary Residence Exemption

Year(s)	Primary Residential Exemption	Taxable Value as Percent of Market Value
1983 - 1990	25%	75%
1991	29.75%	70.25%
1992 - 1993	29.50%	70.50%
1994	32%	68%
1995 - 2004	45%	55%

Source: Utah Tax Commission

In recent years, the state has not directly levied a property tax. It does require, however, that local districts impose a uniform local levy for school purposes. At .001825 cents per dollar of taxable property value, it is the largest component of the property tax for many counties, and in the top three for all others. This state-mandated local school levy is one of the factors that determine the amount of state aid that a local district will receive under the minimum school program. Utah law also allows a local tax levy for capital outlay and debt service that is used for building equalization purposes.

In the mid-1980's the Utah Legislature enacted "truth in taxation" laws that (1) changed the level of property assessment, (2) revised the way tax rates are expressed and (3) required public notice and hearings whenever a taxing entity intended to raise property tax revenues. When growth in property values would bring additional revenues to a local agency, the agency is required to either reduce the tax rate to produce equivalent revenue as the previous year or to label the increased revenue as a tax increase and hold a public hearing on the reasons for increasing taxes. This has placed a great deal of pressure on local officials to reduce property tax rates over time, resulting in a low property tax burden for Utahns.

INDIVIDUAL INCOME TAX

Taxes on individual income provide the largest single source of tax revenue for Utah state government. In 2002, individual income taxes accounted for about 30% of all state and local tax revenue.

The Utah Legislature adopted the individual income tax in 1931. From the beginning, both individual and corporate income taxes were used only for public education. In 1996, voters approved a constitutional amendment to allow higher education to also be funded by income tax revenues. Revenues from the Uniform School Fund now support both public and higher education.

The personal income tax in Utah is divided into 6 brackets as shown in Figure 5. Utah's brackets remained essentially unchanged from 1931 to 2000. The top bracket in 1931 was $8,000. Four years later, in an effort to increase the income tax yield, the Legislature increased the tax rates and eliminated the top three brackets.

Figure 5: Income Tax Rate Changes

Brackets	1931	1935	1965	Brackets	1973	1975	1981	Brackets	2004
$1000	1.00%	1.00%	2.00%	$1,500	2.50%	3.00%	2.75%	$1,727	2.30%
2,000	1.25%	2.00%	3.00%	3,000	3.50%	4.00%	3.75%	3,450	3.30%
3,000	1.50%	3.00%	4.00%	4,500	4.50%	5.00%	4.75%	5,176	4.20%
4,000	1.75%	4.00%	5.00%	6,000	5.50%	6.00%	5.75%	6,900	5.20%
5,000	2.00%	5.00%	6.00%	7,500	6.50%	7.00%	6.75%	8,626	6.00%
6,000	2.50%		6.50%	7,500+	7.25%	8.00%	7.75%	8,626+	7.00%
7,000	3.00%								
8,000	3.50%								
8,000+	4.00%								

Source: Financing Government in Utah, Utah Foundation

In 1973, separate brackets were created for single or married filing separate and married filing joint. For simplicity, only the brackets and rates for married filing joint are shown. In 2001, the Legislature raised the 1973 threshold for each bracket by 15%. The highest single bracket is now $4,313 (a 13% lower threshold than in 1935), and the highest married filing joint bracket is $8,626 (a 72% higher threshold than in 1935). By comparison, the consumer price index of inflation increased by 1192% between 1935 and 2001. A $5,000 taxable income in 1935 was the equivalent of a taxable income of $64,635 in 2001.

Nationally, thirteen states have provisions to automatically adjust brackets, personal exemptions or standard deductions for inflation. Utah is not one of them, and therefore has an income tax that is essentially flat, because inflation has pushed most taxpayers into the highest bracket. Greater than 80% of all single filers and greater than 95% of all married joint filers in the highest bracket. However, Utah is not unique here. Two states have a true flat tax, with no exemptions; four more have a flat tax with exemptions; an additional nine states have top single brackets at or below $10,000, which makes them essentially flat taxes.

Figure 6: National Comparison of Income Tax Structure

States without an Income Tax	States with Unique Income Tax Structure	States with Top Bracket Below $10,000	States that Index for Inflation	States with Nonproportional Exemptions	States that allow Federal Tax Deductions
Alaska	Colorado[1]	Alabama	Arkansas	Alabama	Alabama
Florida	New Hampshire[2]	Connecticut	California	Arizona	Iowa
Nevada	Pennsylvania[1]	Georgia	Idaho	California	Louisiana
South Dakota	Rhode Island[3]	Kentucky	Iowa	Connecticut	Missouri[4]
Texas	Tennessee[2]	Maryland	Maine	Louisiana	Montana
Washington		Mississippi	Michigan	Maine	Oklahoma[4]
Wyoming		Missouri	Minnesota	Massachusetts	Oregon[4]
		Oklahoma	Montana	Mississippi	Utah[5]
		Oregon	Nebraska	New Jersey	New Jersey
		Utah	Ohio	New York	New York
			Oregon	Wisconsin	Wisconsin
			South Carolina		
			Vermont		

Source: Federation of Tax Administrators
(1) Flat
(2) Dividends & interest taxable only
(3) 25% of Federal tax liability
(4) Deduction is limited to $10,000 for joint returns and $5,000 for individuals in Missouri and to $5,000 in Oregon
(5) Allows 1/2 of Federal taxes to be deducted

Personal exemptions are another way that states can adjust the impact of their income tax. Most of the states, including Utah, have proportional exemptions. This means that the exemption for a married couple is double that of a single person and each child is exempted at the rate of a single person. In Utah, singles can take a $2,325 exemption, for married couples the exemption is $4,650 and each child is $2,325.

There are ten states that have nonproportional brackets. Connecticut is an example of this incongruence. For 2004, a single filer receives an exemption of $12,500, the largest in the country. Married filers also receive the largest exemption in the country at $24,000. However, this is slightly less than double suggesting a marriage penalty since a couple cohabitating but filing separately will receive a total of $25,000 in exemptions. Notably, Connecticut is also the only state that does not offer an exemption for children. There are six additional states that have a lower exemption for children than singles. This contrasts with four states that have incongruent exemptions in favor of children.

SALES AND USE TAX

In 2003, state sales and use taxes generated $1.441 billion, or 26% of Utah's overall state and local taxes. That made it the second largest source of tax revenue for the state. Local sales and use taxes generated another $318 million, or approximately 6% of all tax revenue received in the state.

LOCAL SALES TAX

Beginning in 1959, Utah's counties and municipalities were authorized by the state Legislature to charge their own sales and use tax. The local governments can set the level of the tax, subject to voter approval and other tax-levying requirements, up to a maximum of 1%. The state administers the collection and distribution of the tax, retaining up to 2.5% to cover expenses.

As Figure 7 shows, Emery and Millard County share the state's lowest overall state and local sales tax rate and Garfield County claims the highest overall rate. Rates for individual cities can be found at the Tax Commission's website: http://www.tax.utah.gov/sales/rates.html

Figure 7: County Sales Tax Rates

County	Tax Rate	County	Tax Rate	County	Tax Rate	County	Tax Rate
Beaver	6.00%	Garfield	7.00%	Piute	6.00%	Tooele	6.00%
Box Elder	6.00%	Grand	6.00%	Rich	6.00%	Uintah	6.50%
Cache	6.10%	Iron	6.00%	Salt Lake	6.60%	Utah	6.00%
Carbon	6.00%	Juab	6.00%	San Juan	6.00%	Wasatch	6.00%
Daggett	6.00%	Kane	6.75%	Sanpete	6.00%	Washington	6.00%
Davis	6.50%	Millard	5.75%	Sevier	6.00%	Wayne	6.00%
Duschene	6.00%	Morgan	6.00%	Summitt	6.10%	Weber	6.50%
Emery	5.75%						

In Box Elder, Cache, Summitt, Tooele, Utah, and Washington Counties, some cities add an additional 0.25% Mass Transit tax.

Source: Utah Tax Commission

SALES TAX ON FOOD

Utah is one of 14 states that charges sales tax on food. This is seen as a regressive tax, since lower-income households spend a greater percentage of their income on food. States that exempt food from sales tax usually restrict the exemption to food that is consumed "off-premise," or away from the place where it was purchased. This allows restaurant taxes to draw financial support from tourists and other visitors to the state who take advantage of government services but are not required to pay for them. Utah law allows for an additional 1% sales tax on restaurant food, and only four counties in Utah do not levy the tax: Emery, Millard, Piute and San Juan.

Removing the sales tax on food in Utah has been the subject of debate. Advocates argue that making such a change is the humane thing to do, since food is essential to sustain life. Detractors point to the fiscal impact an exemption would have. In 2002, taxes on food (sold for off-premise consumption) generated $218.42 million in sales tax revenue within the state, or 4.0% of state and local taxes. Approximately 74% of this revenue went to the state general fund, 16% went to cities and counties, and 10% was divided among public transit, highways, counties, zoo, resort and rural hospital taxing districts.

DISTRIBUTION & STREAMLINED SALES TAX

There has been ongoing disagreement over the distribution of the sales tax. Initially, the state collected all sales taxes, and returned them, minus the 2.5% charge, to the cities where the tax was collected.

However, suburb cities and other smaller cities, with large populations and little economic activity, argued that their citizens were contributing to larger cities' tax revenues without making comparable contributions to their own. It was unfair for them to have to provide police, fire and other services for their citizens without receiving revenue from them. By contrast, the larger cities argued that they required the revenues to provide infrastructure for the businesses and buildings where the suburban dwellers came to work and shop.

A solution was presented in 1981. It proposed changing the distribution of local sales & use tax revenues to include population as a factor. 50% of all local sales tax revenue would be returned to the city where the sale was made. The other 50% would be divided based on population. The bill was passed by the Legislature, but vetoed by the governor that year. Two years later, a revised bill went into effect. It provided for a 5-year transition period into the 50%/50% distribution model.

A more recent development has been the adoption of the Streamlined Sales Tax by the Legislature in 2003. This legislation is part of a nationwide movement that seeks to make it easier for businesses, specifically catalog, internet and other businesses that operate across state borders, to collect and remit sales taxes. Currently, and until the Streamlined Sales Tax takes effect on July 1st, the sales tax rate on all purchases in Utah depends on the location where the sale is made. For instance, if a customer living in Washington County purchases an item from a store in Salt Lake City, and requests it to be mailed to Washington County, the tax rate for that purchase would be the current rate for Salt Lake City, 6.6%. After July 1, if merchandise is shipped to a customer, the point of delivery will determine the tax rate, rather than the point of sale. A person who takes possession of the merchandise at the store location will continue to pay the rate determined by the city and county where the business is located.

Within Utah, a "hold harmless" clause provides that the 1% local option sales tax will be returned to the cities and counties where the sale originated. This guarantees that cities and counties with strong retail bases won't suffer huge revenue losses as a result of the Streamlined Sales Tax. More information on this new method of handling the sales and use tax is available at http://tax.utah.gov/sst/index.html.

This research report was written by Research Intern Lowe Rudd, Executive Director Stephen Kroes and Director of Research Janice Houston. Ms. Houston may be reached for comment at (801) 272-8824 or janice@utahfoundation.org.