

D.C. Tax Revision Commission Policy Options

Policy Option #1: Expand the Sales Tax to Additional Services (UPDATE)

MEMORANDUM

Proposal: Extend the sales tax to additional services

Tax Type: Sales

Origin: William Fox

Commission Goal: Broaden the tax base

Current Law

An analysis by the Office of Revenue Analysis (ORA) shows that D.C. applies its general sales tax (5.75%) to 74 out of a possible 183 services listed by the Federation of Tax Administrators (FTA). The list of services is used by FTA as a metric for the breadth of a state's sales tax base and is not exhaustive. D.C. taxes far more services than its neighboring states: Maryland taxes 49 services on the list and Virginia taxes 29. Please see the attached spreadsheet for the full FTA list of services examined.

In 2011, D.C. added several services to its sales tax base, including armored cars, private investigation and security services. This expansion was projected to raise \$20.5 million in new tax revenue over a four-year period. D.C. followed Maryland in taxing these three services.

Proposed Change

In his paper on sales taxes for the Commission, Professor William Fox suggested that D.C. expand its sales tax to the following services:

- Construction contractors
- Carpentry and other construction related services
- Storage of household goods
- Mini-storage
- Water for consumption at home
- Barber and beautician services
- Carpet and upholstery cleaning
- Health clubs and tanning studios
- Carwashes
- Bowling alleys and billiard parlors

Professor Fox selected these specific services for taxation for two reasons:

1. These services are typically a final purchase by consumers.
2. These services are linked to tangible goods or real property located in D.C. and therefore it is difficult for consumers to purchase such services in another state or online.

These services are highlighted in red on the attached list of services.

An alternative approach would be to extend the sales tax to any service taxed in Maryland or Virginia but not in D.C. Doing so could extend the sales tax to the following services:

- Packing and crating items for storage
- Cellular telephone services
- Coin-operated video games
- Bowling alley and billiard parlors
- Taxidermy
- Custom processing on customer's property
- Diaper service
- Gift and package wrapping services
- Advertising agency fees (not ad placement)
- Admission to cultural events
- Pinball and other mechanical amusements
- Aircraft rental to individual pilots, short term
- Chartered flights (with pilot)
- Trailer parks (overnight)

These services are highlighted in yellow on the attached list of services. Bowling alley and billiard parlor services are on both lists and highlighted in orange.

Reason for Change

The sales tax base has declined both nationally and in D.C. as consumers shift their spending to services. In 1979, services accounted for 47.4% of total personal consumption expenditures. In 2011, services accounted for 66% of personal consumption. Extending the sales tax to certain services is an alternative to future rate hikes (or a means for lowering the current rate).

Pros

- Taxing additional services broadens the D.C. sales tax base and may generate new tax revenue and/or allow for a lower sales tax rate.
- Expanding the base to more services addresses both horizontal equity (treating transactions equally) and vertical equity (services are disproportionately consumed by wealthy consumers while low-income consumers are more reliant on goods).
- The services highlighted by Professor Fox are linked to tangible goods and/or real property located in D.C. This prevents consumers from avoiding the tax by making purchases in other jurisdictions and limits any negative effects of the tax on the D.C. economy/businesses. Alternatively, D.C. could expand its tax only to services already taxed in neighboring states. This could also mitigate any negative effects from expanding the tax.

Cons

- Consumers might travel to neighboring jurisdictions to consume a service that is now taxed in D.C., but untaxed in Maryland or Virginia.
- Policymakers in numerous states have resisted similar efforts to expand the sales tax to services for political reasons.

- The list of proposed services excludes most of the major services in D.C. (lawyers, accountants, consultants, etc.) and therefore revenue gains and/or opportunities for rate reduction are limited.

Revenue Impact

ORA estimates the following revenue increases in the first year of implementation:

Apply the Sales Tax to Specific Services	
1. Water consumption for home ¹	\$2 million
2. Storage of household goods/mini storage	\$0.5 million
3. Barber and beautician services	\$7 million
4. Carpet and upholstery cleaning	Less than \$0.5 million
5. Health clubs and tanning studios	\$5 million
6. Car washes	Less than \$0.5 million
7. Bowling alleys and billiard parlors	\$0.7 million
8. Construction contracts	\$12 million
TOTAL if all of the eight services listed are taxed	\$28.2 million

Please note: ORA has not made a revenue estimate for all 183 services listed by FTA. These estimates are only for the eight services recommended by Professor Fox.

¹ This estimate is based on NAICS Code 454390 and is broader than water consumption at home. This industry comprises establishments primarily engaged in retailing merchandise (except food for immediate consumption and fuel) via direct selling, such as in-house sales (i.e., party plan merchandising), truck or wagon sales and portable stalls (i.e., street vendors).