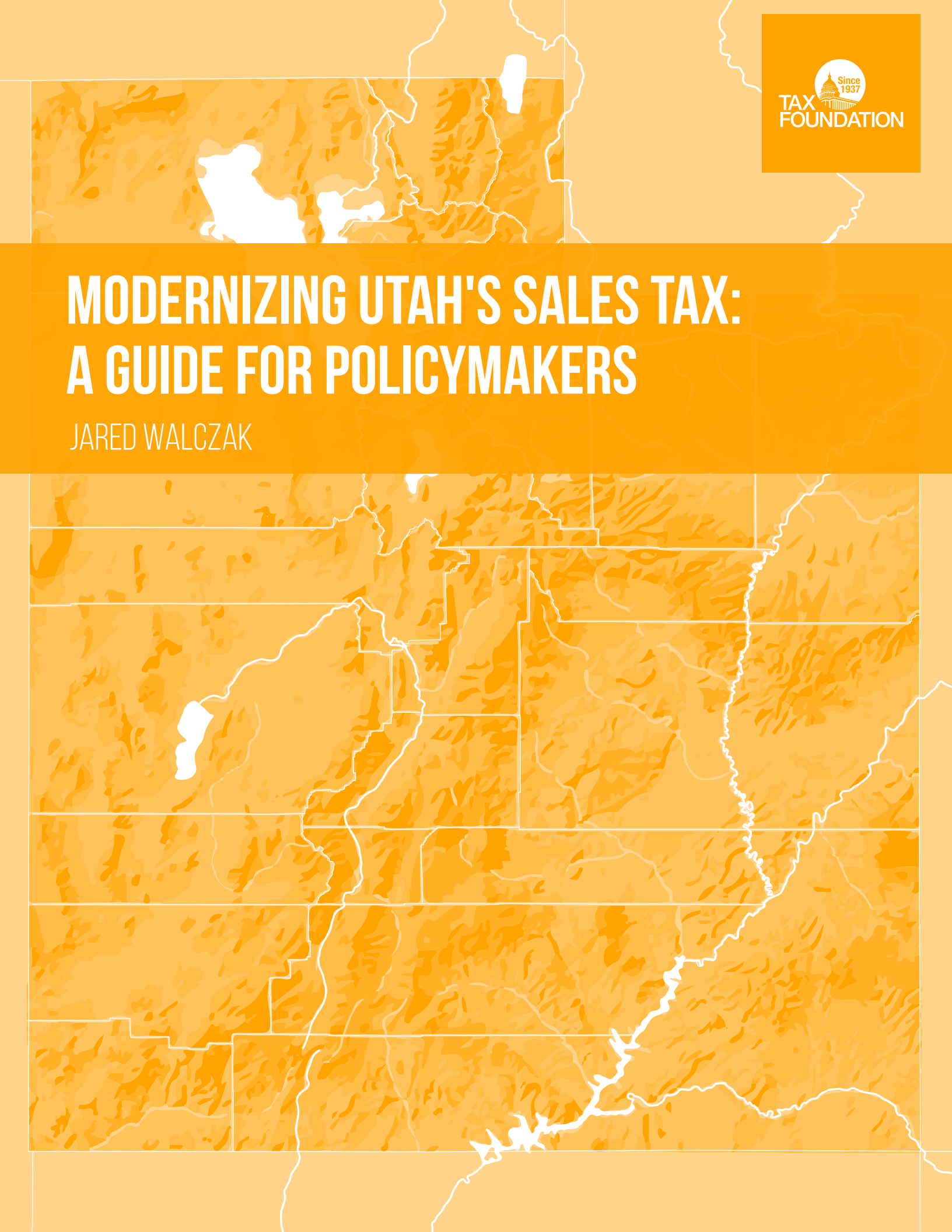

MODERNIZING UTAH'S SALES TAX: A GUIDE FOR POLICYMAKERS

JARED WALCZAK

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Executive Summary

By almost any measure, Utah is, and deserves to be, the envy of its peers. The state's economy has nearly doubled in size over the past two decades, growing at twice the rate of the nation at large. Income is rising, tax collections are robust, and Utah leads the country in job growth. Tax reforms adopted in 2007 improved the structure and competitiveness of the state's individual and corporate income taxes and established a model for other states to follow.

But today, some of the gains made in 2007 are being undone—not by conscious policy choices, but by their absence. The three-legged stool—income, property, and sales taxes—is increasingly unbalanced, to the detriment of the state's economic competitiveness and revenue stability. Utah's sales tax breadth is barely half what it was at its peak, shortly after the end of World War II, and the percentage of personal consumption subject to the tax has declined from nearly 50 percent to just 35 percent over the past 20 years.

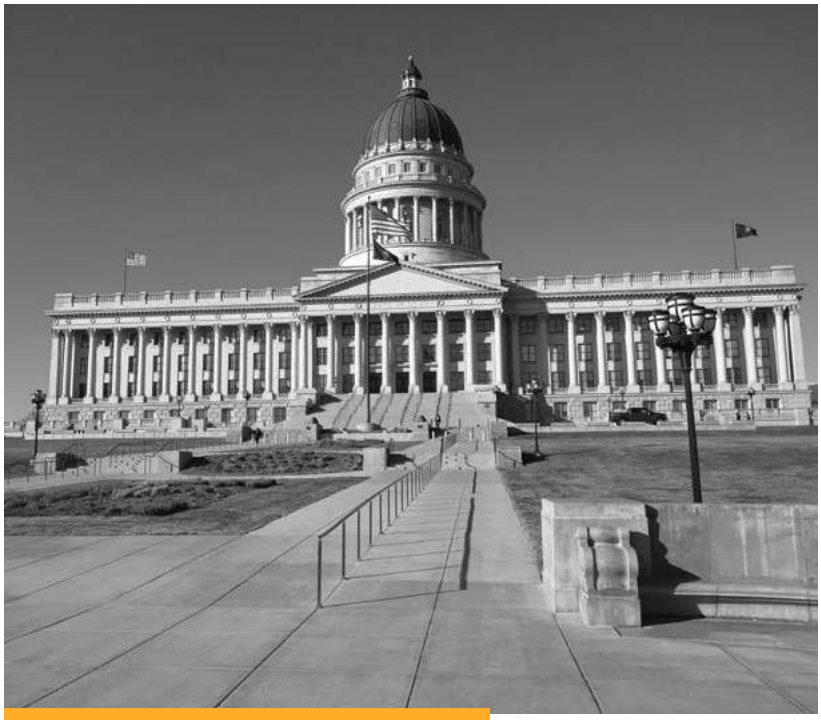
The result is a tax code that leans more heavily on income taxes, contrary to the intentions of tax reformers a little more than a decade ago, and a sales tax that increasingly puts a thumb on the scale, favoring some transactions over others. Alone among states, Utah earmarks the entirety of its individual and corporate income taxes and generates almost all its general fund revenue from the sales tax. Yet, over the past four decades, the sales tax has declined 31 percent as a share of state tax collections while the income tax is up 60 percent.

Utah does not have a revenue problem, but it does face a problem of imbalance. Shifting consumption patterns are eroding the sales tax, with untaxed services assuming an ever-greater share of personal consumption. The consequence is that the existing sales tax base is taxed at a higher rate than would otherwise be necessary, certain kinds of consumption are given preferential treatment, and the income tax—which is considerably less pro-growth than the sales tax and does not contribute to the general fund—has emerged as the dominant state tax.

The state's sales tax is a reflection of its Depression-era roots and is constructed around an economy which long since vanished. Today's economy has little in common with that of 1933, with higher incomes and changing consumer tastes shifting a greater share of consumption to services, while a digital economy upends traditional spending categories. A modernization is long overdue—for fairness, revenue stability, and a rebalancing of the tax code to secure the future of one of the more economically efficient forms of taxation available to states.

Sales tax reform follows the familiar refrain of "broad bases and lower rates," but rather than simply speaking of broadening the base, we might instead speak of right-sizing the base. There is little question that the current sales tax base is too narrow, arbitrarily exempting large swaths of personal consumption. But not all base-broadening measures are created equal.

There is a scholarly consensus that an ideal sales tax is imposed on all final consumption, both goods and services, but exempts all intermediate transactions (business inputs) to avoid tax pyramiding, where the same tax is embedded multiple times in the final purchase price. In contrast with this ideal, Utah's base exempts the majority of personal consumption while over a quarter (and possibly



considerably more) of current revenues are generated from business inputs. Although theoretical ideals may be out of reach, Utah policymakers should build on the state's successes in reducing tax pyramiding by excluding intermediate purchases from base-broadening provisions, either excluding them by classifications of purchases or based on the identity of the purchaser.

Utah policymakers have wrestled with the proper definition of business inputs, with some advocating narrow definitions involving consumption of products that are "integral" to production or consumed in the production process, while others have advanced more expansive definitions which would exempt most business purchases. In these pages, we outline the negative ramifications of an overly narrow definition and how a poorly structured sales tax can increase consumer prices, disincentivize investment, and in many respects transform the sales tax into something else entirely.

This paper seeks to make the case for sales tax modernization. It also delves into questions of policy design, from the aforementioned exclusion of business inputs to rate-setting mechanisms to sourcing rules to ways to include local governments within the framework of reform. We also explore the possible use of sales tax base-broadening revenues to reduce individual income as well as sales tax rates. It is our hope that this analysis can help inform deliberations about the structure and implementation of a tax reform agenda.

We argue that legislators should avoid the temptation to chase a rate. Legislators should determine the appropriate sales tax base with reference to sound policy principles and adjust the rate accordingly rather than identifying a target rate and then pursuing whatever base-broadening measures are necessary to meet that target. The appropriate goal of revenue-neutral sales tax reform is a stable, economically neutral tax that reflects a 21st century economy, not the lowest possible rate.

We examine several options for phasing in sales tax base changes and for the inclusion of local governments. While policymakers can approach the local sales tax issue in several ways, it is important that local option sales taxes be included in any reforms—both base and rate changes. Doing otherwise introduces new complexities, puts state and local governments on divergent revenue trajectories, and renders Utah out of compliance with a multistate sales tax agreement that has taken on greater importance now that states have the legal authority to tax online sales.

We both discuss and apply several broadly accepted standards and observations about sales taxes, including that:

- Sales taxes should be imposed on goods and services alike, while exempting business inputs to avoid double taxation through tax pyramiding;
- The sales tax is more economically efficient than many competing forms of taxation, including the income tax, because it only falls on present consumption, not saving or investment;
- Because lower-income individuals have lower savings rates and consume a greater share of their income, the sales tax can be regressive, though broadening the base to include additional consumer services represents a progressive change;
- The sales tax scales well with ability to pay; and
- Consumption is a more stable tax base than income, though the failure to tax most consumer services is leading to a gradual erosion of sales tax revenues.

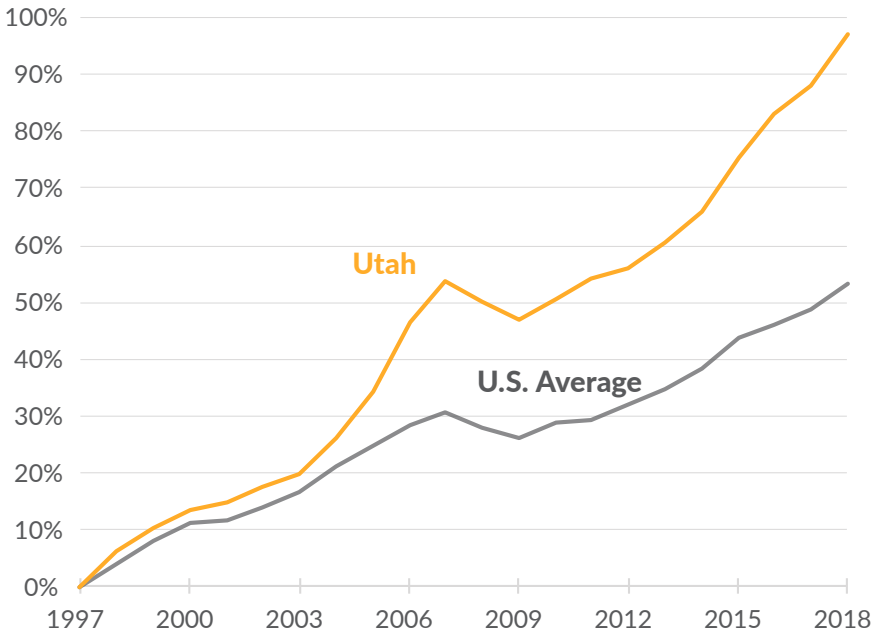
Conditions are ripe for reform. With the formation of a task force to consider sales tax modernization and other tax reform options, this is Utah's chance to bequeath future generations a flexible tax code that can adapt to a changing economy, and a pro-growth tax code that harnesses Utahns' work ethic and creative energy to continue—and build upon—the state's many economic successes.

Introduction

Utah is awash with beehives—but not with bees, so much. The state has never been known for its apiaries. The beehive symbol[1] is ubiquitous, appearing on road signs, the state flag, business logos, and many other places, not as a callback to a specific industry, but rather to the industriousness, community, and prosperity of the people. It is a depiction of Utah as a land flowing with, if not milk, certainly honey. And it is a fitting symbol for a state with a booming economy. Utah's gross state product has nearly doubled in real (inflation-adjusted) terms since 1997, growing at close to twice the national rate and vastly outpacing its regional peers, and the state has led the nation in job growth since the end of the Great Recession.[2]

FIGURE 1.

GDP Growth, Utah and Competitors, 1997-2018



Utah	**+97%**
U.S. Average	**+53%**
Arizona	+68%
Colorado	+73%
Idaho	+68%
Nevada	+75%
New Mexico	+21%
Wyoming	+71%

Sources: U.S. Bureau of Economic Analysis; Tax Foundation calculations.

Reforms adopted in 2007 enhanced the overall competitiveness and simplicity of the state's tax code,[3] but while Utah boasts a prosperous 21st century economy, its sales tax is designed for an economy that no longer exists. The erosion of the sales tax base, particularly in a state where the sales tax is the only major source of (unearmarked) general fund revenue, makes the tax code less equitable, increases reliance on less economically efficient taxes, and unduly influences the budget process. Lawmakers have a unique opportunity to finish the job begun in 2007 with the implementation of a modern, pro-growth sales tax code.

1 Technically a traditional straw skep; today's commercial beehives are wooden boxes with frames.

2 Kem C. Gardner Policy Institute, "Utah Informed: Visual Intellection for 2019," January 2019, 16, https://gardner.utah.edu/wp-content/uploads/2019-Utah-Informed-Final.pdf.

3 The 2007 reforms represented a tax reduction of roughly $400 million, including a new individual income tax system ($190 million cut), a reduction in the sales tax on food ($120 million), and a general sales tax rate reduction ($40 million), along with other smaller cuts for businesses and individuals, while granting counties new sales tax authority and permitting some local governments to increase sales tax rates to mitigate revenue losses related to the reduced sales tax on food. See Utah Legislature, "Tax Relief & Reform: What Does It Mean for Taxpayers?" Briefing Paper, March 2007, https://le.utah.gov/lrgc/Briefings/TaxReliefandReform2007.pdf.

Something that is conceptually simple—updating the sales tax to reflect modern consumer purchasing patterns—is, in fact, a complex undertaking. Care must be taken to avoid what is known as tax pyramiding, where the same final good or service is taxed multiple times across the production process. Rate reductions should be adopted to offset additional revenue from base broadening, with an adjustment mechanism to account for the inherent uncertainty of revenue estimates for currently untaxed transactions. How to include local sales taxes in any reforms must be the subject of thoughtful deliberation.

But in tax policy as in life, the things most worth doing are rarely easy. The good news is that it can be done. And the pressure is on, because with each passing year, the problem grows more acute—and harder to solve. Utah's three-legged stool—income, sales, and property taxes—increasingly unbalanced, overemphasizing the comparatively less economically inefficient income tax over the sales tax. The legislature's present interest in sales tax-centric tax reform offers a unique opportunity to address the issue. This paper seeks to make the case for legislative action, and to offer insights and recommendations on enacting pro-growth reform.

A Short Overview of Utah Taxation

The first great fact of Utah taxation is the earmark. Alone among states, Utah dedicates the entirety of its income tax collections—individual and corporate[4]—to public education.[5] Nor is the sales tax immune, with a growing share (about 32 percent as of 2018, up from 2.5 percent 13 years earlier) earmarked for priorities ranging from transportation and other infrastructure to water and natural resources.[6]

Two other facts inform the first: less than a third of Utah's land is privately owned,[7] and three-quarters of the population is concentrated in four most populous counties of the Wasatch Front.[8] Property taxes, a mainstay of school funding elsewhere,[9] are woefully insufficient in small, low-density counties. Taxable value in Salt Lake County alone is more than the taxable value of 26 of the remaining 28 counties—combined. Nearly 85 percent of all taxable property value is concentrated in just six counties. This high concentration of taxable property helps explain why only a quarter of public education funding is at the local level in Utah,[10] compared to about 45 percent nationwide.[11] It also has important implications for state taxation as a whole.

4 UT Const. Art. 8, § 5.

5 Arturo Pérez, "Earmarking State Taxes," National Conference of State Legislatures, September 2008, 4, 83, http://www.ncsl.org/documents/fiscal/earmarking-state-taxes.pdf.

6 Utah State Tax Commission, "History of the Utah Tax Structure," December 2018, 10-13, https://tax.utah.gov/esu/history/history.pdf.

7 National Wilderness Institute, "Public Land Ownership by State," https://www.nrcm.org/documents/publiclandownership.pdf.

8 Kem C. Gardner Policy Institute, "Utah at a Glance," January 2018, https://gardner.utah.edu/wp-content/uploads/UtahAtAGlance_20180207.pdf.

9 Andrew Reschovsky, "The Future of U.S. Public School Revenue from the Property Tax," Lincoln Institute of Land Policy, July 2017, https://www.lincolninst.edu/sites/default/files/pubfiles/future-us-public-school-revenue-policy-brief_0.pdf.

10 Utah State Board of Education, "Property Tax, Overview," https://www.schools.utah.gov/financialoperations/propertytax?mid=2198&tid=0.

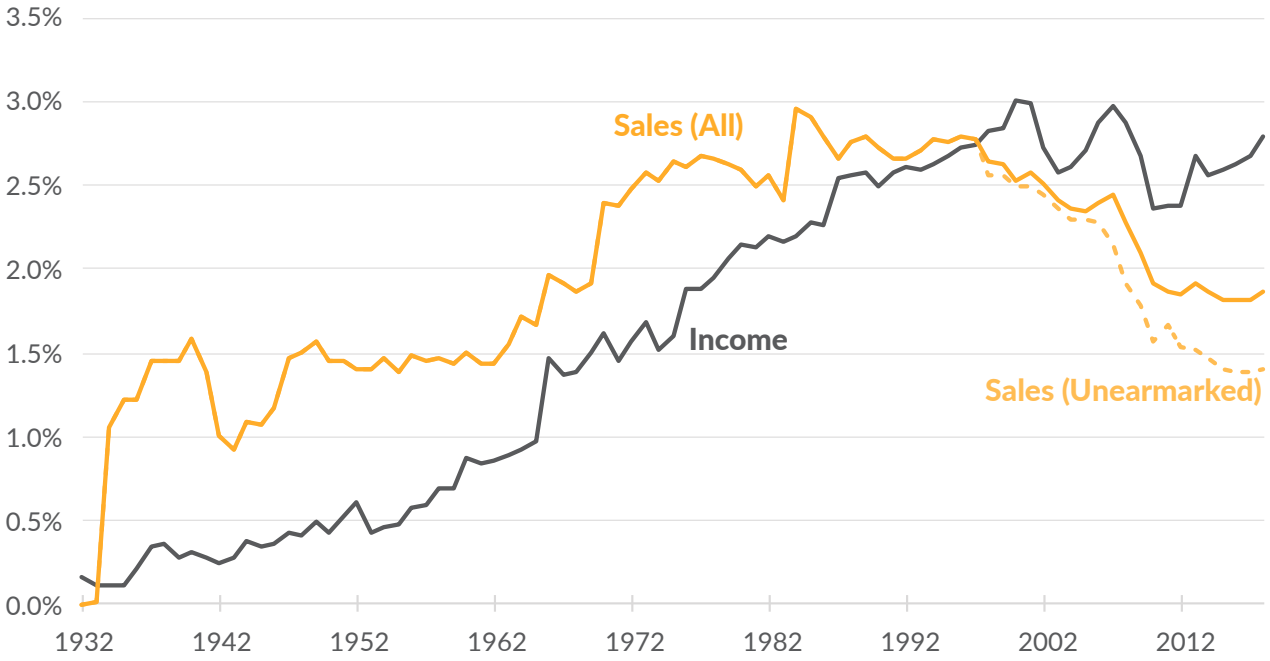
11 Andrew Reschovsky, "The Future of U.S. Public School Revenue from the Property Tax."

High rates of income tax earmarking are rare. Only Alabama, which earmarks nearly 98 percent of its individual income tax for K-12 and higher education, comes close. After Alabama, the next-highest is Massachusetts, which designates 40 percent of its individual and corporate income tax collections to local government aid. All told, eight states earmark 10 percent or more of their individual income tax collections, and three states earmark at least 10 percent of their corporate income taxes.[12]

By dedicating the income tax to education, along with more typical dedications (like earmarking the gas tax for infrastructure spending), architects of Utah's tax code made the sales tax supremely important for funding the rest of government. Unfortunately, while income taxes continue to show robust revenue growth, sales tax revenues show signs of stagnating. Three decades ago, sales tax collections were equal to 2.8 percent of state income while income tax collections stood at 2.6 percent. Today, despite income tax rate reductions and other reforms, income tax collections are 2.8 percent of state income, while sales tax collections have fallen to 1.9 percent, with the unearmarked share of the sales tax—the full 2.8 percent three decades ago—at 1.4 percent.[13]

FIGURE 2.

Income & Sales Tax Collections as a Percentage of State Income



Source: Utah State Tax Commission.

This still represents an increase in sales tax collections, in real as well as nominal terms. It is, moreover, indisputably good that Utah's economic success is such that income is growing faster than consumption can keep up. Still, it means that even as Utah's overall tax collections continue to increase, an ever-shrinking share is available for the general fund, creating budget stress in some spending categories while surpluses accumulate elsewhere. It reflects, moreover, not just a change in the amount of consumption relative to income—something to which the sales tax ought to be sensitive—but also the kind of consumption that takes place. Changes in the overall economy and

12 Arturo Pérez, "Earmarking State Taxes."

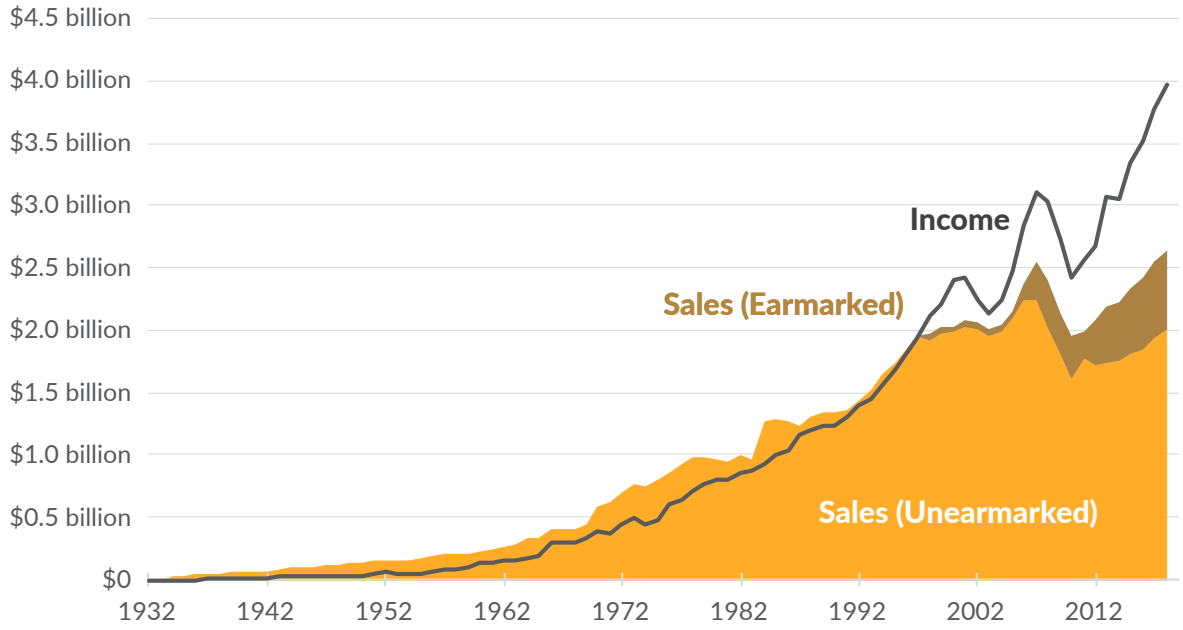
13 Utah State Tax Commission, "Revenue Summary Reports," 2019, https://tax.utah.gov/econstats/revenue; U.S. Bureau of Economic Analysis, "Personal Income by State," last updated April 9, 2019, https://www.bea.gov/data/income-saving/personal-income-by-state.

in the relative affluence of many Utahns have shifted a growing share of consumption into largely untaxed services, contributing to the growing disconnect between income and sales tax revenue growth.

For most of the history of both taxes, the sales tax has outperformed the individual income tax. That trajectory began to shift during the 1990s, first aligning the two taxes, then resulting in a decisive shift toward the income tax in the late '90s—a trend that has not abated, despite several recessions, to which income taxes are more susceptible than sales taxes. Today, the income tax brings in nearly $4 billion a year, compared to less than $2.7 billion from the sales tax (about $2 billion unearmarked).[14]

FIGURE 3.

Income and Sales Tax Collections



Source: Utah State Tax Commission.

There is, moreover, a longstanding recognition that the sales tax as presently constituted is, among the state's major taxes, the least aligned with principles of sound tax policy, particularly in the wake of the 2007 tax reform package which significantly overhauled the state's income tax. In 2017, the Utah Tax Review Commission's members were asked to evaluate income, property, and sales taxes on their adherence to widely-embraced tax principles. Rankings were on a scale of 1-7, with 1 being best and 7 worst. When the evaluators' scores were aggregated, the income tax's component scores ranged from 1.8 to 3.5, with an average of 2.7 across all categories. Property tax component scores ranged from 1.8 to 4.3, with an average of 3.2. Meanwhile, sales tax scores ranged from 4.1 to 5.7, with an average of 4.5. Across seven categories, the income tax scored above midpoint on all seven, and the property tax on five of seven. The sales tax received failing grades in all but one category (reliability), with members of the commission faulting its lack of simplicity, neutrality, equitability, competitiveness, and transparency, along with its high compliance costs.[15]

14 Utah State Tax Commission, "Revenue Summary Reports."

15 Utah Tax Review Commission, "2017 Report of the Utah Tax Review Commission," Nov. 15, 2017, https://le.utah.gov/interim/2017/pdf/00005007.pdf.

TABLE 1.

Adherence of Utah's Major Taxes to Key Tax Principles
On a Scale of 1-7

Tax Principle	Income	Property	Sales
Simplicity	1.8	3.1	5.7
Neutrality	2.9	4.3	4.8
Reliability	2.8	1.8	3.6
Equitability	3.5	4.0	4.2
Competitiveness	3.3	2.4	4.1
Compliance Costs	2.3	3.9	4.7
Transparency	2.3	2.8	4.2
Average	2.7	3.2	4.5

Source: Utah Tax Review Commission (2017).

In short, Utah's tax code is due for a realignment. An opportunity exists to modernize the sales tax and increase revenue predictability while enhancing the state's economic competitiveness. The level of attention generated by 2019 House Bill 441, which represented an extremely broad expansion of the sales tax base (to both intermediate and final consumption) paired with significant rate cuts, has resulted in a widespread understanding of the need for reform. As Utah policymakers continue to grapple with the issue over the interim, they should seek to capitalize on that enthusiasm, while taking care to avoid double taxation from tax pyramiding or making the sales tax unnecessarily complex.

The Development of Utah's Sales Tax in Brief

Utah's sales tax was first imposed on a temporary basis in 1933, at a rate of 0.75 percent, but was almost immediately made permanent at 2 percent.[16] In this, Utah followed in the footsteps of many other states which adopted supposedly short-lived sales taxes during the Depression but quickly moved to extend their lives.

The rate stayed at 2 percent for three decades before beginning to inch up in 1962, peaking at 4 percent before entering a period of more frequent adjustments, and significantly more decimal places, maxing out at a 5.09375 percent rate in 1987. The modern era of sales tax revenue earmarking began in 1988, and the lower rate on food (now 1.75 percent) began with a phasedown commencing in 2007.[17] Other exemptions through the years include motor fuels (1957), prescription drugs (1976), manufacturing machinery for new or expanding operations (1985), replacement parts (1995), home medical equipment (1996), and repair parts with three year asset lives (2006). A 2 percent tax on certain services was adopted in 1959, but many of these services are outside the current tax base.[18] Earmarks currently cover transportation (several different highway and transportation funds), water and natural resources, food pantries, and even, for a while, the Olympic Winter Games.[19]

16 Utah State Tax Commission, "History of the Utah Tax Structure," 13.

17 Id., 9-10.

18 Id., 86.

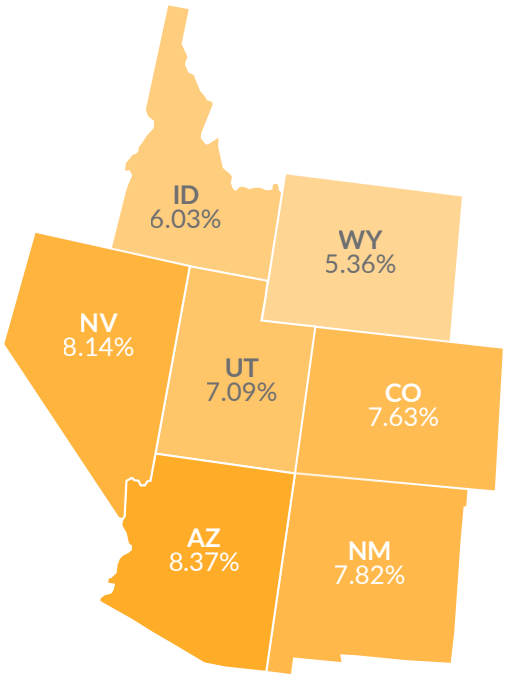
19 Office of Legislative Research and General Counsel, "Utah's Sales & Use Tax: Issues and Options," Feb. 16, 2010, https://le.utah.gov/lrgc/briefings/SalesTaxBagelsBriefingPresentation.pdf.

The local sales tax was adopted in 1959, and today, all counties, cities, and towns in Utah have ordinances on the books imposing the full 1 percent local option sales tax, which is collected by the state and remitted to localities on the basis of population and point of sale. Although the weighting of those two factors has varied over the years and was previously biased toward the point of sale, today the two factors are evenly weighted.[20] An additional county option sales tax of 0.25 percent was implemented in 1997[21] along with a town option tax, and localities also enjoy the option of imposing supplemental local option sales taxes for specific purposes like transportation,[22] rural health care facilities, and recreation.[23]

The state sales tax rose from 4.7 to 4.85 percent as of April 2019, in line with the requirements of Proposition 3, which used an increase in the state sales tax rate to fund the state's share of Medicaid expansion.[24] Currently, atop Utah's statewide rate of 4.85 percent, local governments—in a mix of universally- and partially-embraced local option taxes—add, on average, another 2.24 percent, yielding a weighted average state and local sales tax rate of 7.09 percent, roughly in line with Utah's regional peers. Combined rates among neighboring states range from a low of 5.36 percent in Wyoming to a high of 8.37 percent in Arizona.[25]

FIGURE 4.

Combined State and Local Sales Tax Rates, Utah and Neighboring States



Note: Local sales tax rates calculated as of January 1, 2019, but state rates reflect the Utah state sales tax increase implemented on April 1, 2019.
Sources: Sales Tax Clearinghouse; Tax Foundation calculations.

20 Utah State Tax Commission, "History of the Utah Tax Structure," 91.

21 U.C.A. 1953 § 59-12-1102.

22 Utah State Tax Commission, "History of the Utah Tax Structure," 131.

23 Id., 144.

24 Utah Lieutenant Governor's Office, "Proposition 3," 2018 Ballot Measure, https://elections.utah.gov/Media/Default/2018%20Election/Issues%20on%20the%20Ballot/Proposition%203%20-%20Full%20Text.pdf.

25 Janelle Cammenga, "State and Local Sales Tax Rates, 2019," Tax Foundation, Jan. 30, 2019, https://taxfoundation.org/sales-tax-rates-2019/.

Utah's Eroding Sales Tax Base

Like most states, Utah imposes its sales tax on a base that consists of most goods—with economically significant policy carveouts—and relatively few services. With limited exceptions, the state's sales tax is imposed on transactions involving tangible property—appliances but not apps, light fixtures but not landscaping. This was less a conscious choice than an accident of history, a relic of the fact that Utah's sales tax was first imposed in 1933, at the height of the Great Depression.[26] Services comprised a far smaller share of the economy, and it was administratively simpler in that earlier era to focus almost exclusively on retail sales of goods.

Fortunately for Utah but unfortunately for the reliability of the state sales tax, today's economy has little in common with that of 1933 or even 1993. Higher incomes and changing consumer tastes have shifted a greater share of consumption to services, while a digital economy is upending traditional categories.

We subscribe to streaming services rather than buying DVDs, VHS tapes, CDs, or records (all of which were taxable), and we obtain programs and games through digital downloads rather than physical media (disks or cartridges). Increasingly, younger generations purchase "experiences" more than tangible goods—and most of those experiences involve services, whether it's fitness classes or cooking lessons or excursions.

But it's not just new services; it's also a matter of older services taking on greater importance in the modern economy. Domestic help has all but vanished, but increasingly, there's an app for that, or at least a number to call: house cleaning services, dog walking and pet-sitting, ridesharing as an alternative to car ownership, or landscaping services in lieu of buying a lawn mower, to name just a few. The mower was taxed; its replacement (the lawn care service) is not. It is a story that can be told many times over. It is the story of a sales tax code built around an economy that no longer exists.

Utah's sales tax base is not as narrow as some of its peer states' bases, but it remains narrow—and erodes further each year. Apples-to-apples comparisons of state sales tax bases are difficult, but one method is to calculate the value of taxed transactions as a percentage of personal income. Hawaii, for instance, has a sales tax breadth of 107 percent of state income.[27] The state exempts some transactions which arguably should be taxed, but double-taxes others. Utah also exposes some transactions to multiple levels of taxation but omits far more transactions altogether. The state's sales tax breadth, as a percentage of state income, is 41 percent. A robust sales tax base would not reach 100 percent, as not all income is consumed in any given year, but, per personal consumption data, should be about 77 percent of state income in Utah, suggesting that the state is only at slightly more than half of its sales tax potential.

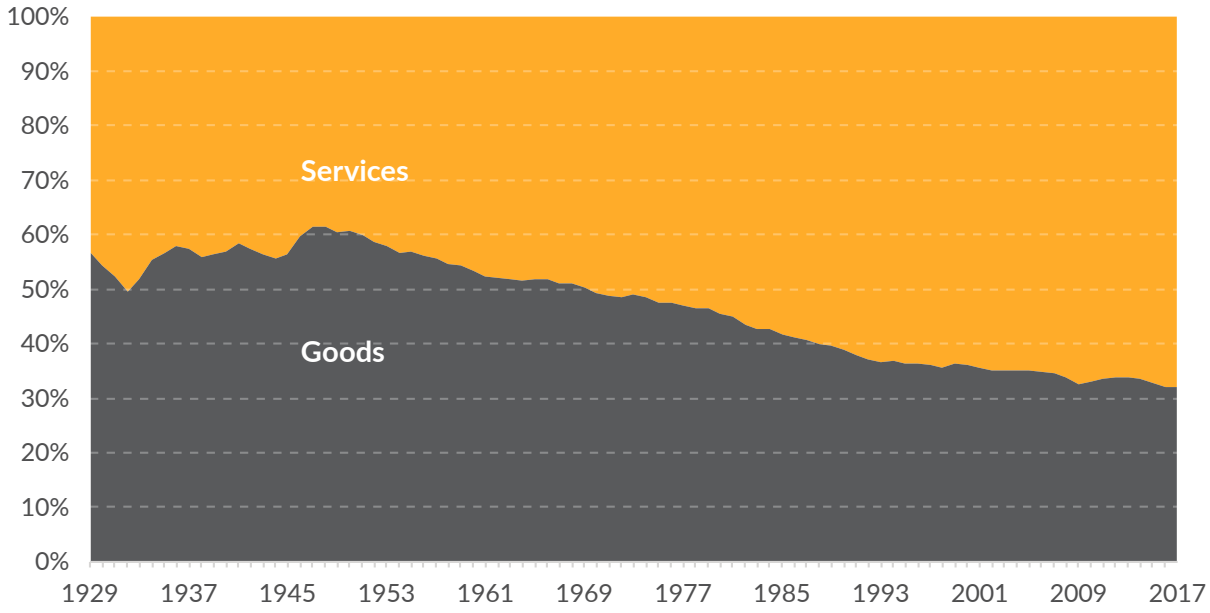
26 At that time, state property taxes were a major revenue sources, and assessed values had plummeted 28 percent between 1929 and 1933, while retail sales were somewhat more stable (nationally, a 10 percent decline in the purchase of perishables). See Council of State Governments, "Assessed Valuations of Property: 1929-1938," The Book of the States, IV (Chicago, 1941), 128-130; and David Greasley, Jakob B. Madsen, and Les Oxley, "Income Uncertainty and Consumer Spending During the Great Depression," *Explorations in Economic History* 38:2 (April 2001), 234.

27 Calculation by Prof. John Mikesell, Indiana University, FY 2016.

FIGURE 5.

Percentage of Total Personal Consumption Expenditures

Goods vs. Services, U.S., 1929-2017



Source: Bureau of Economic Analysis, Regional Economic Accounts.

TABLE 2.

Sales Tax Breadth as a Percentage of Personal Income (FY 2016)

State	Breadth
Arizona	37%
Colorado	34%
Idaho	40%
Nevada	54%
New Mexico	58%
Utah	41%
Wyoming	45%

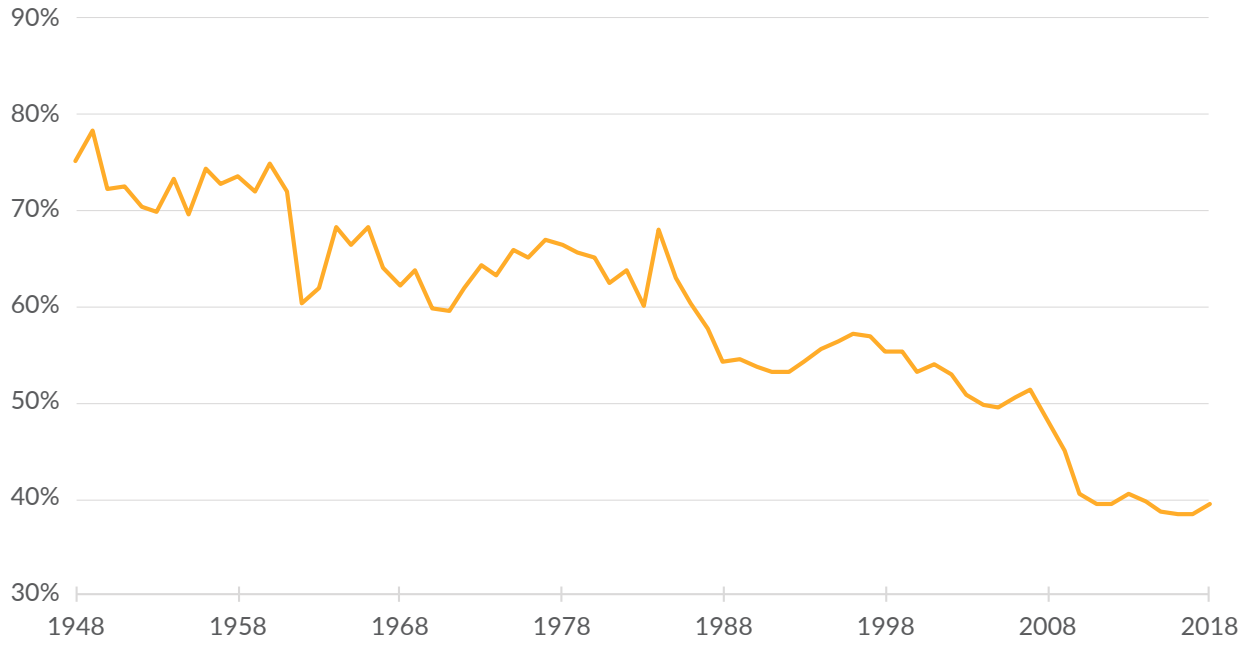
Source: Prof. John Mikesell (Indiana University).

This represents a substantial decline over time. In the early post-World War II years, Utah's sales tax breadth hovered between about 70 and 80 percent of personal income, and entered a steep decline in the 1980s, reflecting base-narrowing policy choices, the rise of e-commerce (with low-use tax compliance), and an accelerating shift toward consumption of services.[28] Utah has taken action to tax online sales, but there is an opportunity to build on that change with broader efforts to stabilize the tax base.

28 The figure below, which draws from data from the U.S. Bureau of Economic Analysis and the Utah State Tax Commission, differs slightly from Prof. Mikesell's calculations. This minor discrepancy can be accounted for by different data sources; Mikesell uses Census sales tax collections data to ensure comparability across states, while we use Utah-specific sources.

FIGURE 6.

Utah's Sales Tax Base as a Percentage of Personal Income



Sources: Utah State Tax Commission; U.S. Bureau of Economic Analysis; Tax Foundation calculations.

Another way of coming at the question of just how much Utah carves out its sales tax base is to multiply all personal consumption in the state ($111 billion in 2017) by the state sales tax rate (4.7 percent in 2017), which yields $5.2 billion in state sales tax collections, more than twice what the state actually collects even though the base includes many transactions which do not represent personal consumption at all.[29] Even if the sales tax base actually included all final consumer transactions, collections on those transactions would fall short of this figure since the state does not achieve 100 percent tax compliance; but at the same time, the state's current collections also include significant revenue from business-to-business transactions which do not form a part of personal consumption. Whatever measure is used, the conclusion is inescapable: Utah's sales tax fails to reflect modern consumption.

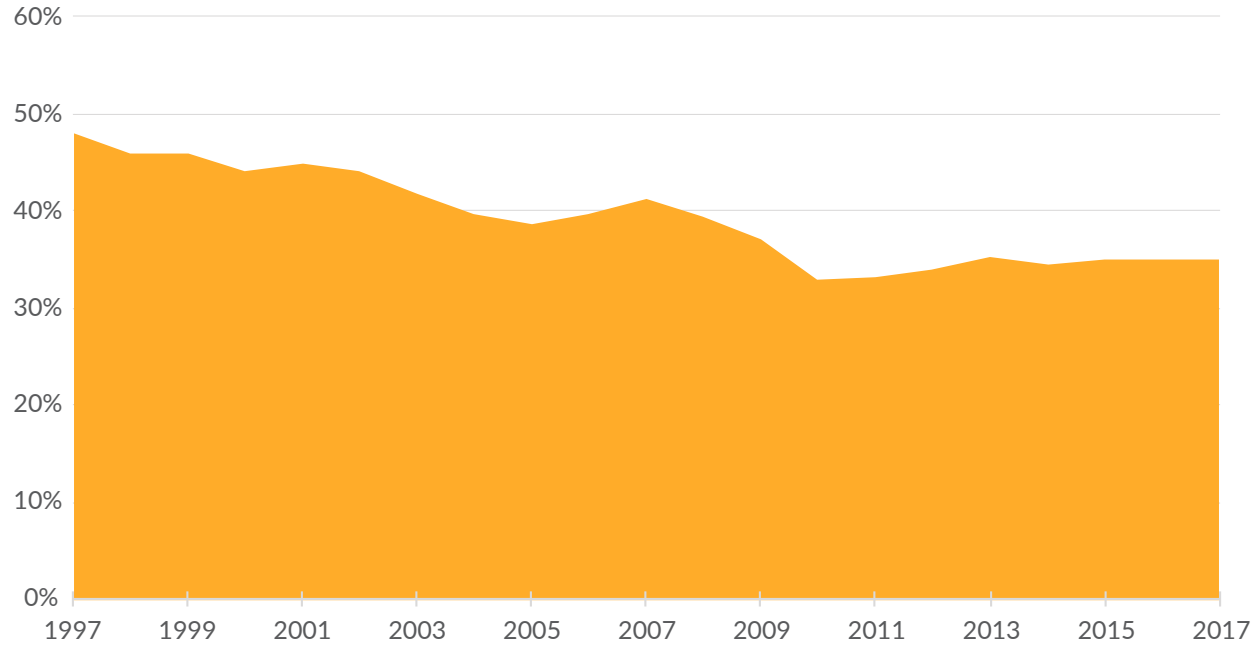
In fact, Utah only taxes about 35 percent of consumption, down from nearly 50 percent a mere two decades ago. Some of this shift owes to policy choices like the preferential rates imposed on groceries and residential utilities,[30] though much of it is the result of an economy that increasingly operates outside the definitions of the state's sales tax base, particularly in the realm of services.

In practice, policymakers are unlikely to opt for the inclusion of all personal consumption in the sales tax base, since this would include education and health services, the latter a particularly strong growth sector in recent years. Failing to make any realignment, though, risks a sales tax that no longer reflects sales and consumption in Utah.

29 Bureau of Economic Analysis, "Total personal consumption expenditures (PCE) by state (millions of dollars)," GDP & Personal Income series, 2017, https://apps.bea.gov/iTable/index_regional.cfm.

30 This measurement treats preferential rates as only a partial inclusion of the underlying transaction in the tax base.

FIGURE 7.
Percentage of Personal Consumption Taxed



Sources: Utah State Tax Commission; U.S. Bureau of Economic Analysis; Tax Foundation calculations.

Too often, policymakers are confronted with a false choice: expand to everything (even the politically unpalatable, logistically difficult, or, in the case of business inputs, economically unsound) or accept the *status quo*. Time constraints during a busy legislative session can strengthen the hand of the all-or-nothing approach. Using the summer to develop options gives policymakers the chance to deliberate and break out of those counterproductive constraints.

The goal is not—or at least should not be—higher revenue, but rather, greater balance. Over time, Utah has become more reliant on income taxes. Over the past four decades, sales tax collections as a percentage of all state tax collections have risen 3.3 percent nationally but are down 31.1 percent in Utah. Over the same period, income tax collections rose 47.6 percent nationally but a full 60.0 percent in Utah.[31] Since the sales tax is more conducive to economic growth than the income tax is[32]—a consideration explored at greater length later—this shift is economically inefficient.

Equally inefficient is the way the current sales tax code picks winners and losers, favoring some forms of personal consumption over others. A broad-based tax is more economically beneficial and helps yield a base stable enough not to require rate increases to maintain revenues. Particularly in Utah, where other forms of taxation tend to be heavily earmarked, an economic downturn could create a scenario where overall revenues are not in crisis, but the state faces a serious general fund shortfall, potentially necessitating a tax increase even though total revenues are adequate. Reforming the sales tax is an investment in sound tax policy, now and in the future.

31 U.S. Census Bureau, "Annual Survey of State and Local Government Finances," https://www.census.gov/programs-surveys/gov-finances.html (series).

32 Jens Matthias Arnold, Bert Brys, Christopher Heady, Åsa Johansson, Cyrille Schwellnus, and Laura Vartia, "Tax Policy For Economic Recovery and Growth," *Economic Journal* 121 (February 2011), F59-F80,

The Sales Tax Consensus

Public finance scholars and tax policy researchers have their fair share of disagreements on taxation, but the sales tax is an area of surprising consensus. Decades ago, scholar John Due wrote that "sales tax structure should produce a uniform distribution in consumption, should be neutral regarding methods of production and distribution, and should be collected at a reasonable cost."[33] Another leading tax scholar, Charles McLure, identifies the ideal sales tax as a destination-based tax on all final consumption (but only final consumption).[34] These standards are broadly accepted, as are several related precepts and observations:

1. An ideal sales tax is imposed on all final consumption, both goods and services;

2. An ideal sales tax exempts all intermediate transactions (business inputs) to avoid tax pyramiding;

3. Sales taxes should be destination-based, meaning that tax is owed in the state and jurisdiction where the good or service is consumed;

4. The sales tax is more economically efficient than many competing forms of taxation, including the income tax, because it only falls on present consumption, not saving or investment;

5. Because lower-income individuals have lower savings rates and consume a greater share of their income, the sales tax can be regressive, though broadening the base to include additional consumer services (much more heavily consumed by higher-income individuals) represents a progressive change;

6. The sales tax scales well with ability to pay, because it grows with consumption and is therefore more discretionary than many other forms of taxation; and

7. Consumption is a more stable tax base than income, though the failure to tax most consumer services is leading to a gradual erosion of sales tax revenues as services become an ever-larger share of consumption.

Taxes should apply to all final consumption in service of economic neutrality, the idea that taxes should not interfere with economic decision-making any more than is strictly necessary, nor should they pick winners and losers. It is not the role of the tax code to favor piano lessons over baseball bats or to preference e-books over hardcovers. It makes little sense to tax the purchase of a lawn mower but not tax the purchase of lawn care services that obviate the need to own a mower.

33 Quoted in John Mikesell, "A Quality Index for State Sales Tax Structure – Measuring the States Against an Ideal Standard," *Tax Notes*, Jan. 26, 2005, https://www.taxnotes.com/state-tax-today/sales-and-use-taxation/corrected-full-text-states-mind-quality-index-state-sales-tax-structure-measuring-states-against/2005/01/26/4c5r?highlight=Mikesell%20%22Quality%20Index%22.

34 Charles E. McLure Jr., "Rethinking State and Local Reliance on the Retail Sales Tax: Should We Fix the Sales Tax or Discard It?" *BYU Law Review* 2000:1 (March 1, 2000), 77, https://digitalcommons.law.byu.edu/cgi/viewcontent.cgi?article=2052&context=lawreview.

The sales tax should also be broad-based in service of tax equity.[35] Sales taxes have two potential sources of regressivity: one, the propensity of lower-income individuals to consume a greater share of their income, and two, a scope of taxable consumption that is more likely to fall on the sorts of transactions which dominate the consumption of lower- and middle-income individuals.

Policymakers often exempt or lower rates on certain classes of consumption as a progressive reform. Utah's reduced rate on groceries is one such example—though there is reason to believe it may not be terribly effective. Prepared foods are taxed at the standard rate and most of the progressivity of taxing unprepared foods is addressed by the exemption for SNAP (food stamps) and WIC purchases, while the exemption is enjoyed by high-income earners as well—who often spend considerably more on groceries.

In fact, while not enough work has been undertaken to establish a consensus, there is research finding that lower-income taxpayers would actually be better off if groceries were fully included in sales tax bases (while retaining the federally-indicated exemption of SNAP and WIC purchases) and revenue-neutral adjustments made to the tax rate.[36] The lower grocery rate is designed to create progressivity but largely fails to do so. Yet, at the same time, policymakers have largely neglected a much more straightforward way to promote equity within the sales tax.

Consumption of personal services tends to be more discretionary than consumption of goods. Consequently, higher-income individuals tend to spend a greater share of income on services, which are frequently untaxed. Expanding the sales tax base to additional services rights an accidental wrong in the sales tax as currently formulated, one that presently favors wealthier individuals.

Broadening the sales tax base to services, while excluding business inputs, was a recommendation of Utah Tax Review Commission studies in both 2004 and 2009.[37] The Commission's 2009 recommendations, in summary form, were:

1. Tax final consumption;
2. Do not tax business inputs;
3. Do not tax investment and savings;
4. Consider taxpayer and administrative simplicity; and
5. Recognize evolving interstate, international, and electronic commerce.[38]

35 See generally, Nicole Kaeding, "Sales Tax Base Broadening: Right-Sizing a State Sales Tax," Tax Foundation, Oct. 24, 2017, https://taxfoundation.org/sales-tax-base-broadening/.

36 Anna L. Johnson and Steven M. Sheffrin, "Rethinking the Sales Tax Food Exclusion with SNAP Benefits," *State Tax Notes*, Jan. 11, 2016, 157, https://pdfs.semanticscholar.org/6f18/cca38dfaa9591be264e4bff539573dae6d7c.pdf.

37 Utah Tax Review Commission, "Report of the Sales and Use Tax Working Group," Jan. 13, 2009, https://le.utah.gov/interim/2009/pdf/00000070.PDF.

38 Office of Legislative Research and General Counsel, "Utah's Sales & Use Tax: Issues and Options."

The 2009 Tax Review Commission report broadly defined "business inputs" as any purchase "that qualifies as a deduction as an ordinary and necessary trade or business expense under Section 162 of the Internal Revenue Code." Similar assumptions undergird the Utah Office of Legislative Research and General Counsel's presentation on sales tax reform options in 2017.[39] Also that year, a sales tax working group operated from guiding principles which included taxing all final consumption, and like the 2009 report, exempted "ordinary and necessary business purchases."[40]

However, while the 2017 working group adopted an "ordinary and necessary" standard for business inputs, just as the 2009 report did, it did not tie this definition to the Internal Revenue Code. This led to discussions about potentially crafting a Utah sales tax standard different than the broad Internal Revenue Code standard. Such standard would involve trying to determine for any particular business in Utah what services are "integral," "essential," "necessary," or "indispensable" for that business—an ill-defined proviso that had not appeared in previous recommendations, is unrepresentative of the broad consensus, and has bled into a new discussion of just which business-to-business transactions truly merit an exemption.

Taxation of Business Inputs

To varying degrees, business-to-business transactions are taxed in every state with a sales tax, meaning that the sales tax is often embedded in the final price of a good or service several times over. This is not an ineluctable law of consumption taxes, but it has, unfortunately, been the reality in the United States.

In Europe, value-added taxes (VATs) are structurally designed to avoid such double taxation; while each stage of production is taxed, the tax only falls on the incremental increase in value, such that, when the product is finally sold to a consumer, the VAT is imposed on 100 percent of its value—no more, no less. Theoretically, a retail sales tax could also exempt business inputs altogether, either by adopting a sufficiently robust set of exemptions or by tying the exemption to the identity of the purchaser rather than the nature of the product. In practice, though, no state has succeeded in eliminating all business inputs from the sales tax base, even though state revenue offices frequently cite it as an important principle of sales taxation.

A well-structured sales tax is imposed on all final consumer goods and services while exempting all purchases made by businesses that will be used as inputs in the production process. This is not because businesses deserve special treatment under the tax code, but because applying the sales tax to business inputs results in multiple layers of taxation embedded in the price of goods once they reach final consumers, a process known as "tax pyramiding." The result is higher and inequitable effective tax rates for different industries and products, which is both nonneutral and nontransparent, hiding actual tax costs from consumers.[41]

Ideally, business inputs would be exempted based upon the identity of the purchaser. In practice,

39 Office of Legislative Research and General Counsel, "Utah's Sales and Use Tax System," Revenue and Taxation Interim Committee presentation, Aug. 30, 2017, https://le.utah.gov/interim/2017/pdf/00003760.pdf.

40 Utah Tax Review Commission, "2017 Report of the Utah Tax Review Commission."

41 Office of the Governor, "Governor Olene S. Walker's Recommendations on a Tax Structure for Utah's Future," November 2004, 12.

however, states generally make binary choices which are not always clear-cut, as there are many goods and services which are consumed by businesses and individuals alike. For instance, when a business retains an outside accounting firm, it constitutes a business input, but individuals sometimes hire accountants as well.

Sometimes this conundrum can be resolved, if only imperfectly, by considering typical use. It is true, for instance, that a select few individuals might occasionally rent a cold storage facility or take out advertising, but these services are overwhelmingly purchased by businesses, and the rare exception should not guide policy. A more interesting case arises with goods which are consumed by both businesses and individuals but which, when used by businesses, are not a direct part of the production process.

Businesses and individuals both buy desk chairs and procure landscaping services. In such cases, exemption certificates are optimal, as they can address the use case of the company ordering a thousand desk chairs. If, however, a sales tax fails to distinguish the ultimate purchaser for goods which are *consumed* by the business rather than used in the course of production and sale (equipment, machinery, raw materials, packaging, advertising, etc.),[42] the consequent tax pyramiding may be less extreme than with the inclusion of more direct production inputs.

Nonprofits and agricultural purchasers are often granted exemption certificates which exempt transactions from tax based on the purchaser's identity rather than a determination of whether the good or service is most likely to be purchased by a business or a consumer. The chief shortcoming of exemption certificates is the administrative hassle they create for the state, the seller, and the purchaser alike. Given their frequency of use by nonprofits and even by for-profit businesses making certain purchases, however, there is little reason to believe that such a system would be too onerous. A policy of exempting transactions which are overwhelmingly or exclusively business inputs, while allowing exemption certificates to be used to avoid tax on mixed-use goods and services when the purchaser is a business, likely represents the best available policy option.

Although Utah's current code is imperfect, the state has made important progress in reducing the share of business inputs subject to taxation in recent years. For the most part, lawmakers have proceeded industry-by-industry, exempting intermediate purchases common to those industries. Among major industrial sectors, only oil and gas and electrical generation are still subject to substantial business-to-business sales tax liability. This approach has succeeded in exempting some of the costliest and most pyramiding-prone inputs, though it has the disadvantage of doing less for smaller businesses.

According to state revenue statistics, only about 26 percent of all taxable sales represent business inputs, down over a quarter (almost 10 percentage points) since the high-water mark year of 1981. It should be noted that the Council on State Taxation (COST), which does its own 50-state analysis of business tax costs, estimates that 37 percent of the burden of Utah's current sales tax is borne by business,[43] compared to the 26 percent indicated by state estimates. It is possible that the correct

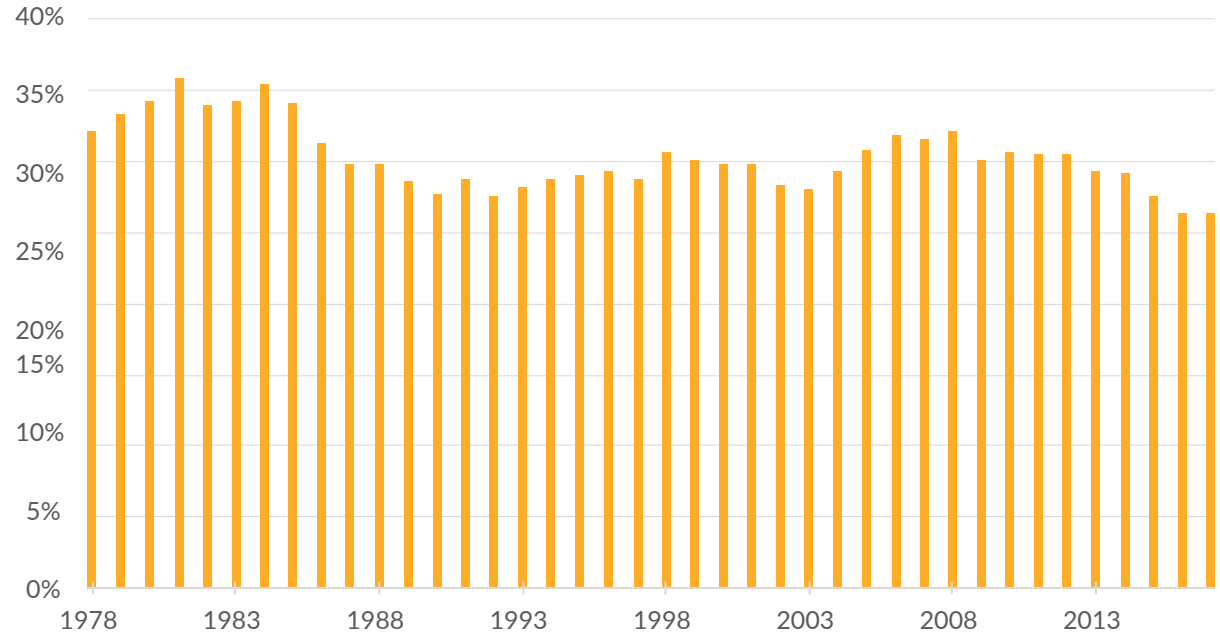
42 Some inputs, particularly raw materials, are consumed in production. In this case, we do not mean products consumed in the production process, but consumption that is made by the business.

43 Karl Frieden and Fred Nicely, "The Best and Worst of State Sales Tax Systems," Council on State Taxation, April 2018, 9, https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/the-best-and-worst-of-state-sales-tax-systems-august-17-2018-final.pdf.

answer is somewhere in between. Either way, it represents a better-than-average exclusion of intermediate transactions (Utah ranks 10th in COST's analysis), though it is still far from the ideal.

FIGURE 8.

Business Inputs as a Percentage of Utah's Sales Tax Base



Sources: Utah State Tax Commission; industry data; Tax Foundation calculations.

Utah policymakers should seek to build on this progress as part of any sales tax base-broadening effort, not undermine it. Any policy which increases tax pyramiding raises prices for consumers and puts Utah businesses at a competitive disadvantage. Unfortunately, over three-quarters of the base broadening under H.B. 441 fell upon business-to-business purchases.[44] This would have represented a reversal of Utah's decades of progress on removing business inputs from the tax base, with adverse consequences for the state's tax competitiveness.

Policymakers in Utah have struggled with what constitutes a business input in the service sector, keying in on the question of whether many professional services are consumed by the business or by its customers. For instance, if an appliance maker engages an outside engineer to design its manufacturing equipment or draw up plans for a new appliance, that is quite clearly directly related to the production process, though it is not *consumed* in production the way that steel, plastics, paint, or washers might be. But when the company engages outside legal counsel to defend the company's patents, or marketers to promote sales, or contracts with an outside janitorial or laundry service to keep the factory floor clear or to clean uniforms, are those also part of the production process, or are they final consumption, with the business as the consumer?

Economists tend to regard almost all business purchases as inputs, because with limited exceptions, businesses do not engage in final consumption.[45] A business may err in incurring costs, but the purpose of business purchases is to better enable the company to earn profits, whether the

44 State estimates.

45 It is possible to imagine scenarios in which companies offer fringe benefits to employees in lieu of direct compensation, which constitute final consumption and therefore ought to be taxed. Meals furnished to employees, for instance, may fall into this basket: clearly a business cost, but also clearly final consumption for employees.

spending is on machinery, raw materials, advertising, accounting, legal services, human relations, or even plowing the parking lot in winter. A tax on any of these activities increases the cost of doing business and is inconsistent with the purpose and design of a sales tax, which is intended to fall on consumption.

To the extent that similar taxes fall on most or all competitors (particularly relevant for industries that are inherently local), this will increase consumer costs. If highly susceptible to out-of-state competition not responsible for such taxes, the company will find itself at a competitive disadvantage. Taxes on these professional services when consumed by businesses also discriminates against smaller, less vertically-integrated firms which rely more extensively on vendors and subcontractors.[46]

A large manufacturing company likely has its own in-house legal team, a marketing department, and accountants and HR professionals on staff. A much smaller competitor might subcontract for many or all of these services rather than putting people on payroll. If the sales tax were broadened to these professional services without an adequate exemption for business inputs, the large corporation would not face additional liability, since it procures these services without generating a taxable sale, but the smaller firm would be on the hook for sales tax at each point of the production process.

It is possible to think of some business inputs as less harmful than others, but it would be economically damaging to adopt narrow definitions about what is "integral" or "essential" to production. It may be possible to design a product without patenting it, advertising it, or designing appealing packaging for it. Similarly, accounting and HR services might not be a direct part of the production process. However, it is hard to run a business of any size without such services, and those services are clearly procured for business purposes. Often they are, in fact, transformative: a better-advertised product may gain market share, with implications for price, availability, and product innovation, and a product with intellectual property protections has different prospects than one without them.

Fundamentally, the sales tax is designed as a tax on household consumption, and it works poorly when applied to any other base. As John Mikesell, a national expert on sales taxation, explains:

> What tax policy is a retail sales tax expected to be carrying out? Its essential logic is to distribute the cost of government according to household consumption expenditure. It is not an effective handle on any other fundamental base. It is not an income tax because it makes no allowance for costs associated with generating receipts from sales. It is not a punitive excise on use of resources in ways that are luxurious or harmful to ourselves or others. It is not a business activity tax with intent to distribute the cost of government according to business utilization of public services. It is the U.S. approach, albeit an imperfect one, to impose a general levy on consumption expenditure, collected on an indirect or transaction basis like the value-added tax, but applied only at the last transaction in the chain of production and distribution leading to the household consumer. If the intent is to distribute governmental cost on a basis other than household consumption, some tax format other than the retail sales tax should be applied.[47]

46 A vertically integrated firm is one in which multiple stages of production are combined, as opposed to being distributed across multiple companies. A technology company which does its own manufacturing is more vertically integrated than one which contracts with overseas manufacturers, and by the same token, a company that has its own legal, accounting, and other business services in-house is more vertically integrated than one that outsources those functions.

47 John Mikesell, "Quality Index for State Sales Tax Structure – Measuring the States Against an Ideal Standard."

Imagine, for sake of argument, a manufacturer with $5 million retail sales and $4.5 million in expenses, earning a healthy profit of $500,000. Assume that they do their actual manufacturing in-house, but as a relatively small company, they contract out for a range of services, from accounting and legal services to packaging, distribution, and marketing, such that $580,000 of their $4.5 million in expenses are business services procured from other firms. For sake of argument, we will assume that none of their non-service inputs are subject to the sales tax, though in practice, some may be.

Under a properly-structured sales tax, the goods are taxed when sold at retail. At a rate of 4.85 percent, that would yield $242,500 on $5 million in sales. Under a European-style value-added tax, nearly every cost of production (in our example, everything except labor costs) would be taxed, including the final retail sale, but with credits against any previously taxed amount, meaning that only the incremental increase in value is subject to tax. This would also yield $242,500 in total taxation. If, however, a sales tax which falls on service inputs is applied, then the total tax is $272,813, an effective sales tax rate of 5.41 percent, compared to the statutory tax rate of 4.85 percent.

Note here that both a properly-applied general sales tax and a VAT impose the 4.85 percent rate on 100 percent of the value of the final transaction, whereas a sales tax which includes these service inputs functionally falls on 112 percent of the cost. This double taxation occurs whether the taxed service is inseparable from the final product (like packaging and distribution) or not (like marketing).

TABLE 3.

Sales Tax Pyramiding Within a Model Manufacturing Firm

Component	Amount	Sales Tax	VAT	Sales Tax with Inputs
Labor	$2,000,000	$0	$97,000	$0
Property	$275,000	$0	$13,338	$0
Machinery	$600,000	$0	$29,100	$0
Energy	$350,000	$0	$16,975	$0
Raw Materials	$650,000	$0	$31,525	$0
Packaging	$60,000	$0	$2,910	$2,910
Distribution	$100,000	$0	$4,850	$4,850
Legal Services	$40,000	$0	$1,940	$1,940
Accounting/Auditing/HR	$75,000	$0	$3,638	$3,638
Marketing	$300,000	$0	$14,550	$14,550
Consulting	$50,000	$0	$2,425	$2,425
Retail Sales Revenue ($500,000 in profit)	$5,000,000	$242,500	$24,250	$242,500
Total Sales Tax		**$242,500**	**$242,500**	**$272,813**
Effective Sales Tax Rate		**4.85%**	**4.85%**	**5.41%**

Source: Tax Foundation calculations.

When services consumed by businesses are taxed, this places Utah businesses at a competitive disadvantage and raises complicated questions about where and how to "source" service income, questions much more easily answered for final consumption. In 2004, then-Gov. Olene Walker (R) convened a tax commission that recommended sales tax base broadening to services, but on the

condition that professional services only be taxed "if they are provided to personal consumers."[48] Although tax reformers at the time chose not to tackle the sales tax, the recommendation is as correct today as it was when it was written 15 years ago.

Base-Broadening Options

As currently constituted, Utah's sales tax base excludes select goods and most services. Accordingly, base broadening could theoretically include certain goods—a full rate on groceries, for instance, or including gasoline or pharmaceuticals in the sales tax base—as well as currently untaxed services. In broad terms, services can be conceptualized as falling into five categories:

1. Business services, like advertising, employment services, consulting, and public relations;
2. Personal services, like dry cleaning, fitness classes, haircuts, lawn care, and personal storage;
3. Professional services, like legal, accounting, medical, engineering, and other services generally associated with specific licensing or educational requirements;
4. Services to real property, including repairs, maintenance, construction, and installation of fixtures; and
5. Services to tangible personal property, like delivery, installation, and repairs of furnishings and appliances.

In a well-structured sales tax, business services would be exempt, but all other categories could be taxable, though in some cases—particularly professional services—with exemptions for intermediate purchasers. These exemptions can be provided for using broad industry categories (e.g., exempting engineering as predominantly a business-to-business transaction) or based on the purchaser being a business, or some combination of the two. Implementation options are discussed later.

Many services that represent or, depending on the purchaser, can represent personal consumption are taxed by one or more of Utah's neighbors, and these services offer an obvious point of departure in any consideration of expansion of Utah's own base. New Mexico has a particularly broad-based "sales tax,"[49] but all of Utah's neighbors except Colorado tax some consumer services the Utah code exempts.[50]

48 Office of the Governor, "Governor Olene S. Walker's Recommendations on a Tax Structure for Utah's Future," 13.

49 New Mexico terms its sales tax a gross receipts tax, but this terminology can be misleading. While the state's relatively broad sales tax base includes an above-average share of business inputs, which should be avoided, it is still more similar to a general sales tax of the sort imposed in 44 other states (several of which use "gross receipts tax" terminology), and is not directly comparable to the traditional gross receipts taxes imposed in Delaware, Texas, Nevada, Ohio, and Washington, which are business taxes imposed on multiple stages of production.

50 Federation of Tax Administrators, "Sales Taxation of Services," 2017, https://www.taxadmin.org/sales-taxation-of-services.

TABLE 4.

Services Taxed in Neighboring States but not in Utah

Taxable Service	AZ	CO	ID	NV	NM	WY	Total
Taxis	✓			✓	✓	✓	4
Mini-storage	✓				✓	✓	3
Limousine service	✓				✓	✓	3
Bus fares				✓	✓	✓	3
Custom processing (on owner's property)			✓		✓	✓	3
Custom meat processing			✓		✓	✓	3
Barber shops and beauty parlors	✓				✓		2
Health clubs, tanning parlors, reducing salons			✓		✓		2
Fur storage	✓				✓		2
Household goods storage	✓				✓		2
Pinball and other mechanical amusements	✓				✓		2
Construction contracting	✓				✓		2
Repairs or remodeling of real property	✓				✓		2
Carpentry, painting, plumbing, and similar trades	✓				✓		2
Construction service (grading, excavating, etc.)	✓				✓		2
Carpet and upholstery cleaning	✓				✓		2
Parking lots and garages	✓				✓		2
Water well drilling	✓				✓		2
Automotive storage	✓				✓		2
Coin-operated video games	✓				✓		2
Marine towing service	✓				✓		2
Residential water	✓				✓		2
Water softening and conditioning					✓	✓	2
Admission to school and college sports events			✓		✓		2
Veterinary services (both large and small animal)					✓		1
Travel agent services					✓		1
Packing and crating					✓		1
Sewer and refuse (residential)					✓		1
Service charges of banking institutions					✓		1
Investment counseling					✓		1
Property sales agent services					✓		1
Real estate management fees (rental agents)					✓		1
Dating services					✓		1
Debt counseling					✓		1
Laundry and dry cleaning services, coin-op					✓		1
Massage services					✓		1
900 Number services					✓		1
Personal instruction (dance, golf, tennis, etc.)					✓		1
Swimming pool cleaning and maintenance					✓		1
Tax return preparation					✓		1
Exterminating (includes termite services)					✓		1
Private investigation (detective) services					✓		1
Window cleaning					✓		1
Accounting and bookkeeping					✓		1
Legal services					✓		1
Dentistry					✓		1
Nursing services out-of-hospital					✓		1
Physician services					✓		1
Labor charges on repairs delivered under warranty						✓	1

Source: Federation of Tax Administrators.

Existing sales tax exemptions for tangible property should also be on the table. As noted previously, so long as an exclusion remains in place for purchases made using SNAP or WIC, the reduced rate on groceries is not noticeably progressive and may even be regressive, to the degree that it raises rates on other purchases made by low-income individuals. Other consumer purchases, like gasoline, were likely exempted because they are subject to separate excise taxes, but here too, there is cause for reconsideration.

Excise taxes are imposed on specific products rather than a broad range of consumption. Although some states clearly use them primarily as a revenue generation tool, the policy justifications for excise taxes are as user fees or to internalize some of the negative externalities associated with consumption. The gas tax illustrates both characteristics: primarily, it operates to collect transportation revenue from road users in rough proportion to their share of utilization. Secondarily, it "prices" pollution and road congestion, which are both negative externalities. By forcing the consumer, rather than society at large, to incur these prices, the tax encourages drivers to consider more fuel-efficient vehicles, avoid unnecessary trips, or carpool.

Notably, none of these legitimate purposes for a motor fuel tax are relevant to the sales tax itself, which is a generalized tax on consumption. Gas taxes and other taxes can, of course, be set at excessively high rates (though if anything, most gas taxes tend to understate the cost of road usage), such that any additional tax on those transactions would compound an existing problem; but theoretically, it makes sense for these goods to be taxed both as general consumption and as specific purchases with set costs to be recovered through excise taxes. Motor fuel tax revenue in Utah goes to transportation (as it should), further underscoring that the existing tax on gasoline is not a tax on consumption, but a specific pricing mechanism for infrastructure use. Utah already imposes the sales tax on alcohol and tobacco, which are subject to excise taxes as well, and could consider joining the states which include gasoline in the sales tax.[51]

The following table demonstrates, both separately and on a cumulative basis, how much additional revenue could be generated at the current 4.85 percent rate by broadening the base to additional goods and services, and indicates the revenue-neutral sales tax rate if all base broadeners through a given row were adopted, and all revenues used to pay down sales tax rate reductions. In practice, it may be better to apply some of the revenue to pay down income tax rate reductions as well. For simplicity's sake, this table assumes an either-or approach, showing resulting rates if all revenue from base broadening was applied either to sales or income tax reductions. However, as a general rule of thumb, at a 3:2 ratio, where 60 percent of revenue were put toward sales tax rate reductions and 40 percent were applied to income tax rate reductions, each $100 million in base broadening would permit a reduction of just under 0.1 percentage points on the sales tax and 0.05 percentage points on the income tax.

51 It should be noted that Utah earmarks more money for transportation out of the sales tax than it raises for transportation using motor fuel taxes. Ideally, transportation funding would be derived from the motor fuel tax and other road usage fees, and should the gas tax or any future transportation tax be expanded to generate higher revenue, that would provide an opportunity for countervailing sales tax cuts as the need for that earmark declines or is eliminated.

TABLE 5.

Base-Broadening Options with Revenue Estimates and Revenue-Neutral Rates

Revenues in Millions of Dollars

Revenue-Neutral Rate		Revenue Generation		
Sales	Income	Cumulative	Component	Base Broadener
4.85%	4.95%	$0.0	$0.0	*Current sales tax base*
4.77%	4.90%	$43.1	$43.1	Untaxed recreational services
4.73%	4.87%	$63.8	$20.7	Magazines and newspapers
4.73%	4.87%	$66.9	$3.1	Delivery services
4.65%	4.81%	$114.6	$47.8	Personal care and clothing services
4.56%	4.74%	$167.6	$53.0	Public transportation
4.40%	4.62%	$263.8	$96.2	Audio-video and similar services
4.21%	4.46%	$395.2	$131.5	Motor vehicle fuels, lubricants, and fluids
4.18%	4.43%	$419.8	$24.6	Household maintenance
3.91%	4.17%	$626.5	$206.7	Remainder of grocery tax
3.87%	4.13%	$661.5	$35.0	Remainder of residential fuel tax
3.80%	4.06%	$720.8	$59.3	Professional and other services (personal consumption)
3.63%	3.86%	$877.8	$157.0	Financial service charges, fees, and commissions
3.46%	3.65%	$1,047.7	$169.9	Insurance
3.29%	3.42%	$1,236.4	$188.7	Pharmaceutical and other medical products
3.26%	3.37%	$1,276.7	$40.3	Dental services
3.16%	3.23%	$1,389.2	$112.5	Paramedical services
3.15%	3.21%	$1,405.0	$15.8	Commercial and vocational schools
3.11%	3.14%	$1,464.5	$59.5	Nursing homes
3.06%	3.07%	$1,520.0	$55.5	Higher education
3.05%	3.05%	$1,534.6	$14.6	Nursery, elementary, and secondary schools
2.93%	2.83%	$1,709.4	$174.8	Physician services
2.72%	2.42%	$2,045.3	$335.9	Hospitals
2.72%	2.42%	$2,046.0	$0.7	Group housing
2.59%	2.14%	$2,266.3	$220.3	Rental of tenant-occupied nonfarm housing
2.59%	2.14%	$2,273.3	$6.9	Rental value of farm dwellings
2.31%	1.39%	$2,876.0	$602.7	Imputed rental of owner-occupied nonfarm housing

Sources: U.S. Bureau of Economic Analysis; Utah statutes; Tax Foundation calculations.

For purposes of the above calculations, we assume an evasion rate of 15 percent on newly taxed services, in line with estimates of federal income tax evasion, and 10 percent on newly taxed goods. On the one hand, sales taxes have far fewer points of collection and remittance, making auditing easier and more likely, which should enhance compliance. On the other hand, income tax withholding substantially increases reporting, and there is no analogous provision in the sales tax. We assume that these countervailing forces roughly cancel each other out and adopt 15 percent as our evasion assumption, a figure which further benefits from its close approximation of evasion estimates for value-added taxes in Europe.[52]

52 Tax Policy Center, "Would tax evasion and avoidance be a significant problem for a national retail sales tax?" Tax Policy Center Briefing Book, https://www.taxpolicycenter.org/briefing-book/would-tax-evasion-and-avoidance-be-significant-problem-national-retail-sales-tax.

Some of the above goods and services are obvious candidates for sales tax base broadening. Others, like hospitals and rental homes, may be almost impossible. This table includes nearly all currently untaxed final consumption, exempting only those categories that lack an actual transaction (like imputed rents from housing) or are legally or structurally unreachabe by the sales tax. While it is unlikely that many policymakers would favor taxing all of the above-mentioned transactions, the table can help provide a general sense of how much of a reduction can be achieved under different base-broadening scenarios.

Income and Sales Tax Rate Reduction Choices

All taxes are not created equal. Any tax creates a certain amount of economic drag; this is unavoidable. There is truth to the adage that "whatever you tax, you get less of"—so it makes sense for policymakers to think carefully about what they choose to tax, and how. Individual income taxes fall on labor; on the margin, they lower the payoff to work, decreasing the supply of labor while increasing its cost.

An income tax can be conceptualized as a tax on consumption plus the change in savings, while a well-structured sales tax is a tax on income less the change in savings. An income tax reduces capacity for future consumption; economically, it acts like a sales tax that increases the cost of future consumption, with each additional hour of labor producing fewer goods in the future. Consumption taxes are much more economically neutral by comparison, and the economic literature consistently finds that sales taxes are less of an impediment to economic growth or location decisions than are income taxes.[53]

Consumption taxes do fall on suppliers of labor and capital, like income taxes, but they do so neutrally and—at least when well-designed—avoid double-taxing these factors. Sales taxes are destination-sourced, meaning that they are taxed where a good or service is consumed, not where it is produced. Thus, unlike income taxes, they do not discourage investment or job creation.[54] This is, however, only true insofar as the tax falls on final consumption; when the tax falls on business inputs, it increases the cost of investing in-state.

Because a well-structured sales tax is more efficient than income taxes, using revenue from sales tax base broadening to pay down income tax rather than sales tax rate reductions is therefore the more economically competitive option and has the added advantage of shifting more revenue into a less earmarked tax. Under H.B. 441, revenue from base broadening and other tax changes would have been used to reduce the state sales tax rate from 4.85 to 3.1 percent while lowering the income tax rate from 4.95 to 4.75 percent. Those figures represent a roughly 6:1 allocation of revenues toward sales over income tax reductions. As lawmakers deliberate throughout the summer, they should consider whether a different ratio would be appropriate, dedicating a greater share of the revenue from sales tax modernization to income tax rate reductions.

53 See Joseph Bankman and David A. Weisbach, "The Superiority of an Ideal Consumption Tax over an Ideal Income Tax," *Stanford Law Review* 58:5 (April 2010), 1413; and Jens Matthias Arnold et. al, "Tax Policy For Economic Recovery and Growth."

54 Douglas L. Lindholm and Karl A. Frieden, "After Wayfair: Modernizing State Sales Tax Systems," *State Tax Notes*, May 14, 2018, 667, https://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/after-wayfair-modernizing-state-sales-tax-systems.pdf.

Structural Considerations for Sales Tax Reform

Theoretically, the design of a well-structured sales tax is relatively simple—far simpler, arguably, than the sales tax regimes that already exist in Utah and elsewhere. Yet reforming an existing system is always more difficult than starting from scratch. Policymakers must determine how to define business inputs, to the extent that they are excluded; they must make rate adjustments based on uncertain revenue estimates; to the extent that services are included in the base, they must determine how to source them for tax purposes; and they must decide how to include local taxing jurisdictions in these reforms.

Phase-in Options

Sales tax base broadening contemplates the taxation of sales that have previously gone untaxed, and for which economic data are sometimes limited. State revenue offices can look to federal governmental data sources like the Economic Census and Personal Consumption Expenditure data; to other states that have made forays into the taxation of similar services; and to industry data and private sector economic models. These datasets can help states develop reasonable estimates of the sales tax revenue associated with base broadening, but they come with a larger margin of error than would an estimate based on adjusting the rate on already-taxed income or transactions. If rate reductions—to the sales tax or other taxes—are intended to avoid a net tax increase, this uncertainty can make it difficult to project the revenue-neutral rate.

Utah lawmakers can address this uncertainty in a variety of ways. The most taxpayer-friendly option would be to set an artificially low rate initially, one likely to yield a net tax reduction in the first year, and then use that first-year data to scale the rate up in the second year. This approach would be the most viable during a period of economic growth, when the state is running a surplus and can afford an additional one-time measure of tax relief. It would also offer a lower rate while service businesses are accommodating themselves to the new tax for the first time, in some respects providing a tax benefit while they are building out their compliance.

Utah has some revenue set aside in the budget for tax reform, and expects additional moneys from remote sales tax collections, providing some flexibility for a taxpayer-friendly initial estimate. A potential downside to this approach is that, even though the second-year rates would be revenue-neutral compared to pre-reform taxation, they would also represent a year-over-year tax increase, which may be unpalatable to some legislators.

Alternatively, the process can be reversed, with a conservative rate reduction adopted in the first year, one likely to yield slightly higher overall collections. Any revenue above baseline could be deposited into a fund earmarked for tax relief or spent on a one-time appropriation to the pension fund or the rainy day fund. Rates would then be adjusted automatically the next year, based on a year of actual collections, to set a revenue-neutral rate going forward.

A variation on either option would be to phase up the rate on newly taxed services while the rate on the existing base declines, meeting at a consolidated rate in the second or third year. This would substantially reduce the initial costs for newly taxed businesses as they enter the system but still allow

the state to generate adequate data on the size of these markets. The downsides of this approach are, however, more considerable: first, it bifurcates the rate, with some risk that it would remain that way, and second, it has all the administrative and compliance costs of a full-rate tax while only generating a fraction of the revenue.

Finally, the state could just make its best estimate of revenue neutrality, with no triggered second-year adjustment, and only return to the rate legislatively should it prove necessary. If the state *does* choose some sort of phase-in, a short process should be favored over a longer one, since there are costs associated with rate changes, for the state and taxpayers alike.

Rate-Setting Considerations

Policymakers should avoid the temptation to chase the rate, selecting a target rate then finding base broadeners sufficient to pay down such a rate reduction. This is an inversion of the process, and while lawmakers *should* ask the hard questions and balance difficult base-broadening choices against the promise of significant rate reductions, they should not feel under pressure to tax transactions they know should not be in the sales tax base, simply because it is necessary to achieve a preset rate target.

Utah's combined state and local sales tax rates are consistent with regional averages, though not as competitive as the rates of its other taxes. There is an opportunity to bring the rate down meaningfully, perhaps in tandem with income tax rate reductions, but a goal of a 3.1 percent state rate (or any other similar target) turns deliberations into an exercise in arithmetic over policy. Both rates and bases are factors in the tax's overall competitiveness, and one should not be emphasized to the neglect of the other.

Approaches to Exempting Business Inputs

Business inputs can be exempted in one of two ways: based on the nature of the product or the identity of the purchaser. Either approach can suffice, or can be used in tandem.

Most states exempt manufacturing machinery from their sales taxes, since such machinery is clearly part of the production process and its consumption is almost exclusively by businesses. (Very few of us acquire sheet metal bending machines for personal use.) The same approach works for a variety of business services, like marketing, engineering, logistics management, and human resources, which are almost exclusively the province of businesses. For such categories, it is administratively simplest to grant an outright exemption.

Some professional services, however, can be consumed by both businesses and individuals. For instance, a consumer might retain the services of an accountant or a tax preparer, and a business might also contract with an accountant. In such cases, an exemption could be granted based on the identity of the purchaser. Utah already has experience with this approach, exempting any purchase by a nonprofit entity, and select purchases by farms and certain types of businesses, because of the identity of the purchaser. It would be relatively easy to extend these provisions to businesses more broadly to apply to the purchase of certain professional services.

Under an ideal sales tax, exemptions based on the identity of the purchaser could do away with the entire patchwork quilt of business input exemptions. Anything in the sales tax base would be taxable if purchased by a final consumer, and exempt if purchased by a business. In practice, however, applying this broadly would wipe out all inputs currently included in the sales tax base—good policy, to be sure, but a significant hit to state revenue.

A continued policy of reviewing and reducing reliance on the taxation of business inputs is important, and the state should take steps to avoid increasing the taxation of business inputs under sales tax base broadening, but a total exemption may be too radical an undertaking. A more realistic approach, then, would be to exempt certain services outright, as consisting almost entirely of business-to-business transactions, and allowing an exemption certificate approach for other services added to the base which are consumed by both businesses and individuals.

Sourcing Rules for Services

Under most circumstances, state sales taxes are destination-sourced, meaning that the relevant taxing authority is the one with jurisdiction over the location at which a customer receives a product. For these purposes, receipt is typically synonymous with taking possession, so a consumer who purchases an item in a Provo store pays Provo sales tax (collected by the seller at the point of sale) even if she then takes her purchase home to Lehi. If, however, she bought the product online and it was shipped to her Lehi address, it is the Lehi sales tax that applies.

For tangible property, sourcing is relatively easy. There tends to be a clearly defined physical location where a good is received. The same goes for some services, particularly those involving on-site labor. In many cases, however, services are performed in a different location than the one in which they are received. Hiring a home cleaning service poses few challenges—but how about a cloud computing service?

Sometimes the determination is complex. If a customer who lives in Salt Lake City pays for a digital service offered by a company headquartered in San Francisco but served out a of a data center in Phoenix, and that customer uses the service while on vacation in Honolulu, to which jurisdiction is the service sourced? Or if, for sake of argument, business-to-business services are taxed (even though they should not be), if a company based in New York City pays for a customer relations database that is used by salespeople across the country, including sales teams based in Ogden and St. George, is any portion of that transaction taxable in Utah?

Within corporate taxation, some states have adopted a "look-through" approach for corporate apportionment, based on the location of the customer's customer. Under this approach, if a service contracted in Utah was ultimately consumed (either by the company or its customer) in another state, Utah would not tax it, but if the customer's customer was in Utah, that transaction would be sourced—or partly sourced—to the state. This approach has relatively little appeal in sales taxation, because it is complex and requires an assessment of a service's use over time, information that may not be available when the sale is transacted.

Therefore, Utah would do well to avoid look-through and source services consistent with its current sales tax code, with receipt of a service sourced to wherever first use is made of the service, or for digitally transferred services, taking possession or making first use.[55] This approach cuts down substantially on complexity for taxpayers and tax collectors alike, and requires no change to the state's existing sourcing rules.

Sourcing, moreover, is chiefly relevant for business and professional services, and is most complex for those purchased by businesses. Exempting business inputs, consistent with good tax policy, clears most of the complexity of sourcing. While it would remain a relevant issue for professional services consumed by individuals, the determination is rarely complex. A Utah resident individual using a service would pay the sales tax on their fees; a Utah company providing a service to an Arizona customer would not collect sales tax on Utah's behalf.

Incorporating Local Sales Taxes

In addition to the state rate of 4.85 percent, Utah has a baseline of 1.25 percent in local sales taxes that are uniformly assessed across all jurisdictions, to which are added optional additional local levies for transportation, hospitals, and culture, as well as optional taxes for the general fund purposes of cities and towns. Technically, the 1.25 percent levy—consisting of a 1 percent local piece and a 0.25 percent county piece—is local option, but in practice, all local governments have opted into the 1 percent rate and all county governments levy the 0.25 percent rate. As noted previously, the state collects these taxes and disburses the revenue back to localities by formula, based in equal portion on the point of sale and on local population.

With an average local sales tax of 2.24 percent, local sales taxes account for over a third of total sales tax revenue[56] and cannot be neglected in any effort to undertake sales tax reform. Any substantial sales tax base broadening should be paired with rate reductions at both the state and local levels to avoid a net tax increase. Different localities, however, have different mixes of goods and services, so a local rate reduction that is revenue-neutral in aggregate across the state will yield variations in revenue effects jurisdiction-by-jurisdiction.

This should not be considered an insuperable obstacle to reform. First, prior adjustments to the way local sales taxes are allocated (changing from point of sale to a 50-50 weighting of point of sale and population)[57] similarly created winners and losers and proved palatable. Second, right now every locality is a net loser as a greater share of consumption shifts to untaxed services. In the longer term, adopting a sustainable rather than eroding base is in the best interest of localities, whether or not they currently have an above-average share of service consumption.

The simplest approach, then, is to scale down local tax rates in proportion to the state rate reduction. If, for instance, base broadening permitted a 20 percent reduction in the state rate, then the local and county option sales tax rates should also be reduced by 20 percent, to 0.8 and 0.2 percent

55 U.C.A. 1953 § 59-12-211.

56 Utah State Tax Commission, "Revenue Summary, Final Fiscal Year 2017-2018 Through 12 Months," December 2018, 1, https://tax.utah.gov/esu/revenuereports/summary2018.pdf.

57 Utah Office of Legislative Research and General Counsel, "Utah's General Sales & Use Tax: Where Are We? How Did We Get Here? Where Are We Going?" Sept. 2001, https://le.utah.gov/lrgc/briefings/SalesTaxBriefingPaper.Sept11.pdf.

respectively. Other optional rates could also be scaled down accordingly. If, however, policymakers want to take additional steps to address local revenue distribution, several other options are worthy of consideration.

Legislators could phase in the change over four years to give localities time to adjust to any revenue changes, positive or negative, and adjust other taxes (including other local option sales taxes) accordingly. This could be accomplished by comparing the percentage of total local sales tax revenues allocable to the jurisdiction under the new base to the share allocable to them the final year under the old base.

Imagine, for instance, that under the current sales tax base, a given county (under the 50-50 distribution formula) receives 5 percent of all local option sales tax revenues distributed statewide, but in the first year under the new base it would only be entitled to 4.8 percent. In the first year, the actual allocation could be weighted, with a 75 percent weight assigned to the pre-reform percentage and a 25 percent weight applied to the new percentage (yielding 4.95 percent). The second year, it would be 50-50 (yielding 4.9 percent, assuming the new base still resulted in 4.8 percent of aggregate collections), then 25-75, before fully phasing in the new allocation in the fourth year.

Alternatively, legislators might base the distribution formula on the existing sales tax base, or some close approximation of it. Utah records industry codes for sales tax transactions, so it would be possible to predicate distributions on the old base even as sales taxes are paid on the new one. This adds a significant additional layer of complexity, and will become increasingly anachronistic over time, but the complexity is mostly assumed by state government, not taxpayers or localities.[58]

Another option would be the further adjustment of the disbursement formula in concert with the base broadening. On the assumption, for instance, that services are more heavily consumed in the same areas that already have high sales volume compared to population, the ratio might be adjusted to 45 percent point of sale, 55 percent population, or some other amount, in tandem with the base broadening and local rate reductions.

During the final days of the 2019 legislative session, lawmakers also contemplated limiting sales tax base broadening to the state sales tax, with localities maintaining a narrower base (and their current rates). Although keeping localities outside the scope of sales tax modernization "resolves" the distributional problem, it creates more problems than it solves.

In the long term, it is disadvantageous to localities, as their revenue will not grow at the same rate as state sales tax revenue—and may even decline. It increases compliance costs by creating different state and local sales tax bases. It also takes Utah out of compliance with the Streamlined Sales and Use Tax Agreement (SSUTA), which is particularly unproductive now, as Utah has just begun taxing remote (online) sales and will rely on the Streamlined Sales Tax Project to enhance and simplify compliance by out-of-state sellers.

58 Some newly-taxed services might be bundled with previously-taxable sales, like repair parts (already taxable) and labor (potentially newly taxable), and the existing incentive to itemize and report these separately would be diminished, so North American Industry Classification System (NAICS) industry codes may not match the old base perfectly, but it could come extremely close.

Sales Tax Reform in Other States

Several states, including Hawaii, New Mexico, North Dakota, and South Dakota, already have fairly broad sales tax bases, though often with an overreliance on business inputs. Recent efforts to adopt significant base broadening have fallen short in several states, including in Illinois and Maine, where proposed by Republican governors, and Pennsylvania under a proposal by a Democratic governor. A legislative push in South Carolina fell short this year but is likely to be revisited, and in Connecticut, Gov. Ned Lamont (D) continues to advocate for a major expansion of the sales tax base.

Some states have, however, succeeded in adopting base broadening on a moderate scale in recent years. Examples include Iowa, Kentucky, North Carolina, and the District of Columbia.

In Kentucky, as part of a broader tax reform package, lawmakers expanded the sales tax base to include many (primarily) personal services, including:

- landscaping;
- janitorial services;
- pet care and grooming;
- small animal veterinary services;
- fitness and recreational sports;
- laundry, dry cleaning, and linen supply;
- nonmedical diet and weight loss centers;
- limousine services;
- bowling;
- overnight trailer campgrounds;
- extended warranties;
- and select other personal services.[59]

In North Carolina, an emphasis was placed on taxing services delivered by providers with an existing sales tax collections obligation. Beginning in 2017, a range of installation, repair, maintenance, and service charges were added to the sales tax base. The rationale for inclusion of these services, in particular, was that the service providers were already sales tax collectors in some aspects of their business, charging tax, for instance, on the tangible property being installed, or on parts used for maintenance and repair. Accordingly, broadening the sales tax base to cover other transactions in their purview did not require new sellers to register and begin collections for the first time. It should be noted, though, that within the existing base—whether in North Carolina, Utah, or anywhere else—many very small sellers succeed in complying with the sales tax, and there is little reason to believe that new services providers could not as well.

Iowa is typical of the states that have broadened their sales tax bases specifically to digital goods, like e-books, movie and music downloads, file storage, and software as a service (cloud-based software). Ride-sharing services are also included in the base broadening.[60] Criteria cited by a tax commission in

59 Morgan Scarboro, "Kentucky Legislature Overrides Governor's Veto to Pass Tax Reform Package," Tax Foundation, Apr. 16, 2018, https://taxfoundation.org/kentucky-tax-reform-package/.

60 North Carolina Department of Revenue, "Repair, Maintenance, and Installation Service," SD-16-4, Nov. 15, 2016, https://files.nc.gov/ncdor/documents/directives/SD-16-4.pdf.

the District of Columbia in advance of the adoption of its tax reform package included (1) purchase by final consumers and (2) services linked to tangible goods or real property situated in the District, making them difficult to purchase online or in another state.[61]

Newfound authority to tax remote sales,[62] along with Utah's size and geography compared to the District of Columbia,[63] may suggest greater possibilities in the Beehive State. Moreover, one might expect that, while Washington, D.C. hosts the offices of many professional service providers, the personal consumption of those services is more likely to take place in neighboring jurisdictions, limiting the appeal of such base broadening in a way that is less relevant to Utah.

Ideally, Utah would exceed the base broadening implemented by Kentucky, North Carolina, Iowa, and the District of Columbia, among others, though successes here provide encouragement as to the possibilities. Base broadening worked for these states. Utah now has the chance to make a bolder reform, like policymakers did with income taxes in 2007.

Conclusion

The establishment of a task force to consider tax reform options, with a focus on sales tax base broadening, grants Utah policymakers the opportunity to take the lead in sales tax modernization, blazing a trail that other states could soon follow. Utahns have proven themselves to be innovative, hard-working, and entrepreneurial, and state lawmakers deserve considerable credit for prior tax reforms which made the state more competitive and gave Utahns the opportunity to thrive.

The time has come to finish the work begun years ago, tackling the sales tax the way prior reformers tackled the individual and corporate income tax. Although the 2007 tax reform package included sales tax changes, it did not represent the sort of overhaul made to other taxes. A well-crafted sales tax reform package could be a trifecta for the state: (1) enhancing the neutrality and competitiveness of the state tax code; (2) improving revenue stability for the state with a tax code that grows with the economy; and (3) rebalancing state revenues and allowing income and sales tax collections to grow at similar rates.

Utah showed the way on income tax reform in 2007. The time has come to do the same with the sales tax. This is Utah's chance to bequeath future generations a flexible tax code that can adapt to a changing economy, and a pro-growth tax code that harnesses Utahns' work ethic and creative energy to continue—and build upon—the state's many economic successes.

61 D.C. Tax Revision Commission, "Recommendations," May 2014, 22, http://docs.wixstatic.com/ugd/ddda66_b54af5563fa54a17af9b41fc06aa672f.pdf.

62 *South Dakota v. Wayfair, Inc.*, 585 U.S. ___ (2018); Joseph Bishop-Henchman, Hannah Walker, and Denise Garbe, "Post-Wayfair Options for States," Tax Foundation, Aug. 29, 2018, https://taxfoundation.org/post-wayfair-options-for-states/.

63 Utah is nearly 1,250 times the size of the District of Columbia, and no point in the federal district is more than a few miles from the borders of Virginia or Maryland.

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Jared Walczak
Senior Policy Analyst

Katherine Loughead
Policy Analyst

Janelle Cammenga
Policy Analyst

Publications

Rachel Shuster
Editor

Dan Carvajal
Designer

Utah does not have a revenue problem, but it does face a problem of imbalance. Shifting consumption patterns are eroding the sales tax, with untaxed services assuming an ever-greater share of personal consumption. Rates have risen over time to keep up, and the income tax—which is considerably less pro-growth than the sales tax and is fully "earmarked"—has emerged as the dominant state tax.

Utah's sales tax breadth is barely half what it was at its peak shortly after the end of World War II, and the percentage of personal consumption subject to the tax has declined from nearly 50 percent to just 35 percent over the past 20 years. A modernization of Utah's sales tax is long overdue—for fairness, revenue stability, and a rebalancing of the tax code to secure the future of one of the more economically efficient forms of taxation available to states.

In this publication, we make the case for sales tax modernization. We also delve into vital questions of policy design. We explore why and how to avoid the taxation of intermediate transactions (business inputs), which causes multiple layers of tax to be embedded in purchase prices. We examine ways to address the preliminary revenue uncertainty associated with base broadening, as well as options for including local sales taxes in any reforms. We offer suggestions for right-sizing the sales tax base, as well as ideas on how best to rebalance the overall revenue picture to encourage economic growth.

Conditions are ripe for reform. It is our hope that this analysis can help inform deliberations about the structure and implementation of reforms that benefit all Utahns.

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Editor, Rachel Shuster
Designer, Dan Carvajal

Tax Foundation
1325 G Street, N.W. Suite 950
Washington, D.C. 20005
202.464.6200

taxfoundation.org