

COMMENTARY



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For release Tuesday, April 28, 2015

The Latest Big Idea in Montpelier: Taxing Services

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On April 15 the Democratic/Progressive chair of the Senate Finance Committee, Sen. Tim Ashe, lamented the difficult time the legislature is having trying to fill a \$113 million General Fund budget gap. Some believe that the state is spending beyond its taxpayers' means, but Ashe sees it differently. There's not enough revenue! And there won't be enough revenue for the next two fiscal years either!

But wait! There's a nifty solution! Just extend the retail sales and use tax to services!

There are some economic arguments for doing this. For example, taxing consumption is generally better than taxing production, and a broader sales tax is less volatile than a narrow one. However the current push by Sen. Ashe is clearly motivated by the need of liberal legislators to find new tax dollars to pay for spending increases. As the liberal Center for Budget and Policy Priorities has pointed out, "taxing additional services can generate substantial new sales tax revenue."

How would a sales tax on services work? First the legislature would have to decide which of 164 different services are to be taxed, and which are to be exempted. (This will be a guaranteed full employment plan for lobbyists.)

It's generally agreed that "business to business" services – such as a lawyer drafting a contract for a manufacturer - ought not to be taxed. But lawyers performing services to non-businesses, like defending someone charged with a crime, wouldn't qualify for that exemption.

Certain specific entertainment services are already taxed, like ski lift tickets and movie admissions. There are probably not enough votes to tax the services provided by doctors, dentists, psychologists, home health and day care workers, pastoral counselors, tutors, and funeral parlors.

What's left? Here's a partial list: barbers, cosmetologists, cab drivers, electricians, plumbers, painters, carpenters, truckers, butchers, architects, lawyers, auto and truck mechanics, small engine repair, excavators, seamstresses, veterinarians, advertising services, computer repair, gunsmiths, custom farm and garden services, snow plowers, tattoo artists, musicians, and many others.

All of these, faced by a sales tax on services, would face a daunting record-keeping problem, and the prospect of heavy handed state tax audits based on the principle of "guilty until proven innocent." Worse yet, putting a 6% tax on services would motivate lots of people to purchase those services from another state, such as New Hampshire.

Economists agree that sales taxes are regressive. Liberals would insist that broadening the sales tax to include services purchased by lower income families requires "targeted credits" or "rebates to protect the poor." Of course these credits and rebates eat into the revenue.

The sales tax on services advocates invariably put forth the idea that broadening the sales tax might allow dropping the present 6% sales tax rate to 5% or 4.5%. This is a pathetically hollow argument.

Reducing the sales and use tax rate depends on how much new revenue can be swept in from taxing a broad range of services. Every politically-won exemption reduces the projected revenue and, since the whole idea is to extract more revenue, that requires pushing the rate back up again.

Vermont's original sales tax law of 1969 imposed a three percent rate, exempted food, and offered a rebate to low income families. In 1982 the rate was raised to 4% and the low income rebate had disappeared. In 1991 the rate went up to 5%, to sunset in mid-1993.

When the sunset date came, the 5% went back to 4%. A month later Gov. Dean called a special session, which pushed the sunset date ahead to 1995. When that date came it was advanced to 1996, and a year later to 1997. In that year Senate leader Peter Shumlin presided over repeal of the sunset forever, leaving the rate at 5%. In 2003 Gov. Douglas agreed to another increase, to 6%.

This makes a crucial point: once a tax is on the books, legislators can always nudge the rate up, and further broaden the base to affect more taxpayers, without facing a public uproar.

The leftist "Fight Back" coalition has urgently demanded that the legislature raise more revenue to prevent any cutbacks in state spending or employment. Sen. Ashe may think extending the sales tax to services is a brilliant solution. But politically, it's not. He might want to go back and read the partial list of service providers above, and ponder his political future before going further down this road.

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