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HOT TOPIC ALERT

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Sales Tax

WHAT, IF ANYTHING, IS GOING ON?

Extending sales taxes is a perennial idea of policymakers and commentators. The idea has been around for a long time. Is it catching on? Are states really moving to expand their tax bases to include services?

The continuing popularity of the idea is based on the premise that sales tax revenue is shrinking. The national economy is switching from the production of things, to one based on the provision of services, arguably requiring a response on the tax front. Another argument for the extension of the tax is that it would allow a reduction of the overall sales tax rate, or a reduction or elimination of a state's income tax.

However, all the talk has not gone very far towards turning the idea into reality. While some states have moved in recent years to impose sales taxes on some services, there has not been a mass movement in that direction. Early-adopter states have moved carefully. In April 2012, the Governor of Georgia signed legislation that slightly expanded the range of services that would be taxed. The newly taxable services are generally personal or consumer-related services, such as laundry and dry cleaning, and home security service charges.

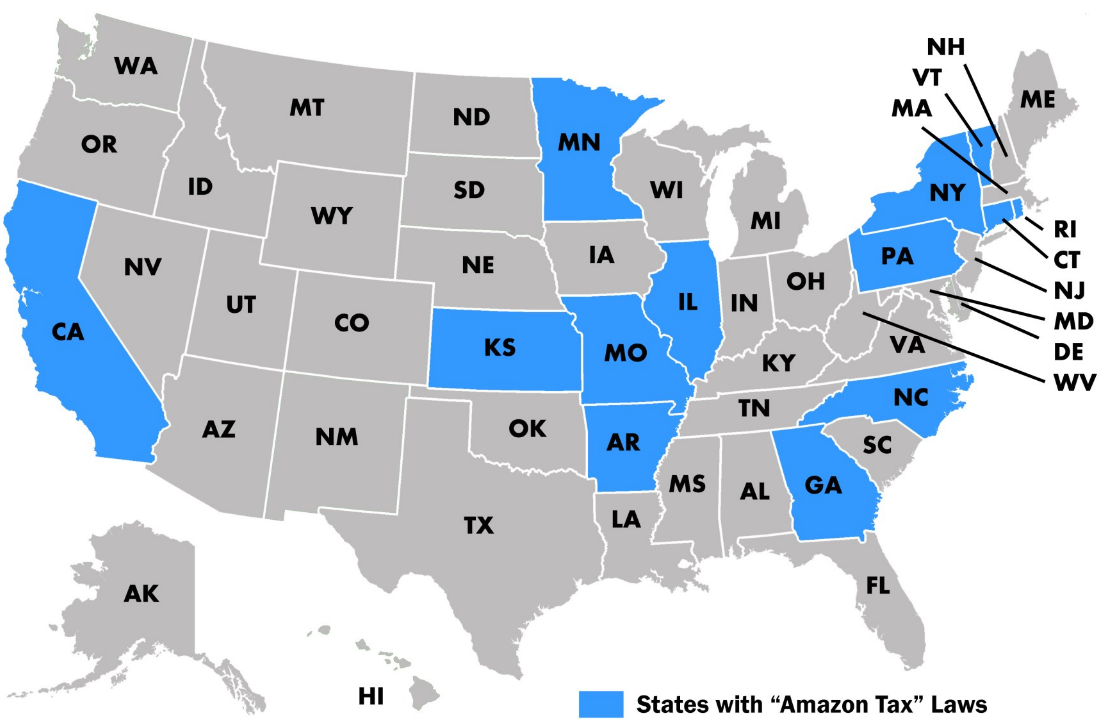
Further, it seems that once there are specific proposals to extend the tax to more services, the idea loses its appeal. In 2011, a Blue Ribbon Study Commission in Vermont proposed a broad expansion of the sales tax to include "all consumer-purchased services" with limited exceptions for certain health and education services and business-to-business service transactions, but the proposal was not adopted. One concern in Vermont was that the tax extension would put the state at a competitive disadvantage New Hampshire, a neighboring state with low taxes.

In 2013, according to the National Council of State Legislatures, 16 states considered legislation to implement an increased or expanded sales tax, typically as a way to lower or limit increases in income tax rates. Minnesota enacted a law in 2013 to impose taxes on a variety of business-to-business services, but the law proved to be extremely unpopular within the business community, and was repealed before it took effect. In Louisiana, Governor Jindal proposed a sweeping plan to replace corporate and individual income taxes with an increased sales tax, and a broadening of the sales tax base to include numerous services (but not including real estate or other professional services). The Governor's proposal was met with very strong opposition from business and other groups, and ultimately was dropped.

In Maine, legislators considered a concept draft for a broad tax reform proposal that would have extended the state sales tax to all services. The Maine proposal, like its Louisiana counterpart, was met with strong opposition. The tax reform issue was delegated to a task force for study. The tax force issued its report in December of 2013. The report proposed some modifications to existing sales taxes, and also suggested extending the state's sales tax to amusement, recreation, and entertainment services. The task force also noted that there was "both support and opposition" from task force members for extending the sales tax to basic cable and satellite TV services, "certain [undefined] personal care services," trust fiduciary and custody services, and "other [undefined] direct commissions." None of these proposals were written into legislation for the 2014 session.

There has been little movement towards implementing broad sales tax expansions in the election year of 2014. A bill in Georgia would have abolished the state's income tax and replaced it with increased sales taxes, and an expanded sales tax on services, but that bill did not progress past second reading. Instead, the focus of state sales tax legislation in 2014 has been to enable the collection of sales taxes on internet sales—so-called "Amazon" taxes. These tax bills were motivated not only by an interest in raising revenue that would otherwise be lost, but also by an interest in protecting traditional brick-and-mortar retailers who lose sales to untaxed internet retailers. The Amazon taxes don't extend the tax to any new categories of transactions—taxes are still imposed on sales of tangible personal property. The only difference is the geographic location of the retailer from whom the goods are purchased.

States with "Amazon Tax" Laws



State action on sales taxes seems to be a recurring possibility. It would be a mistake to conclude that state sales taxes will never be extended to real estate services just because it proves unpopular and hasn't happened yet. Public policy has been known to take strange—and often unwise—turns.

SALES TAX, OR GROSS RECEIPTS TAX?

Although only seven states have sales taxes that cover all professional services, other states have gross receipts taxes that may apply to real estate businesses. What's the difference?

The big difference between a sales tax and a gross receipts tax is who pays it, or who is supposed to pay it. A sales tax is a separate line item added to the purchase price of taxable goods or services. A gross receipts tax requires a covered business to pay a percentage of its gross receipts from all sources to the taxing authority. Unlike sales taxes, a gross receipts tax is not levied on individual transactions, but is a tax on the money received by a business. The business is directly responsible for paying gross receipts taxes, even though the amount of the tax is passed on to the customer.

ALL THOSE OPPOSED?

State associations of REALTORS® have been instrumental in defeating proposals to extend sales taxes to all services. In North Carolina and Maine, for example, REALTOR® associations took strong stands on sales tax bills in their respective states. Association representatives and members made their opposition known by testifying at hearings on the proposals before the proposals were turned into legislation. In both states, the proposals remained just proposals: no bills were introduced that would have extended the sales tax to real estate services. However, sales tax expansion is not unstoppable. Early mobilization and organization are the first steps to take for effective advocacy.

KEEP IT IN NEUTRAL

Proponents of broad sales tax expansions often couple their proposals with reductions in other taxes, especially income or property taxes. The oft-made claim is that the shift will be revenue neutral; that is, the tax shift will bring in no more or no less money for the state than the current tax structure. This assertion allows politicians to paint the shift as a tax cut, while responding to concerns that popular spending programs will be underfunded or eliminated altogether.

The revenue neutrality claim does not necessarily hold up. First, estimates of the sales tax rate that would be needed to replace other taxes tend to be too low. The actual rates necessary to make a revenue neutral tax swap are higher than most voters would find palatable. For example, one study found that the statewide sales tax rate in Georgia would have to be increased as high as 14.5% in order to make a revenue neutral replacement of income and business taxes. Most consumers would probably pay more than that, when local sales taxes are included (for comparison, the highest statewide sales tax rate in the U.S. is California's 7.5% tax, and the highest average combined state and local sales tax rate is 9.45% in Tennessee. The sales tax in Georgia is presently 4%, and many communities impose additional local sales taxes that range from 2 to 4%).

Second, collections of all types of tax revenue are volatile, and will vary widely according to the performance of the economy. In particular, sales taxes will decline significantly during recessions. The goal of revenue neutrality will call for repeated adjustments to tax rates, unpopular spending cuts, or both.

The best solution for state revenues is not to rely too much on any one revenue stream, whether that stream is sales tax or income tax.

BUT DOES ANYONE REALLY LIKE ANY TAX?

What is the most unpopular tax in America? Given the civic ritual of grumbling about April 15, you might think it's the income tax. That's a good guess, but surveys show that the property tax is the most unpopular. Property taxes are expensive to administer and increase frequently to keep up with revenue needs. Plus, they are regressive.

The sales tax is another tax that will not be winning any popularity contests: a Rasmussen survey conducted in 2012 found that only 31% of the respondents favored replacing the income tax with sales taxes.

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