States generally levy three primary types of taxes—income taxes, property taxes, and sales taxes. Since state sales and gross receipts taxes are a significant revenue source for state governments, these taxes receive significant attention from state legislatures, especially when budgets are tight. As a result, tax laws from one jurisdiction to another are both different and often subject to change. This article examines the evolving state of the law on sales taxes.

In this Hot Topic Alert, we provide a current snapshot of different types of taxes, including sales taxes, use taxes, and value added taxes. We provide an overview of significant legislation and court decisions related to sales taxes, and then summarize some of the tax policies that can affect homeowners and renters in their communities. We also show how REALTORS® can influence tax policies that affect the housing and rental markets in their communities.

SALES TAXES IN GENERAL

A sales tax is generally levied by a jurisdiction on goods and sometimes services. Although most states have a sales tax, several states (namely, Alaska, Delaware,
Montana, New Hampshire, and Oregon) do not. However, even in some of these states, broadly-based gross receipts taxes or corporate taxes on sales may apply.

As of 2020, seven states (namely, Washington, Oregon, Nevada, Texas, Ohio, Tennessee, and Delaware) have a gross receipts tax. Unlike a sales tax, a gross receipts tax requires a business to pay a percentage of its gross receipts from all income sources. Thus, a gross receipts tax is not levied on individual transactions, but on the money a business receives. The business is directly responsible for paying gross receipts taxes, even though the amount of the tax is passed on to the consumer. As a result, gross receipts taxes may apply to real estate businesses.

Another tax on goods, and on some services, is a use tax. Use taxes apply when a consumer makes a purchase from a business located outside of their jurisdiction. Use taxes complement sales taxes, which only apply within a specific jurisdiction. In other words, use taxes are used to compensate the state when sales tax has not been paid on a particular sale.

A final type of tax on goods is a value-added tax (VAT). A VAT applies at every stage of a product’s supply chain at which value has been added. Although the United States does not have a VAT, it is the most common type of tax on products and is used by over 160 countries.

Given the different types of taxes on goods and services, and the different tax rates of various jurisdictions, some states initiated the Streamlined Sales and Use Tax Project (SSTP) in March 2000 to develop a uniform tax system that eases the burden of tax compliance for businesses. The Project’s purpose is to establish uniform tax standards, modernize tax laws, and make the burden of compliance the same for all businesses in all sectors of commerce. As of 2021, 23 states are full members of SSTP.¹

HISTORY OF SALES TAXES

Sales or transaction taxes date back to ancient times. Economic historians have noted tomb paintings depicting tax collectors in Egypt as early as 2000 B.C., and sales taxes on some commodities, such as cooking oil, have also been traced back to that time. More general sales taxes also existed in ancient Egypt, Athens, and Rome, and Romans are credited as being responsible for spreading sales taxes to the rest of Europe.

Although many countries have experimented with a national sales tax, the United States has never applied a general sales tax on a nationwide basis. Economic historians believe that the use of sales taxes by the states dates back to the Pennsylvania mercantile license tax, which was initially introduced in 1821. Like numerous other early taxes, the Pennsylvania tax was not broad-based and was only limited to local commerce within the state. Even so, these early sales taxes were unpopular. Taxes were at the heart of the Boston Tea Party and the American Revolution. After independence, a small group of

¹ Specifically, AR, GA, IN, IA, KS, KY, MI, MN, NE, NV, NJ, NC, ND, OH, OK, RI, SD, UT, VT, WA, WV, WI, and WY.
U.S. citizens staged a small-scale revolt after Congress instituted an excise tax on whiskey, which came to be known as the Whiskey Rebellion. In July 1794, several whiskey rebels attacked and destroyed a tax inspector’s home. This insurrection represented the largest organized resistance against federal authority between the Revolutionary War and the Civil War. Although the opposed tax, which ranged from 7 and 18 cents per gallon, does not seem oppressive in today’s economy, even a small annual tax of $5 would have cost farmers a large percentage of their disposable income at the time.

Sales taxes became more common starting in the late 1920’s, after West Virginia instituted a broad-based sales tax. By 1933, when the onset of the Great Depression had states looking for additional revenue streams, eleven more states had instituted their own sales tax. Less than seven years later, that number increased by eighteen, bringing the total number of states with a sales tax to 30. By 1969, 45 states, and the District of Columbia, had instituted a sales tax.

By their nature, sales taxes are a regressive tax. The tax rate remains the same regardless of an individual’s income level. As such, they have a disproportionate impact on the poor, who spend a greater portion of their total income on purchases of goods and services than the wealthy.

Since each jurisdiction has its own sales tax laws and tax rates, many states have grappled with the question of whether, and by how much, to tax out-of-state purchases. This issue first arose with mail order catalog sales and has become more important with the advent of the Internet and online shopping. In 1992, the U.S. Supreme Court decided Quill Corp. v. North Dakota, a case which arose from North Dakota’s attempt to collect sales tax on computer software offered by Quill Corporation, a retailer that had no physical presence in the state. The Court decided that North Dakota’s tax was improper, effectively preventing states from collecting sales taxes on out-of-state purchases unless the seller had a physical presence in the state.

As a result, many states were left without an effective means to tax e-commerce and online purchases. Internet retailers like Amazon.com used this to their advantage. The fact that they did not have to collect sales tax meant that they had a competitive advantage over brick-and-mortar retailers. In response, many states passed legislation enabling the collection of sales taxes on Internet purchases, so-called “Amazon” taxes. These tax bills were motivated by a desire to both protect traditional brick-and-mortar retailers and to raise revenue that would otherwise be lost.

The ongoing ramifications of the Quill decision led the Supreme Court to reconsider, and ultimately reverse, that decision in 2018. In South Dakota v. Wayfair, Inc., the Court held that states could properly charge sales taxes on purchases from out-of-state sellers, even if the seller lacks a physical presence in the state.

At the federal level, there has been an ongoing proposal, first put forth in 1999, to institute a so-called national “FairTax.” This proposal would eliminate federal income and other
taxes, and replace them with a flat 23% sales tax. Although proponents argue that a national sales tax would be simpler and fairer by allowing individuals to only pay taxes on what they spend, some economists think that lower- and middle-class individuals would suffer, since they generally spend a greater percentage of their income.

SALES TAXES ON SERVICES

Although most consumers are aware of which goods are taxed in their state, they may be surprised to learn that 81 percent of state-level jurisdictions impose a sales tax on at least some services, most commonly telecommunications, entertainment admissions, or utilities. On average, states assess a sales tax on 55 of the 168 services the Federation of Tax Administrators has identified as being potentially taxable. Most of these taxes do not, however, apply to construction services, real estate commissions, or other services related to the real estate industry.

There are two general ways that a jurisdiction taxes could tax real estate services:

- A business or occupation tax, and
- A broad-based sales tax on services.

Generally, these are the same type of tax but they can be additive. For example, if a contractor performs “retail services” during the construction of a home, and then the client of a REALTOR® pays a sales tax on the services rendered for the purchase of that home, then the state would collect twice the tax on that home.

Eight jurisdictions (Delaware, Guam, Hawaii, New Mexico, Oregon, South Dakota, Virgin Islands, and Washington) have a business or occupation tax. Although technically not a sales tax, a business or occupation tax effectively taxes the sale of services in the jurisdiction. The state of Washington’s fairly complicated tax scheme includes both a sales tax on some services and a business or occupation tax on many services. Oregon’s excise tax is a tax for the privilege of doing business in the state. It is assessed on a company’s net income, rather than on its sales.

Professional services are broadly taxed in only five states: Delaware, Hawaii, New Mexico, South Dakota, and Washington. Additionally, the jurisdictions of Guam, Puerto Rico, and the Virgin Islands also tax some professional services. The majority of these states apply their tax to most professions, although South Dakota exempts medical professionals. These are the same five states that tax real estate commissions. The definition of “professional services” in these states also includes many occupations that may be involved in a real estate transaction, such as lawyers, accountants, architects, engineers, landscape architects, real estate appraisers, and real estate brokers.

Arguments for instituting a sales tax on services are generally based on the premise that such a tax is necessary because consumers are spending more on services and less on

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2 Specifically, AL, AZ, AK, CA, CO, CT, DC, FL, GA, ID, IL, IN, IA, KS, KY, LA, ME, MD, MA, MI, MN, MS, MO, NE, NV, NJ, NY, NC, ND, OH, OK, PA, PR, RI, SC, TN, TX, UT, VT, VA, WA, WV, WI, and WY.
tangible goods. As a result, sales tax revenues are growing slower than the economy as a whole, adding to budget deficits. Some assert that this spending change is, in part, because the cost of services has risen more quickly than the cost of goods. Thus, taxing services could result in increased tax revenues. Other arguments in favor of such a tax generally state that taxing services would make the sales tax fairer by not singling out goods for taxation, as well as stabilizing the overall tax system since the purchase of services does not vary as sharply with overall economic conditions.

However, efforts to extend sales taxes to more services are frequently met with strong opposition for many reasons. Many argue that the impact of such taxes on businesses is discriminatory. Small businesses and start-ups must often rely on outside services and may not be able to afford the extra cost added by a sales tax, while large, established companies with in-house expertise would not be taxed for the same services.

Opponents of a service sales tax also argue that the potential pyramiding of taxes on services and final goods could result in higher consumer costs. When Minnesota’s Governor Dayton proposed a sales tax on services in 2013, analysts determined that about three-fourths of the $2 billion in expected new revenue from the sales tax expansion would be generated by the tax on business-to-business services. Economists and tax policy experts objected to taxing business-to-business services for numerous reasons, primarily that it would result in tax pyramiding. In other words, since many products and services have multiple production stages, any tax applied to these stages would result in a tax being applied on top of a tax.

Additionally, because state sales taxes are not uniform, companies located in states that have service taxes would be at a competitive disadvantage over their neighbors. Thus, the taxing state may actually create a competitive disadvantage for themselves, ultimately lowering their tax revenues. Companies would also discouraged from relocating to or expanding in the service-taxing states, which would further impede those states' economic growth and development.

Furthermore, sales taxes on services are very difficult to administer. The American Institute of Certified Public Accountants has referred to a potential sales tax on services as an “administrative nightmare,” noting that states would face higher than expected costs, difficulty implementing the tax, or revenues that are lower than expected. These states may then seek to implement additional tax charges that negatively affect the professional and business community.

SALES TAX LEGISLATION AND TRENDS

When state budgets are tight, government officials frequently propose expanding state sales taxes on services. For example, in 2018, Oklahoma Governor Mary Fallin’s budget included a plan to expand Oklahoma’s sales tax to include a long list of services, explicitly including banking and real estate transactions. The Governor’s plan met strong resistance, and was ultimately unsuccessful. In recent years, other states have also considered expanding sales taxes on services. In 2017, Montana’s state legislature
considered a bill that included a broad statewide sales tax, but that bill encountered resistance from several groups, REALTORS® included, which resulted in the legislation dying in committee. The same year, West Virginia’s legislature considered, but did not pass, legislation changing its income tax to a general consumption tax, which is a tax on the money spent on goods and services, and eliminating some sales tax exemptions, including the exemptions that apply to several professional services.

In light of these developments, it is unsurprising that sales tax rates have generally increased over the past decade. This long-term trend has been caused by sales tax bases eroding over time, and states responding by raising sales tax rates. For example, in 2018, the District of Columbia increased its sales tax from 5.75% to 6%. Similarly, Utah increased its sales tax from 5.95% to 6.1% in April 2019. Research by the National Conference of State Legislatures indicates that between 2014 and 2016, the overall sales tax rates increased in Louisiana (temporary increase), Maine (previously temporary increase made permanent), South Carolina (added a local education capital improvement sales tax), South Dakota, and Utah (added a county-option tax). However, during the same time period, New Jersey decreased its overall rate, and 34 states revised their exemptions or tax bases in a manner that was expected to decrease state revenues. Only 19 of those states made amendments that were expected to increase their revenues.

Indeed, although taxing services appears to be an easy fix for budget deficits, some states’ experiences have proven otherwise. Florida, Massachusetts, Michigan, and Maryland had previously passed sales taxes on services and then swiftly repealed those laws, at least in part because of the complexity of administering the taxes. In some cases, the acts were even repealed retroactively to their effective dates.

For example, the Massachusetts legislature attempted to enact a sales tax on certain computer services in 2013. The passed legislation expanded the definition of services to include computer software and design services, including cloud services. Technology is an increasingly large part of the state’s economy, and legislative analysts projected that the new “tech tax” would bring in roughly $160 million per year. However, opponents feared that the law would have had a significant negative impact on the growth of Massachusetts’ technology sector, so the new tax faced an immediate backlash from the technology and services community. Businesses claimed that the tax was putting them out of business, and the tax generated a “firestorm of criticism” from business leaders. As a result, Massachusetts repealed the tax two months later.

Similarly, in 2007, the Michigan legislature passed Public Act 93, which expanded the state’s six percent use tax to several specific services, including consulting and many personal services. Opponents worried that the tax would negatively affect jobs and a taxpayer coalition quickly formed to repeal the law. After considerable public outcry, Michigan’s governor signed Public Act 145, which repealed the tax on numerous services.

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3 Specifically, AZ, AR, CA, CO, CT, FL, GA, ID, IN, IA, KS, KY, ME, MD, MI, MN, MS, NE, NV, NJ, NM, NY, NC, ND, OH, PA, RI, SC, TN, TX, VT, VA, WA, and WI.

4 Specifically, CO, CT, DC, FL, IN, LA, ME, MD, NJ, NM, NC, OH, PA, RI, TN, VT, VA, WA, and WV.
only 17 hours after it became effective. The repeal was effective retroactively to the time the law took effect on December 1, 2007, so the tax was never assessed.

Some states have also experimented with lowering income taxes in tandem with raising sales taxes. Eighteen states and the District of Columbia adopted individual income tax cuts between 2008 and 2012, while a number of states, including several of those same states, raised sales tax rates over the same period. This appears to have primarily occurred in states that targeted income tax cuts and then needed to increase sales taxes to offset part of that decreased revenue. Although no state has recently eliminated its income tax in favor of a higher sales tax, eleven states reduced their income tax rates in 2021. Some of these states, like Missouri and Louisiana, also adopted laws to make collection of sales taxes easier and more centralized.

Other recent trends for sales taxes include a continued push in states to tax online and remote sales in the wake of the Supreme Court’s Wayfair decision. Federal legislation, the Marketplace Fairness Act would enable state governments to collect sales and use taxes from remote retailers that do not have a physical presence in their state. The Act, which has been in limbo for several years, creates a destination-based collection system for sales taxes, so that the tax due is based on the buyer’s location. It also allows certain states to require out-of-state sellers to collect and remit the tax due to the state in which goods are sent.

Another recent state trend involves click-through or affiliate nexus legislation. This legislation requires certain remote sellers to collect a sales tax on sales to residents who are in-state. The rationale behind the legislation is that online sellers should not have a competitive advantage over brick-and-mortar stores in a state that imposes a sales tax. Typically, customers are obligated to pay the appropriate use tax for online purchases, but many individuals are not aware of that obligation or neglect to pay. In most cases, it is not practical for state tax authorities to conduct individual audits. As a result, states are considering legislation to ensure that they are receiving the proper amount of tax due from online sales to their residents. Twenty states currently have click-through nexus rules.5

However, five states have repealed their previously-enacted click-through legislation.6 These states appear to be trying to simplify their sales tax collection laws in the wake of Wayfair. Indeed, the original purpose of click-through legislation was to enable states to collect sales taxes on remote purchases despite the then-requirement of sellers needing a physical presence in the state. Since Wayfair, however, these laws may have outlived their utility.

5 Specifically, CT, GA, ID, IL, IA, KS, LA, ME, MI, MN, MO, NV, NJ, NY, NC, PA, RI, TN, VT, and WV.
6 Specifically, AR, CA, CO, OH, and WA.
IMPACT OF SALES TAXES ON REAL ESTATE AND HOME OWNERSHIP

As described above, most states do not tax real estate commissions. However, other related taxes may apply in some cases. For example, Florida appears to stand alone in assessing a sales and use tax on commercial real property rentals. The total rent paid for the right to use or occupy commercial real property in Florida is subject to a sales tax equal to six percent of the total rent and a discretionary sales surtax, unless the rent is specifically exempt. If the tenant makes certain payments on the landlord’s behalf, such as mortgage, property taxes or insurance payments, those amounts are also subject to the tax. Several exceptions apply, including but not limited to, agricultural property, rentals to certain nonprofit organizations or governmental agencies and dwelling units.

Most of the arguments against assessing a sales tax on professional services apply equally to sales taxes on real estate commissions. However, given the nature of real estate transactions, some additional arguments can be made against taxing real estate commissions and other real estate services. Various state REALTOR® Associations have frequently been successful in their battles against expanding state sales taxes to real estate services using some of the arguments described below.

Most obviously, a new tax of five or 10 percent on residential real estate transactions would have a major, disruptive impact on the real estate market. For example, if the purchase of a $200,000 home were taxed at 10 percent, the home would cost the buyer an additional $20,000. The buyer would need to pay this amount at closing unless the lender was willing to roll it into the mortgage, which would mean the buyer would also need to pay interest on the tax amount. As a result, fewer families would be able to afford a house, which would depress home sales and real estate values, resulting in yet further reduced property tax collections.

Another concern is that many parts of a real estate transaction could be subject to a sales tax on professional services. For example, Norman Morris, Louisiana REALTORS® 2013 Senior Vice President of Governmental Affairs, pointed out that with a tax on real estate services, ten to twelve professionals in a real estate transaction could be subject to the tax.

REALTOR® ASSOCIATION INVOLVEMENT ON SALES TAXES

In response to a 2012 proposal in North Carolina to expand the sales tax to services, the North Carolina Association of REALTORS®, with the assistance of the National Association of REALTORS®, presented the public and state legislators with detailed reasons why the sales tax extensions were bad policy. The Raleigh Regional Association of REALTORS® argued that licensed professionals would need to pass the sales tax on to the consumer in the form of increased costs for the services provided. Furthermore, if all, or even some, of the professional services involved in the home building and home buying process were taxed, the costs of the transaction would increase significantly, pricing some buyers out of the market.
Using a similar approach, the Ohio Association of REALTORS® argued against a proposed five-percent sales tax on real estate services in 2013. The state association emphasized that the tax would *unduly increase* the cost of housing and business throughout the state, threatening a fragile, but critical, sector of the economy. It also placed an unnecessary financial burden on Ohio property owners. The Association’s Chief Executive Officer, *testifying before the Ohio House Ways & Means Committee*, argued that taxing essentially every service involved in purchasing real estate would make housing less affordable for first-time homebuyers, who represent almost 40 percent of Ohio buyers.

Other 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.

In 2016, Missouri REALTORS® led a *coalition to amend the state constitution* to ban sales taxes on services. The coalition was formed in response to the fact that there had been no fewer than a dozen proposed pieces of legislation in the previous seven years that would have instituted a sales tax on services. Voters subsequently *approved the amendment* with roughly 57% of the vote.

Similarly, in 2018, the Arizona Association of REALTORS® helped put the *Protect Arizona Taxpayers Act* on the ballot. The Act passed with 64% of the vote, leading to a constitutional amendment that prevented any new sales taxes on services. Local REALTORS® argued that a sales tax on real estate services could *ripple outward* to taxes on construction, plumbing, lawn care, and heating and air conditioning services, thereby negatively affecting the ability of individuals to afford and maintain their homes.

By continuing to advocate for these and other priorities, individual REALTORS® and state and local REALTOR® Associations can help improve their own communities and ensure that any potential sales tax proposals on services or real estate transactions do not jeopardize affordable and equal access to housing.

### REALTOR® ASSOCIATION RESOURCES ON SALES TAXES

NAR has instituted a variety of programs and grants to help with REALTOR® and REALTOR® Association advocacy. First, the *Advocacy Everywhere* program provides professional services for launching and monitoring an advocacy campaign, including online advertising, message development, and audience targeting. The program also provides training on effective advocacy, targeting a message, and creating and distributing newsletters.
NAR’s Issues Mobilization Grant provides financial assistance to support effective advocacy campaigns on important public policy issues. Local and state REALTOR® Associations can submit applications for such a grant, which include a budget, a campaign strategy, and the proposed tools (such as advertising) to execute that strategy. Applications can be submitted for grants up to $2 million or greater.

Other grants that could be used to advocate for changes to sales tax policies include the Housing Opportunity Grant, since sales taxes on services can negatively influence the ability of individuals in a community to find affordable housing. There are three levels of Housing Opportunity Grants: Level 1 grants can be used to hold educational activities, such as a forum, while level 2 grants can be used to support activities and partnerships that address a specific affordable housing issue. Finally, Level 3 grants can be used to support new projects, or enhance existing projects, that have growth potential. These projects are generally comprehensive, with a broad coalition of partners, and have a broad community reach.

NAR also provides educational on sales tax and other key issues via its Political Advocacy webpage. This page provides links to federal, state, and local issues, as well as classes and educational opportunities on a variety of issues important to REALTORS®. NAR also keeps track of pending legislation that could impact its members, including recently proposed bills regarding sales taxes on services. In addition, online publications inform REALTORS® on key issues and help them advocate effectively for their community. For instance, NAR provides a white paper that explains the issue of sales taxes on services.

PARTNERS ON SALES TAX ADVOCACY

NAR is joined by multiple partners in advocating for fair sales tax policies on the local, state, regional, and national levels.

One such partner is the American Institute of Certified Public Accountants (AICPA) which, along with other accounting groups, has been active in opposing both local and state sales taxes on services. Like REALTORS® and REALTOR® Associations, the AICPA believes that sales taxes on services, including accounting services, are complicated to administer, create a competitive disadvantage for jurisdictions that impose such taxes, and discriminate against small businesses that have a greater need to use outside services. The AICPA notes that these effects may cause any potential sales tax on services to bring in lower than expected revenue, which may cause jurisdictions to seek additional taxes that further negatively affect businesses. The AICPA also tracks legislative trends and proposed legislation on sales taxes on services, which complements NAR’s own tracking efforts.

Other partners on the issue of sales taxes for services include individual professionals in a variety of fields and their respective associations. For instance, those in the legal and insurance industries have worked with NAR to take stands against the expansion of sales taxes to services. In Ohio, local attorneys opposed a 5% tax on legal services in that state, arguing that such a tax would increase the cost of legal representation and
potentially deny Ohioans their fundamental right to an attorney. Additional service providers that have worked with NAR against legislation that would tax services include those working in the automotive, vending, and housing industries. In some cases, local businesses have partnered with NAR to argue that a tax on services would disproportionately affect low- and middle-income members of their community, which would then result in a loss of income for local businesses and a potential loss of jobs.

CONCLUSION

Although many local and state jurisdictions tax the sale of goods, few currently tax the provision of services. Taxing services, including real estate services, may seem appealing in order to “broaden” the tax base and increase incoming revenue. However, such taxes can have significant negative effects for local communities, including burdening those with lower income levels, making home ownership and maintenance more expensive, and creating a competitive disadvantage for local businesses. Service providers, including local REALTORS®, have a key role to play in ensuring that sales tax policy in their community is fair and does not cause unwanted consequences that reduce access to affordable housing. Sudden and disruptive changes to sales tax policies can diminish local economic opportunities and result in a difficult business environment, which can then cause economic hardships for local renters and homeowners. REALTORS® and REALTOR® Associations must therefore continue their advocacy on this issue, and specifically focus on effective and early mobilization and organization with respect to sales tax proposals in their local jurisdictions.
Hot Topic Alerts are prepared for NAR by Legal Research Center, Inc.

To review NAR’s other Hot Topic Alerts, text HOT TOPIC to 30644 to sign up for REALTOR® Party Mobile Alerts and a link will be sent directly to your mobile device. All Hot Topic Alerts can also be found on the REALTOR® Party webpage.

Questions or concerns contact Melissa Horn
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ADDITIONAL STATE & LOCAL RESOURCES

**White Papers:** Comprehensive reports prepared for NAR on issues directly impacting the real estate industry. Examples include: Rental Restrictions, Land Banks, Sales Tax on Services, State & Local Taxation, Building Codes, Hydraulic Fracturing, Foreclosure Property Maintenance, Climate Change, Private Transfer Fees.

**Growth Management Fact Book:** Analysis of issues related to land use and modern growth management topics include density — rate of growth, public facilities and infrastructure, protection of natural resources, preservation of community character, and affordable housing.

All available on REALTOR® Party webpage under the State & Local Issues tab.