Is a Broad-Based Sales Tax Inevitable?

Scott Drenkard
Director of State Projects
Tax Foundation

drenkard@taxfoundation.org
202-464-5111

August 6, 2017
When Was a Sales Tax Adopted in Your State?

Note: Indiana adopted a gross income tax in 1933, but in 1963 it enacted a 2% retail sales and use tax. Gross receipts taxes are not strictly comparable to the retail sales taxes.

To What Extent Does Your State Rely on Sales Taxes?

Sales Tax Collections As a Percent of Total State and Local Tax Collections, FY 2014

Note: Percentages may not add to 100 due to rounding.
Source: Census Bureau; Tax Foundation calculations.
Percent of Total Personal Consumption Expenditures


Since its creation in 1934, Ohio's state sales tax rate has nearly doubled to 5.75 percent today. Except for one rate decrease in 2005, the sales tax rate has increased over time, with four rate hikes. The current state-level rate of 5.75 percent is the 27th highest in the country.

Note: These rates do not include local sales tax rates.

Source: Ohio Department of Taxation, “Sales & Use Tax: History of Major Changes.”
How High Are Sales Taxes in Your State?

Combined State & Average Local Sales Tax Rates, Jan. 1 2017

Note: City, county and municipal rates vary. These rates are weighted by population to compute an average local tax rate. Three states levy mandatory, statewide, local add-on sales taxes at the state level: California (1%), Utah (1.25%), Virginia (1%), we include these in their state sales tax. The sales taxes in Hawaii, New Mexico and South Dakota have broad bases that include many services. Due to data limitations, table does not include sales taxes in local resort areas in Montana. Salem County is not subject to the statewide sales tax rate and collects a local rate of 3.4375%. New Jersey’s average local score is represented as a negative.

Source: Sales Tax Clearinghouse, Tax Foundation calculations, State Revenue Department Websites
A PROPERLY STRUCTURED RETAIL SALES TAX

• Apply to all final consumption
• Most states don’t:
  • They exempt many final consumer goods, instead of taxing them
  • They tax business-to-business transactions, instead of exempting them
  • They do not tax services
• And states are limited in their ability to tax internet sales.
## SALES TAXATION OF GOODS

<table>
<thead>
<tr>
<th>Category</th>
<th>Tax</th>
<th>Tax at Lower Rate</th>
<th>Exempt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Groceries</td>
<td>7</td>
<td>6</td>
<td>33</td>
</tr>
<tr>
<td>Gasoline*</td>
<td>3</td>
<td>0</td>
<td>42</td>
</tr>
<tr>
<td>Clothing</td>
<td>39</td>
<td>0</td>
<td>7</td>
</tr>
<tr>
<td>Prescription Drugs</td>
<td>0</td>
<td>1</td>
<td>45</td>
</tr>
<tr>
<td>Non-Prescription Drugs</td>
<td>35</td>
<td>1</td>
<td>10</td>
</tr>
<tr>
<td>Periodicals</td>
<td>22</td>
<td>0</td>
<td>24</td>
</tr>
</tbody>
</table>
SALES TAXATION OF BUSINESS INPUTS

Ideal Sales Tax on Final Consumption

Taxes
Price of Product

Gross Receipts Tax

Taxes
Price of Product

Price

Farm → Brewery → Distributor → Restaurant → Consumer

Stages of Production

Farm → Brewery → Distributor → Restaurant → Consumer

Stages of Production
### SALES TAXATION OF BUSINESS INPUTS

<table>
<thead>
<tr>
<th>Category</th>
<th>Tax</th>
<th>Tax at Lower Rate</th>
<th>Exempt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farm Equipment</td>
<td>8</td>
<td>2</td>
<td>36</td>
</tr>
<tr>
<td>Office Equipment</td>
<td>46</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Manufacturing Machinery</td>
<td>7</td>
<td>3</td>
<td>36</td>
</tr>
<tr>
<td>Manufacturing Raw Materials</td>
<td>2</td>
<td>1</td>
<td>43</td>
</tr>
<tr>
<td>Business Fuel &amp; Utilities</td>
<td>13</td>
<td>1</td>
<td>33</td>
</tr>
<tr>
<td>Business Leases &amp; Rentals</td>
<td>44</td>
<td>0</td>
<td>1</td>
</tr>
</tbody>
</table>
## Sales Taxation of Services

<table>
<thead>
<tr>
<th>Category</th>
<th>Tax</th>
<th>Tax at Lower Rate</th>
<th>Exempt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal</td>
<td>3</td>
<td>0</td>
<td>43</td>
</tr>
<tr>
<td>Financial</td>
<td>3</td>
<td>0</td>
<td>43</td>
</tr>
<tr>
<td>Accounting</td>
<td>3</td>
<td>0</td>
<td>43</td>
</tr>
<tr>
<td>Medical</td>
<td>2</td>
<td>0</td>
<td>44</td>
</tr>
<tr>
<td>Dry Cleaning</td>
<td>19</td>
<td>0</td>
<td>27</td>
</tr>
<tr>
<td>Fitness Club Memberships</td>
<td>13</td>
<td>0</td>
<td>33</td>
</tr>
<tr>
<td>Barber &amp; Hair Salon</td>
<td>4</td>
<td>0</td>
<td>42</td>
</tr>
<tr>
<td>Landscaping</td>
<td>17</td>
<td>0</td>
<td>29</td>
</tr>
<tr>
<td>Repair</td>
<td>22</td>
<td>0</td>
<td>24</td>
</tr>
<tr>
<td>Real Estate</td>
<td>3</td>
<td>0</td>
<td>43</td>
</tr>
</tbody>
</table>
Tax Repeal on Services In Florida Widely Felt

By JON NORDHEIMER, Special to the New York Times
Published: December 25, 1987

MIAMI, Dec. 24—Florida’s repeal of its tax on personal and professional services is having an impact on states that monitored the progress of the tax, from enactment with broad bipartisan support last spring to crushing defeat earlier this month.

Repeal and the political bloodletting that accompanied it have caused leaders in a half-dozen or so states that were contemplating similar legislation to back away from a fight with powerful national advertising and media forces. The outcry from those forces led to the defeat of the Florida tax.

The print and electronic media contended that the tax was an infringement on the right of free speech, would harm commerce and would establish a precedent for other states. Florida applied the tax to all advertising distributed in Florida, including national broadcasters and magazines whose headquarters are not in Florida, and also to some services of out-of-state architects, lawyers and accountants.

"What happened to Florida on the services tax is having a lot of influence with other states," said William T. Pound, executive director of the National Conference of State
March 12, 2008 Rally: Maryland Computer Services Sales Tax
EDITORIAL

‘Tech tax’ causes confusion, and best fix would be repealing it

AUGUST 08, 2013

BUSINESSES SHOULDN’T be required to guess what they must pay taxes on. Yet that’s exactly where Massachusetts’ software-services industry finds itself several weeks after state legislators passed a bill to put a 6.25 percent sales tax on “computer system design services” to fund transportation projects. But implementation of the so-called “tech tax” isn’t the problem. It’s the irresponsible policymaking that underlies it that is now jeopardizing one of the state’s fastest-growing sectors. Opponents are filing a 2014 ballot initiative to repeal the levy. Legislators, however, should step in to provide a faster fix.

Tax officials, for their part, have made a valiant effort to inform businesses about the new tax...
Sales tax on auto repairs, dozens of other services starts Tuesday

BY COLIN CAMPBELL
ccampbell@newsobserver.com

New sales taxes will take effect across North Carolina on Tuesday, adding to the cost of services ranging from car repairs to appliance installations.

The legislature approved the additional sales taxes last year – part of a Republican-led shift to lower income taxes by expanding the number of services subject to sales taxes.
DC TAX REFORM SAVES MIDDLE CLASS RESIDENTS $400 PER YEAR

How does expanding DC’s sales tax to gym memberships compare to the income tax cuts that everyone will receive?

The sales tax on a $70 per month gym membership is $4 per month ($48 per year). This is greatly outweighed by the income tax cuts.

Note: Income tax cut is average cut for incomes between $50,000-$75,000.
Source: Wes Rivers, Sales Tax on Services Helps Provide Tax Reductions for Most DC Residents, DC Fiscal Policy Institute

taxfoundation.org @taxfoundation
CONCLUDING THOUGHTS

• Sales tax expansion allows for a more neutral tax code
• Sales tax expansion can allow for rate reductions (in sales or other taxes)
• Sales tax expansion is not inevitable, but if you want to keep your sales tax, you should consider it