MINUTES OF THE
UTAH TAX REVIEW COMMISSION
Friday, July 13, 2007 – 1:00 p.m. – Room 125 House Building

Members Present:
Mr. M. Keith Prescott, Chair
Mr. David Crapo, Vice Chair
Mr. Larry Barusch
Mr. Mark K. Buchi
Dr. Gary Cornia
Ms. Janis A. Dubno
Rep. John Dougall
Rep. Wayne Harper
Sen. Lyle W. Hillyard
Comm. Bruce Johnson
Mr. Dixie Leavitt
Rep. Rosalind J. McGee
Sen. Wayne L. Niederhauser

Members Absent:
Sen. Brent Goodfellow
Ms. Kathleen Howell
Mr. Bruce Jones

Staff Present:
Mr. Phillip V. Dean, Policy Analyst
Mr. Leif G. Elder, Research Analyst
Mr. Bryant R. Howe, Assistant Director
Ms. Angela D. Oakes, Associate General Counsel
Mr. Ben Hewett, Research Assistant
Mr. Levi Pace, Research Assistant
Ms. Phalin L. Flowers, Legislative Secretary

Note: A list of others present, a copy of related materials, and an audio recording of the meeting can be found at www.le.utah.gov.

1. TRC Business

Chair Prescott called the meeting to order at 1:06 p.m. He excused Sen. Goodfellow and Ms. Howell from the meeting.

Staff distributed the minutes of the June 15, 2007 meeting. Mr. Howe noted that on page 3, the third full paragraph down, should be reworded to read "Rep. Dougall said that he thinks a higher tax rate with a transparent tax system is better than an artificially low rate with a nontransparent pyramiding tax system."

MOTION: Rep. Dougall moved to approve the revised minutes of the June 15, 2007 meeting. The motion passed unanimously.

The TRC discussed future meetings dates and tentatively scheduled meetings on September 7, September 28, October 19, and November 9, 2007.

Mr. Crapo gave an update on the Trusts and Estates Working Group. He said the Working Group hopes to present recommendations at the next TRC meeting.

2. Penalties Imposed by the Utah State Tax Commission

Mr. Dee Talbot, Director, Taxpayer Services Division, Tax Commission (Utah State Tax Commission), presented "Penalties and Waivers." He discussed penalties imposed by the Tax Commission on individuals and corporations when they are late in filing tax returns and in making tax payments. He also discussed the types and amounts of those penalties.

Mr. Talbot explained that intent based penalties are imposed in cases of negligence, fraud, or evasion on the part of the taxpayer. He said that these types of penalties are rarely imposed and are often difficult to prove.

Mr. Craig Sandberg, Auditing Director, Tax Commission, explained that intent based penalties are only imposed after an audit and that a penalty is not usually imposed for a first offense but when there is a consistent pattern of noncompliance.

Mr. Talbot discussed scenarios where tax penalties may be waived and how the waiver process is administered.

Mr. Crapo asked if the Tax Commission monitors the frequency and amount of penalty imposed by type of tax and if there are any notable trends. Mr. Talbot replied that there is some correlation between collection rates and overall economic conditions. He said that some taxpayers may, for the short-term, treat fiduciary withholdings as working capital rather than timely remit them to the Tax Commission. He said that there is between $150 million and $200 million in delinquent taxes outstanding at any given time.

Rep. McGee asked for information on the appeal process. Mr. Talbot replied that the appeal process has several levels including an informal hearing, administrative hearing, and hearing before the Tax Commission.

Comm. Johnson commented that penalty matters are usually resolved before reaching the Tax Commission level.

Chair Prescott thanked the Tax Commission for its presentation. He said that some areas need improvement including when penalties are imposed in cases of simple taxpayer misunderstanding. He said that the penalty system would be more effective if it were tied to an escalating system of non-compliance. He said that sales and use taxes and employer withholding of an employee's state individual income taxes should not be used as working capital.

Sen. Hillyard asked if the Tax Commission can determine when a taxpayer's failure to pay is an isolated instance or part of a pattern of noncompliance. Mr. Talbot said that the Tax Commission's new integrated information system will be able to collect this type of information. He said that the most common form of delinquency is failure to pay individual income taxes in a timely matter. This is often due to some catastrophic event, such as a health emergency, that prevents a taxpayer from paying on time. He said that most of these taxpayers will eventually pay in full under a payment plan.

MOTION: Mr. Leavitt moved to maintain the current penalty system imposed by the Tax Commission.

SUBSTITUTE MOTION: Sen. Hillyard moved to: (a) proceed to the next item on the agenda; (b) have the TRC send a letter to tax practitioners explaining the new provisions of 2007 General Session S.B. 74 and to solicit comments from these practitioners on its implementation; and (c) return to this issue after S.B. 74 has been implemented.

Sen. Hillyard explained that tax practitioners have an advantage in that they see first hand how the Tax Commission administers and imposes penalties. He said that he has little knowledge of this issue unless it is brought to his attention by a constituent.

Mr. Prescott asked if the letter should be sent to taxpayers, practitioners, or both. Sen. Hillyard said that the letter should be sent to practitioners as they are most familiar with this issue.

Mr. Leavitt said that he supports the substitute motion and supports soliciting information from practitioners.

Mr. Prescott said that while he supports the substitute motion he also believes that improvements are needed. He said that at this point he is unsure how to proceed but that the TRC could act in the future if additional information becomes available.

Rep. McGee noted that the provisions of S.B. 74 do not become effective until May of 2008 and May of 2009 and so any comments that the TRC receives from the practitioners would be in reference to the application of the existing law. Mr. Prescott replied that this is correct but that the TRC letter should explain the provisions of S.B. 74 and ask for comment.

Mr. Barusch said that while he supports the substitute motion, it has been his experience that the Tax Commission is sometimes arbitrary in how it imposes penalties. He said that the current penalty imposition process can at times be unpredictable and inequitable.

Dr. Cornia commented that the TRC may be asking the wrong question. The most important compliance issue is not with the taxpayers whom can be identified and will eventually pay, but with unidentified persons who transact business in the underground economy and never or rarely file tax returns. He said that if the TRC is serious about tax reform that it should consider how the Tax Commission can better identify taxpayers who do not report and file.

Mr. Buchi said that he hopes that the TRC can consider the problem of a taxpayer who files one day late and is assessed a large penalty. Perhaps the Tax Commission should be given more guidance on if and when to waive penalties in these situations.

Comm. Johnson commented that the Tax Commission frequently reviews when and how penalties are imposed. He said that it often waives even large penalties for good cause if the taxpayer otherwise has a good filing history.

The substitute motion passed unanimously.

3. Report of the Sales and Use Tax Working Group

Mr. Buchi distributed and discussed "Recommendations: Issues in Developing an Ideal Sales and Use Tax System." He discussed the issues the Working Group has considered and developed a recommendation for, such as exempting business purchases and imposing the sales and use tax on the consumption of all services by households. He said that the Working Group should have a more detailed proposal to present at the next TRC meeting.

4. Report of the State Tax Revenue Volatility and State Rainy Day Funds Working Group

Rep. Harper distributed and discussed "Policy Issues Associated with Budget Reserve Accounts" and "Potential Statutory Clarifications Related to Budget Reserve Accounts." He explained that the Working Group has been studying the state's budget reserve accounts, discussing current laws and practices regarding these reserve accounts, and drafting recommendations to address certain issues.

Mr. Dean distributed and discussed "Volatility in the Sales Tax Base." He discussed size and volatility trends that affect the state's budget reserve accounts.

Mr. Howe distributed and discussed "The Changing Utah Sales and Use Tax Base." He explained that over the last 21 years the retail trade and services portion of the sales and use tax base has increased and the business purchases portion has decreased. He said that total state gross taxable sales as a percent of gross state product is declining.

Mr. Dean distributed and discussed 2008 General Session draft legislation "Budget Reserve Account and Disaster Recovery Account Amendments." He explained that the bill changes target amounts for the state's budget reserve accounts, requirements that control deposits made to the accounts, the conditions of how money may be appropriated from the accounts, and creates limits on the amounts in the accounts.

Mr. Jonathan Ball, Deputy Director, and Dr. Thomas Young, Fiscal Analyst, Office of the Legislative Fiscal Analyst, and Mr. John Fellows, Deputy General Counsel, Office of Legislative Research and General Counsel, distributed and discussed "Calculation of Rainy Day Deposits (Assume No Caps)." They explained the current and proposed methodology for calculating surplus transfers to the budget reserve accounts with no caps to the accounts, as well as current and proposed methodologies for calculating surplus transfers with a six percent cap to the accounts.

Mr. Leavitt asked how revenue projections are adopted by the Legislature. Mr. Ball explained that Legislature's Executive Appropriation's Committee recommends an expenditure level which must then be approved by the Legislature and Governor. As part of the budgeting process, the Executive Appropriation's Committee adopts a revenue estimate to set the level of authorized expenditures.

Dr. Young distributed and discussed "Rainy Day Fund - Dynamic Recommendation." He explained the formula for dynamic estimating that can be used to determine an optimum range of balances for the budget reserve accounts.

Dr. Cornia suggested that representatives from the Office of the Legislative Fiscal Analyst, Office of Legislative Research and General Counsel, the Governor's Office of Planning and Budget, and Dr. Ray Nelson continue to discuss the information and proposals discussed today.

Mr. Ball noted that if the proposed formula for determining the target size of state budget reserve accounts had been in effect for fiscal year 2008, that the General Fund Budget Reserve Account contains a sufficient balance while the Education Fund Budget Reserve Account does not contain a sufficient balance.

Sen. Hillyard said that budget reserve accounts should only be used as a bridge for one fiscal year. If revenue shortfalls occur for more than one fiscal year then the Legislature should decide how to respond by either reducing expenditures or raising taxes. He also said that it might be politically difficult to increase the balance of the Education Fund Budget Reserve Account.

Mr. David Stringfellow, Governor's Office of Planning and Budget, explained how budget reserve account balances affect state bond ratings issued by bond rating agencies. He explained that the rating agencies do not offer opinions regarding the optimum size of states' budget reserve accounts. He said that most states have budget reserve accounts balances that are between three and eight percent of annual expenditures. Utah sits comfortably in the middle of that range. He said that the rating agencies also consider quality of governance and that Utah is highly regarded in how it manages its budget.

Mr. Barusch said that limiting the budget reserve accounts' balances to cover only one fiscal year of expenditures limits the Legislature's options. If revenue shortfalls continue to occur for more than one year, then there are few good alternatives for the Legislature to adopt. The Legislature may be reluctant to increase taxes during a recession or to reduce expenditures in noneducation programs. The one year stragtegy does not make sense. He said that while no one knows how long a recession will last, it usually lasts longer than just one year.

5. Other Items / Adjourn

MOTION: Rep. McGee moved to adjourn the meeting. The motion passed unanimously with Mr. Crapo and Mr. Leavitt absent for the vote.

Chair Prescott adjourned the meeting at 4:11 p.m.