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Cal-Tax Digest

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Notion of Expanding the State Sales Tax Does a Disservice to Us All

By David R. Doerr

As part of a package to close the state's huge budget deficit, some California legislators and staffers are considering extending the state-local sales tax — already more than 8 percent in some counties — to services. From a tax policy standpoint, this is the worst possible idea.

As part of his 2003-04 budget, Governor Gray Davis called for "structural reforms" of the state's taxes. However, the budget does not specifically call for extending the sales tax to services. At a Sacramento Press Club luncheon on January 16, the governor said the tax on services is on the table for discussion, although he acknowledged that it has not worked well in other states.

A sales tax on services flunks the good-government test on every possible criterion. The defects are as follows:

Discrimination. It discriminates against small business. Many large businesses have people on their payrolls who perform business services, such as lawyers, accountants, janitors, etc. They would not be taxed. But small businesses that must contract out for those services would pay the tax, adding yet another competitive disadvantage in the state's tax system.

Bad for Economy. It's harmful to the business climate in general. California services would immediately have an 8 percent competitive disadvantage compared with services provided in other states. Companies based in California that could obtain services cheaper out of state would do so. The motion picture industry, already hurt by runaway production, would suffer a major blow. If this tax was added to all its services, including star salaries that go into making a movie, fewer films would be made in this state.

Individual taxpayers too would be likely to purchase services out of state. Instead of having a California lawyer handle a case in another state, you could beat the tax by retaining a non-California attorney.

Whenever possible, people would avoid the tax by just performing the service themselves. Unlike personal property, which generally must be purchased, many services can be done on a "do-it-yourself" basis. Some examples: mowing your own lawn, painting your own house, computing your own tax return, instead of hiring a gardener, painter or tax preparer. Many Californians would no doubt take on these tasks to avoid the tax. Small service providers would suffer a loss in business, and some would shut their doors. This would also discriminate against the elderly or frail that cannot rake leaves or trim back bushes.

Big Administrative Problems. It will be an administrative nightmare. A sales tax on services cannot be administered efficiently. Think of all the baby-sitters who would have to register with the State Board of Equalization and file quarterly tax returns. Multiply this by your neighbor's kid who mows the lawn, student car washes, etc. Further, how is the state to audit many services?



David R. Doerr, chief tax consultant to the California Taxpayers' Association in Sacramento, was the state Assembly's chief policy consultant to the Committee on Revenue and Taxation for 24 years, until 1987. He is the author of "California's Tax Machine — A History of Taxing and Spending in the Golden State." This is an expanded version of a commentary that was published January 3 on the Op-Ed page of the Los Angeles Times.

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Inflationary. Taxation of services would ripple through the economy, creating greater pressure for wage increases. The added cost would create a significant hardship for many.

Anti-Private Enterprise. The tax discriminates against private enterprise in competition with government. Where private enterprise is providing a service that government also provides, a tax on the private sector creates greater competitive discrimination, unless the state agrees to impose a tax on the value of all services it provides, which is unlikely. The state cannot tax the U.S. Postal Service, yet in theory a tax on services would cover private services such as United Parcel Service and Federal Express. This is grossly unfair. If educational services are included, there would be more discrimination. Stanford and the University of Southern California would be taxed, while the University of California and UCLA probably would be exempt.

Tax on Misfortune and Misery. Everyone would rather avoid bills for car repair, plumbing services, dental and medical services, etc. While unfortunately part of life, these expenses can really hurt family budgets. A tax on services is akin to going out on the battlefield and shooting the wounded.

Soak the Poor. Studies have shown that expanding the tax on services is more regressive than California's current sales tax. Such impositions would require lower-income individuals to pay a larger portion of their incomes for service taxes than higher-income folk. A good example of this is repair services. The poor tend to drive older cars that are more in need of frequent repairs. If the choice is between raising the existing rate and expanding the tax to services, the latter is the "soak the poor" alternative.

Exemptions. Does anyone expect a tax on services to be free of exemptions that would allow those who are politically well connected to avoid the tax? These exemptions would distort consumer decisions and make a mockery of the whole idea in the first place.

Expansion of the sales tax to services would produce more revenue for the state, which is why it is under consideration by policy-makers, but this revenue would be fool's gold because of the immense underlying problems.