

**MINUTES OF THE
TAX REFORM TASK FORCE**

Thursday, May 26, 2005 – 9:00 a.m. – Room W135 House Building

Members Present:

Sen. Curtis S. Bramble, Senate Chair
Rep. Wayne A. Harper, House Chair
Sen. Mike Dmitrich
Sen. Howard A. Stephenson
Rep. John Dougall
Rep. Gregory H. Hughes
Rep. Todd E. Kiser
Rep. Merlynn T. Newbold
Rep. Gordon E. Snow
Rep. Stephen H. Urquhart
Comm. Pam R. Hendrickson
Mr. Neil H. Ashdown

Members Absent:

Pres. John L. Valentine
Rep. Ralph Becker
Rep. Roz J. McGee

Staff Present:

Mr. Bryant R. Howe, Assistant Director
Mr. Phillip V. Dean, Policy Analyst
Ms. Phalin L. Flowers, Legislative Secretary

Note: A list of others present and a copy of related materials can be found at www.le.utah.gov or by contacting the task force secretary, Phalin Flowers, at 538-1032. A recording of the meeting is available from the task force secretary.

1. Committee Business

Chair Bramble called the meeting to order at 9:15 a.m.

MOTION: Sen. Dmitrich moved to approve the minutes of the May 17, 2005 meeting. The motion passed unanimously with Rep. Dougall, Rep. Harper, and Rep. Kiser absent for the vote.

2. "Governor Olene S. Walker's Recommendations on a Tax Structure for Utah's Future"

Mr. Keith Prescott, CPA, Chair of the Utah Tax Review Commission (TRC), Comm. Bruce Johnson, Utah State Tax Commission, Dr. Gary Cornia, Professor of Management, BYU, and Dr. Ray Nelson, Professor of Management, BYU, distributed "Governor Olene S. Walker's Recommendations on a Tax Structure for Utah's Future" to the task force.

Mr. Prescott said that Utah's current state and local tax system is a patchwork of inadequate policies, especially with regards to the sales and use tax, individual income tax, and corporate franchise and income taxes. The state and local tax system is not rational nor does it have the characteristic of being well thought out. He said that Governor Walker's report examines the state and local tax system as a whole, and not just a few components.

Mr. Prescott said that the state individual income tax is a good example of a tax based on poor policies. Provisions such as deducting only one-half of federal income taxes show that principles have been abandoned in an attempt to raise revenue. In each instance, the base has been made too narrow and rates set too high. He said that the current law is simply an admission of a clumsy attempt to raise rates on a tax base that is too narrow. This results in a loss of simplicity, clarity, and accuracy. He said that what is

needed is a system that is deliberate, simple, cohesive, transparent, promotes compliance, is easy to administer, has a stimulative effect on economy, and is better overall for the average family.

Dr. Gary Cornia told the task force that changes in the nation's business cycle have implications for state and local taxes. Nearly all taxes are affected to a certain degree by changes in the business cycle. He said that this is particularly true for the state corporate franchise and income taxes. This tax is clearly problematic for forecasters and policy makers in that it is difficult to ensure a consistent revenue stream. He said that the sales and use tax is also quite volatile.

Rep. Kiser said that his insurance business is also affected by changes in the business cycle. He said that it would be ideal if his private business could consistently produce stable revenues. He asked why tax revenues should not also be affected by the business cycle, as is the private sector. Dr. Nelson replied that large corporations undertake financial planning to attempt to smooth and diversify revenue sources to be less sensitive to changes in the business cycle.

Dr. Cornia said that it is a good business policy to diversify revenue sources. He said that governments should not be held harmless during an economic downturn and that programs and budgets should be reduced. However, it is good management to have a tax system that is as stable as possible.

Mr. Prescott said that his CPA firm looks for ways to broaden sources of revenue to ensure against an economic downturn. While businesses and governments will always be affected somewhat by changes in the business cycle, the revenue stream should be prudently managed. Creating a broad and stable tax base will also eliminate peaks in revenue.

Rep. Hughes said that the task force should attempt to create stable revenue sources. Government should not grow unnecessarily during periods of strong growth and it is unwise to maintain revenues in an economic downturn.

Commissioner Bruce Johnson reviewed some of the major proposals contained in the recommendations. He said that the state sales and use tax system provides a classic example of a declining tax base. Reasons for this decline include electronic and other forms of remote commerce, public policy decisions as more and more businesses and individuals obtain people exemptions to the sales and use tax, and changing economic patterns. For example, in the 1930s, when the sales and use tax was enacted, most purchases by consumers were of tangible personal property. Consumers are now spending more money on services that are not subject to the sales and use tax.

Commissioner Johnson also said that the sales and use tax should avoid pyramiding. A separate tax should not be imposed on an item as it moves through the production chain. For example, while raw materials purchased for fabricating are generally exempt from the sales and use tax, there are other business inputs subject to the sales and use tax. Property such as research equipment, testing equipment, maintenance equipment, and other items consumed in production are subject to tax. Under Governor Walker's proposal, the sales and use tax would be expanded to include many services, most business purchases would be exempt, and the rate could be reduced to as low as 3.75 percent.

With regards to the individual income tax, by using federal adjusted gross income as a base, a single rate of four percent would yield approximately the same revenues as the current system. However, deductions for mortgage interest, contributions to religious and charitable organizations, and other existing deductions would be eliminated.

Dr. Cornia said that studies have found no statistical effect on consumption of housing by eliminating a deduction for mortgage interest. Studies have also found no effect on eliminating a deduction for charitable giving.

Rep. Snow said that under this proposal the current state individual income tax deduction for retirement income would be eliminated. He asked what would be effects of this change. Mr. Prescott replied that the state and local state system should not negatively affect persons with low incomes. He said that when considering the recommendations as a whole, those with lower incomes would bear no larger burden than now.

Commissioner Johnson concluded the major recommendations by stating that the corporate franchise and income taxes should be eliminated. Sen. Stephenson commented that some corporations have argued that a better option than eliminating this tax would be to adopt a single sales apportionment factor. Commissioner Johnson replied that federal law provides that if a business's only connection to a state is that it makes sales there, then there is no state corporate income tax liability.

Rep. Dougall asked what taxes are appropriate for businesses to pay for the government services that they receive. Commissioner Johnson said that businesses would still pay property taxes under this proposal. Dr. Cornia said that generally the property tax is considered to be an efficient tax in that it does not distort economic decisions.

3. Tax Review Commission and Tax Recodification Commission History

Mr. Mark Buchi, Member, Utah Tax Review Commission, explained the creation of the Utah Tax Recodification Commission and the history of the Utah Tax Review Commission. He explained the actions taken by the Tax Recodification Commission to improve and clarify many aspects of the state and local tax system. However, he said that it was difficult to adopt many substantive changes and even when such changes were made, they were often reversed a few years later.

Mr. Buchi encouraged the task force to not only debate high level policy issues but to also involve taxpayers, tax practitioners, state and county level tax administrators and others to solve some of the problems that have gradually evolved in the state and local tax system over the last 20 years. For example, court cases have introduced certain ambiguities and legislation has been enacted with unintended consequences. He said that what is needed is a clear and understandable tax code. He suggested that the task force seek input and advice from professional tax practitioners who could identify issues for the task force's consideration. He concluded by stating that how to use the state and local tax system to promote economic development was not a topic for consideration in earlier studies.

Mr. Prescott told the task force that he was asked to chair a subcommittee of the Tax Recodification Commission to examine the state's corporate franchise and income taxes. He said that all members of this subcommittee worked very hard to make decisions that were in the public, and not individual, interest. He also said that the TRC is available to help the Task Force if this is desired.

4. 1990 Tax Policy Resolutions

Mr. Frank Knowlton, former legislator and former Chair of the Utah Tax Review Commission, spoke to the Task Force concerning tax policy resolutions that were adopted by the Legislature in 1990. He discussed the positions contained in each resolution.

The Task Force recessed at 12:22 p.m.

5. Subcommittee Meetings

The Income Tax Subcommittee and the Property Tax Subcommittee met.

6. Subcommittee Meetings

The RDA / Other Taxes Subcommittee met.

7. Task Force Reconvenes

The Task Force reconvened at 3:58 p.m.

Rep. Snow presented the Task Force with a report on the Property Tax Subcommittee meeting. He explained that they reviewed the basics of the personal property tax in Utah.

Sen. Stephenson gave the Task Force a report on the Income Tax Subcommittee meeting. He said they passed a motion to agree to examine a flat tax.

Rep. Harper gave the Task Force a report on the Sales and Use Tax Subcommittee meeting. He discussed how the Subcommittee examined several different issues, including expanding the sales and use tax to include services. He discussed "Report of the Sales and Use Tax Subcommittee."

Mr. Ashdown said that Governor Huntsman strongly supports the work of the task force.

8. Other Items / Adjourn

The next Task Force and subcommittee meetings are scheduled for Wednesday, June 8, 2005 beginning at 9:00 a.m.

MOTION: Rep. Dougall moved to adjourn the meeting. The motion passed unanimously with Sen. Dmitrich, Rep. Hughes, and Rep. Urquhart absent for the vote.

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Chair Bramble adjourned the meeting at 4:06 p.m.