March 29, 2006

**Sales Tax Reform**  
*by Janice Houston, Senior Policy Analyst, CPPA*

There was a lot of political capital spent on tax reform during this last legislative session. Members of the House, Senate and the Governor’s Office all had different visions of what sound and fair tax policy meant. After a last minute deal between all three bodies, it looked like reform was going to happen to most of the tax system. In the final minutes of the session, though, income tax reform didn’t make it through the House. This has prompted the Governor to call for a Special Session to resolve the issue. For the moment, the most significant reform to the tax system was a two percent decrease in the sales tax rate on food, to be implemented in 2007. This reduction was a compromise on the Governor’s campaign promise to eliminate sales tax on food. His promise was in response to polling data that showed that the tax issue Utahns cared about the most was the food sales tax.

While the reduction is going to cost the state $70 million in sales tax revenue, what are the impacts going to be on the average Utah resident? Is he or she even going to notice the difference? Who is going to benefit the most and by how much? Will the expenditure of political capital on this issue pay off at the ballot box in November? This article will attempt to address these issues.

First and foremost, how will this impact the average citizen? **Figure 1** breaks down before and after tax income, the average annual amount spent on groceries and the tax implications by income category. Disregarding the “income less than $5,000” category because of its anomalies, these figures show that, on average, Utahns will keep about $71 in their pockets each year. Assuming one trip to the grocery store every week, this is about $1.37 per trip. While the overall savings are small, the reduction in the sales tax on food does seem to help lower income residents to a greater degree than others. For those in the $5,000 to $9,999 income range, the burden of the food tax drops by the most significant degree, one-half of a percent, from 1.1 percent of after-tax income to 0.6 percent of after tax income. For those in the next category up, earning between $10,000 and $14,999, the burden is reduced by two-fifths of a percent, from 0.9 percent of after-tax income to 0.5 percent of after-tax income. It is important to note that “after-tax” income for the purposes of this data set only refer to federal income taxes. Comparing these figures to the savings offered to low-income families through the tax credit proposal favored by the Utah Senate shows that for a married couple with two children and an income under $30,000, the credit would have been a better deal. This couple would have netted an average savings of $75 per person (or a total savings of $300) with the grocery tax credit as opposed to approximately $57 total with the sales tax reduction.

Income is not the only factor that should be considered when reviewing these data. As Utahns tend to have larger families, which in turn spend more on food as well as eat at home more, it is important to examine the impacts based on family size. **Figure 2** provides this information. As it shows, families with five or more members do see the largest return, in percentage terms, with sales tax on food as a percent of after-tax income dropping from 0.4 percent to 0.2 percent. However, the percentage of after-tax income spent on groceries is proportionately larger than that return. On average, families of five or more spend 8.4 percent of their income on groceries, whereas for all other family sizes that percentage is between 6.0 and 6.6.

The final iteration of these data is the impacts by age category. Elderly residents are more likely to be living on modest fixed incomes. Additionally, as mobility declines with age, they are also
more likely to eat at home. **Figure 3** highlights the impacts by the age of the head of household. Here, one can see that those age 75 and over receive the greatest benefit from the sales tax reduction.

Since this issue was one of great concern among Utahns, why wasn’t the impact greater? Even if the sales tax on food were eliminated completely, the largest return would only be $245 a year to a family of five or more, as shown in **Figure 2**. Again, assuming one trip to the grocery store a week, this is about $4.71 per trip.

Part of the answer lies in our eating habits. As **Figure 4** shows, anywhere from 30 to 56 percent of the average food budget is spent on meals outside the home. Even among low-income residents, a significant portion of food expenditures are on dining out. Were the individual impacts of this tax reform larger, one might expect to see more people choosing to eat at home rather than dine out. This substitute effect might positively impact health outcomes, especially among low-income residents. However, since the money saved in individual food budgets is so small, the convenience of fast-food and restaurant meals will still probably outweigh any monetary savings at the grocery store.

A final consideration Utahns should make when reviewing the benefits of the sales tax reduction are the indirect costs. The Legislature set aside $6 million to be allocated to the Utah State Tax Commission. These funds are to be used to assist businesses in converting their cash registers and scanning systems to calculate the new tax rates. The Legislature was very clear in the bill language that they do not anticipate this $6 million will be adequate to meet all the needs of Utah’s businesses. As the statute reads:

"This bill appropriates $6,000,000 from the General Fund for fiscal year 2006-07 only to the State Tax Commission for distribution to certain sellers to reimburse some of their costs in complying with the reduced sales and use tax rate imposed on food and food ingredients.”

(Enrolled Copy H.B. 109 “Sales and Use Tax-Food and Food Ingredients,” italics and emphasis added)

The statute provides monies to businesses with between $15,000 and $500,000 in tax remittances for computer upgrades. These businesses will receive either $10,000 toward the costs of those upgrades or 50 percent of the amount they spent on those upgrades, whichever was lower. Additionally, these businesses will be eligible for reimbursement of the full cost of any computer upgrades done to account for sales taxes that might not have been remitted during the transition to the lower rate. For businesses with over $500,000 in sales tax remittances, the bill provides monies only for accounting of lost sales tax and only at 50 percent of the cost of the computer upgrades. For this reason, small businesses may receive more assistance than larger ones, in getting their scanners and cash registers ready for the change. However, if there are more claims than the $6,000,000 allocated, the pool is pro-rated and all businesses will get less.

So what does this mean to the grocery consumer? If business costs related to the sales tax reduction exceed the assistance offered by the Tax Commission, how is that lost revenue going to be made up? Businesses have the option of either absorbing these costs or passing them on to the consumer in the form of higher prices. Since the costs associated with this change are a one-time event, it is hoped that businesses would just absorb them, perhaps piggy-backing them onto other related costs, such as a planned upgrade to their cash register system. However, the grocery business is one of razor-thin profit margins. In all likelihood then, the costs of changing the tax systems will be passed along to the consumer. If these costs are high enough, Utahns may find their tax savings eroded by higher grocery bills.

All of this leads to the final question posed above, will the expenditure of political capital on this issue pay off for those facing re-election in November. Given that the new policy is not enacted
until January 1, 2007 and most people are more interested in the fact that there was some type of tax cut, regardless of how much money they actually see in return, it is most likely that the reduction in sales tax on food will have a larger political benefit to politicians than financial benefits to Utah households.