California Commission on Tax Policy in the New Economy

San Diego
October 23, 2003

Proceedings

OCTOBER 23, 2003: SAN DIEGO

Commissioner Scott Peters - San Diego City Councilmember

Board of Equalization Perspectives on Sales Tax Issues

Steve Kamp - Senior Tax Counsel to BOE Chairwoman Carole Midgen

Dave Hayes - Manager, BOE Research and Statistics Division

Economic and Fiscal Impacts of Taxing Services

Mark Ibele - Principal Fiscal and Policy Analyst, California Legislative Analyst's Office

SB 1009 Use Tax Collections

Honorable Dede Alpert - California State Senator

House Approves Internet Tax Moratorium

Brian Krebs

MEETING OF THE

CALIFORNIA COMMISSION ON TAX POLICY IN THE NEW ECONOMY

www.caneweconomy.ca.gov

San Diego City Council Chambers
202 C Street, 12th Floor
San Diego, CA 92101
October 23, 2003

AGENDA

Note: This meeting is being simultaneously webcast. To view the proceedings online please go to: www.sandiego.gov, click on the City Hall tab, then in the far right hand column under "I want to…….", select "watch via the web and City Council Meetings."

10:30 AM	Chairman Bill Rosendahl Meeting called to order Announcements Roll Call and Introductions
10:40 AM	Commissioner Scott Peters San Diego City Councilmember Welcoming Remarks
10:45 AM	Steve Kamp, Senior Tax Counsel to BOE Chairwoman Carole Midgen Dave Hayes, Manager, BOE Research and Statistics Division Board of Equalization Perspectives on Sales Tax Issues
11:30 AM	Mark Ibele, Principal Fiscal and Policy Analyst California Legislative Analyst's Office Economic and Fiscal Impacts of Taxing Services
12:00 PM	Senator Dede Alpert SB1009, Use Tax Collections
TBD	Break for lunch
TBD	Chairman Bill Rosendahl Discussion of Final Report
TBD	At the discretion of Chairman Rosendahl Public commentary Adjournment

Chairman's Notes

October 23, 2003
San Diego

Topics for consideration:

- Welcome to the 10th meeting this year, 16th overall
    - simultaneous webcast
    - video taped for delayed broadcast

- Vasconcellos Legislation (SB1933) :
    - sales and use taxes
    - telecommunication taxes
    - income taxes
    - property taxes

- Governor Davis' request on February 3, 2003
    - look at structural reform of the budget process

- Governor - Elect Arnold Schwarzenegger
    - work with fiscal managers
    - our work can be a bridge to the future

- Options for Revising the California Tax System; June 15, 2003

- Final report due December 31, 2003

- Website: www.caneweconomy.ca.gov
    - Reports and presentations
    - schedule of events
    - feedback from the public

- Today's agenda

- Thank you to the San Diego City Council
    - Mayor Dick Murphy
    - Deputy Mayor Ralph Inzunza

CAROLE MIGDEN
CHAIRWOMAN
STATE BOARD OF EQUALIZATION

CALIFORNIA'S SALES TAX IN THE TWENTY-FIRST CENTURY

By Steven Kamp[1] I. Introduction

The year 2003 is the third year of the twenty-first century. The year 2003 is also the seventieth (70th) anniversary of the 1933 enactment of the California Sales Tax Law. Although about 60%of California's General Fund revenues are provided by personal or corporate income taxes, the roughly 30% of general fund revenue[2] provided by the Sales Tax and its complimentary companion, the Use Tax, has been a steady and reliable source of revenue that funds vital California infrastructure services. In Fiscal Year 2001-02, state Sales and Use Tax revenue totaled $21.6 billion. In addition, because the local sales tax base is tied by law to the state sales and use tax, this $21.6 billion also generated $12.8 billion for California's cities, counties, and special districts.[3]

Today, as requested by the Commission, Chairwoman Migden has directed me to give you a presentation on four interrelated Sales Tax issues:

- Streamlined Sales Tax Project (SSTP)
- Use tax collections
- Taxing selected services
- Eliminating certain sales tax exemptions and exclusions

With me today to provide technical assistance is Mr. David Hayes, Manager of the Board of Equalization Research & Statistics Section, which among other things provides the Legislature with revenue estimates for tax legislation. I would also like to gratefully acknowledge the assistance and input to this presentation provided by Betty Yee (Chief Deputy to the Chairwoman and former *Chief* Deputy Director for Budget at the Department of Finance. I am also very grateful for the forthcoming testimony of Senator Dede Alpert, who chairs the Senate Appropriations Committee and who is the author of two major pieces of legislation signed into law this month, Senate Bills 157 and 1009.

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1 Senior Tax Counsel, Board of Equalization Chairwoman Carole Migden. The author gratefully acknowledges the assistance and input to this presentation provided by Betty Yee (Chief Deputy to the Chairwoman and former *Chief* Deputy Director for Budget at the Department of Finance) and David Hayes, Manager, Board of Equalization Research & Statistics Section.

The views expressed in this presentation are made on behalf of Chairwoman Migden and do not necessarily reflect the views of any other Member or employee of the Board of Equalization.

2 See Governor's Budget Summary 2003-04, at 36 (33.6% of general fund revenues, 31.5% of total revenues).

3 Board of Equalization (BOE) Annual Report 2001-02, at 25.

II. The Sales and Use Tax

As U.S. Supreme Court Justice Oliver Wendell Holmes once said, "Taxes are the price we pay for civilization." In most American states and many other countries, the public infrastructure is supported by a combination of levies on property value, income, and consumption. California, 44 other states, and the District of Columbia have a Sales and Use Tax. This consumption tax goes by the name of Value Added Tax in the European Union and the Goods and Services Tax in Canada. While these consumption levies are not operationally identical, they all have one thing in common: they tax consumption.

In the past, there were years when the California Sales and Use Tax provided more revenue than the California personal income tax. Those were the days when commerce in California meant a seller with physical presence making a California point of sale delivery of "tangible personal property" – the touchstone phrases for jurisdiction and taxability under the California Sales and Use Tax Law. Now, as this Commission's authorizing legislation recognizes, California commerce and consumption is now dominated by services and a growing presence of electronic commerce.

III. New Legislation Expanding Use Tax Collection

The first two issues on our list are covered in legislation signed this month by Governor Davis: Senate Bill 157, making California a participant in the Streamlined Sales Tax Project, and Senate Bill 1009, which increases Use Tax collection. Senator Alpert will be speaking after me, and can discuss these bills in greater detail. In essence, Senate Bill 1009 adds a line to the personal income tax form the reporting of use tax on online or out of state purchases, and gives California sales tax nexus over anyone who vends tangible personal property to any state agency. Both bills take effect on New Year's Day, 2004.

California is ready for any federal legislation that results from the Streamlined Sales Tax Project Agreement, **but should only enact SSTP legislation after insuring that the SSTP legislation passed by Congress does not limit California business activity taxes or the California sales and use tax revenue base, other than the requirement that each state use a single rate for taxing remote sales.** *California has been in compliance with this requirement for more than a decade*. In 1987 – when this issue was called "catalog sales" --- California enacted Revenue & Taxation Code Section 6203©(4)(B)[4], which applies the basic California sales tax rate (i.e., no local add-on taxes) to remote sales "upon the enactment of any congressional act that authorizes states to compel the collection of state sales and use taxes by out-of-state retailers.

IV. Board of Equalization Electronic Commerce Enforcement

Equally important is the ongoing Board of Equalization effort to apply the ancient – but broadly worded – California nexus statute – Revenue & Taxation Code Section 6203©(2). I would like to place in the Commission's record the Chairwoman's article in the October 2003 issue of *Western City* magazine entitled "Leveling the Playing Field Between Main Street and Out-of-State Retailers," which describes in detail the Board of Equalization decisions in Borders Online and Barnes And Noble Dot Com. In these

[4] Statutes of 1987, chapter 1145.

cases, the Board explained that the terms "agent" and "representative" in the nexus statute include selling activities by the bricks and mortar operations of Borders and Barnes and Noble where the California store accepted returns or distributed discount coupons for the online operation. The Board members have also directed the Board staff to conduct a full-scale nexus audit of Barnes and Noble Dot Com. The message behind these decisions is loud and clear: do not try to use the Internet as a tax haven for your California stores. If the end result of your Internet commerce is a physical presence in California, you are going to be treated like every other store in the state.

V. Expanding the Sales Tax Base to Selected Services

While these efforts from multiple directions should insure that tangible personal property sold in California pays its fair share, a large amount of consumption that is taxed in other states goes untaxed in California. This is the result of a series of disparate but interrelated events: the legislative decision in 1933 to affirmatively tax only consumption of tangible personal property, and a series of legislative decisions in the following 70 years to affirmatively exempt from sales tax various items of tangible personal property.

The sales tax is a fact of life for 97.2% of America's population. As you can see on our map, only five states (with 2.8% of the population) have no state sales tax – Alaska, Oregon, Montana, Delaware, and New Hampshire. The sales tax was created in the 1930's and 1940's as a quick way of raising needed government revenue for Depression-starved state governments. It is worth noting that despite the old adage of "never raise taxes during a recession", the sales tax was imposed on the for the first time on the consumption economy in a depression, yet all American state economies emerged from the Depression, and today all but 5 have a sales tax.

A few even expanded the sales tax beyond tangible personal property. As indicated on our map, three states – all colored in red [South Dakota, New Mexico and Hawaii] – tax all 18 services on our list, and in fact they also tax many more. In these states, the sales tax is essentially a tax on all of a business's gross receipts – in fact, New Mexico calls it the Gross Receipts and Compensating Use Tax.

At the other extreme, there are another eight states that do not tax any services – the largest of which is California. **We are not proposing that California adopt the "tax all services" approach used in New Mexico, Hawaii, or South Dakota. Rather, we are proposing that the California Legislature carefully examine 18 services, one or more of which are taxed in 39 of the 46 jurisdictions with sales taxes. The Legislature should consider extending the sales tax to these services, possibly with a "sunset" clause after 5 years.**

Each year, California state government loses $1.8771 billion per year – and local governments lose an additional $1.0962 billion – because services that are taxed in many other states – both large and small – are not taxed by California. Moreover, many of these services are provided by retailers that already have seller's permits because they sell taxable tangible personal property. The most obvious example is vehicle repair – any time one takes a car in for repair, one gets an invoice with a taxable parts component and a non-taxable labor component. As indicated in our handouts, California state government loses $705.7 million per year by not applying the sales tax to vehicle repair, even though vehicle repair is subject to sales tax in New York, Florida, Pennsylvania, Ohio, New Jersey, 15 smaller states, and in the District of Columbia. These states have a combined population that is almost half – 46.2% -- of the states other than California with a sales tax.

The charts that we have given you use revenue estimates prepared by Dave Hayes and the BOE Research and Statistics section, and a survey of taxable services compiled by the Federation of Tax Administrators. It is completely up to date and includes Ohio's recent sales tax base expansion that took effect August 1. That expansion was sponsored by Ohio's new Governor, Robert Taft.[5]

I will now review the sales tax treatment of the other 17 services listed on the chart:

Admissions to Amusements – 33 states, 6 big states[6], 67% of population[7], $83 million[8]

ADMISSIONS TO SPORTING EVENTS – 32 STATES, 5 BIG STATES, 58%, $106 MILLION

Admissions to Bowling Alleys – 27 states, 3 big states, 50%, $13.5 million
Appliance/Furn. Repair – 22 states, 6 big states, 55%, $90.5 million
Admissions/Golf – 22 states, 4 big states, 52%, $48.5 million
Laundries – 21 states, 4 big states, 44%, $157.6 million
Shoe Repairs – 20 states, 4 big states, 43%, $1.5 million
Parking – 19 states, 3 big states, 45%, $53.3 million
Arcades – 18 states, 1 big state, 29%, $11.1 million
Funeral Homes – 13 states, 3 big states, 22%, $41.5 million
Security services – 12 states, 4 big states, 37%, $82.9 million
Beauty shops – 5 states and New York City, NYC and Ohio, 15%, $153.7 million
Real Estate Management – 5 states, New York, 12%, $195.3 million
Bail bonds – 4 states – 2%, $5.6 million
Veterinarians – 3 states – 1.6%, $80.3 million
Billboards – 2 states1.3%, $34.4 million
Crop services –- 2 states, 1.7%, $12.8 million

As indicated by the "asterisk" at the top of the chart, many of businesses in these industry code groups already have seller's permits. Their counterparts in many other states already pay sales tax on these services, so applying the sales tax to these services in California will not create an incentive to leave the state.

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[5] Ohio Department of Taxation "Tax Facts: Expansion of Sales Tax Base", July 22. 2003. Available online at www.state.oh.us/tax
[6] The ten largest states (in population terms) other than California.
[7] As used herein, the term "population" means states *other than California* that have a sales tax – i.e., 44 states and the District of Columbia.
[8] The city/county and special district revenue numbers for each service are listed in the "Expected Revenues" chart. The total local revenue number is approximately 58% of the state revenue number.

VI. SALES TAX EXEMPTIONS AND EXCLUSIONS

The final area that I would like to discuss is Sales and Use Tax exemptions enacted by the Legislature. I would like to place into the record the May 2003 edition of the Board's annual Publication 61, *Sales and Use Taxes: Exemptions and Exclusions*, which lists over one hundred exemptions of tangible personal property from the sales tax. Some of these exemptions – for necessities of life such as food, medicine and housing – are worthy ones. In fact, the food exemption was given 66% approval by the voters when they approved Proposition 163 in November 1992.[9] However, if you look on pages 22-24 under "Industry Benefit" you will see over $500 million in sales tax exemptions. The Legislature should seriously consider placing a sunset provision on each of these exemptions so that we can determine whether they actually create sustainable jobs, or whether they simply reward businesses for something they would do anyway. This year, the Legislature allowed the Manufacturers Investment Credit (MIC) to expire. The MIC was costing the state $400 million per year in lost income or sales tax revenue, and Employment Development Department statistics indicated that far from creating 100,000 jobs, our state actually experienced a net manufacturing job loss during the 10 years of the MIC.

VII. CONCLUSION

In conclusion, for the last 70 years, the Sales and Use Tax has proven to be a reliable revenue source for California. However, the new economy's reliance on services and cross-border deliveries of goods makes it more difficult – but not impossible – for the Sales and Use Tax to effectively create a level tax playing field for all consumption. By insuring that nexus standards reach to the maximum extent permitted by the U.S. Supreme Court and Congress, by expanding the sales tax base to selected services, and by carefully monitoring sales tax exemptions, we can insure that the Sales and Use Tax works as well in the New Economy as it has in the "old economy."

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[9] David Doerr, *California's Tax Machine* (Caltax, 2000), at 246.

Steve Kamp, BOE

State	2002 Population (Millions)	Cumulative Population Percentage 1/	Population Rank	Amusement Parks *	Sporting Events *	Bowling Alleys *	Appliance and Furniture Repair *	Golf *	Vehicle Repair *	Laundries	Shoe Repair *	Parking	Arcades *	Funeral Homes *	Security
California State Sales Tax Revenue Estimate ($ Millions)				**$83.0**	**$106.0**	**$13.5**	**$90.5**	**$48.5**	**$705.7**	**$157.6**	**$1.5**	**$53.3**	**$11.1**	**$41.5**	**$82.9**
Number of States Taxing Each Service				**33**	**32**	**27**	**22**	**22**	**21**	**21**	**20**	**19**	**18**	**13**	**12**
California	***35.1***		***1***												
Texas	21.8	8.9%	2	21.8		21.8	21.8	21.8		21.8	21.8	21.8			21.8
New York 2/	19.2	16.6%	3	19.2	19.2		19.2	19.2	19.2			19.2			19.2
Florida	16.7	23.4%	4	16.7	16.7	16.7	16.7	16.7	16.7		16.7	16.7	16.7		16.7
Illinois	12.6	28.5%	5												
Pennsylvania	12.3	33.6%	6				12.3		12.3	12.3					
Ohio	11.4	38.2%	7				11.4	11.4	11.4	11.4	11.4				11.4
Michigan	10.1	42.3%	8								10.1			10.1	
New Jersey	8.6	45.8%	9	8.6	8.6		8.6		8.6						
Georgia	8.6	49.3%	10	8.6	8.6	8.6								8.6	
North Carolina	8.3	52.6%	11	8.3	8.3					8.3				8.3	
Virginia	7.3	55.6%	12												
Massachusetts	6.4	58.2%	13												
Indiana	6.2	60.7%	14											6.2	
Washington	6.1	63.2%	15			6.1	6.1		6.1	6.1	6.1	6.1			
Tennessee	5.8	65.5%	16	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8		5.8	
Missouri	5.7	67.8%	17	5.7	5.7	5.7		5.7					5.7		
Maryland	5.5	70.1%	18	5.5	5.5					5.5			5.5		5.5
Arizona	5.5	72.3%	19	5.5	5.5	5.5		5.5				5.5	5.5		
Wisconsin	5.4	74.5%	20	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4		
Minnesota	5.0	76.5%	21	5.0	5.0	5.0		5.0		5.0		5.0	5.0		5.0
Colorado	4.5	78.4%	22												
Alabama	4.5	80.2%	23	4.5	4.5	4.5							4.5		
Louisiana	4.5	82.0%	24	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5		4.5	
South Carolina	4.1	83.7%	25	4.1	4.1	4.1		4.1		4.1					
Kentucky	4.1	85.3%	26	4.1	4.1										
Oklahoma	3.5	86.8%	27	3.5	3.5	3.5		3.5				3.5	3.5		
Connecticut	3.5	88.2%	28	3.5	3.5	3.5	3.5	3.5	3.5		3.5	3.5	3.5		3.5
Iowa	2.9	89.4%	29	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9		2.9
Mississippi	2.9	90.5%	30	2.9	2.9	2.9	2.9		2.9	2.9	2.9	2.9			
Kansas	2.7	91.6%	31	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7		2.7	2.7	
Arkansas	2.7	92.7%	32	2.7	2.7	2.7	2.7		2.7		2.7	2.7	2.7		
Utah	2.3	93.7%	33	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3			2.3	
Nevada	2.2	94.5%	34												
New Mexico	1.9	95.3%	35	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
West Virginia	1.8	96.0%	36	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Nebraska	1.7	96.7%	37	1.7	1.7	1.7		1.7							
Idaho	1.3	97.3%	38	1.3	1.3	1.3							1.3		
Maine	1.3	97.8%	39												
Hawaii	1.2	98.3%	40	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Rhode Island	1.1	98.7%	41												
South Dakota	0.8	99.1%	42	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
North Dakota	0.6	99.3%	43	0.6	0.6	0.6		0.6					0.6		
Vermont	0.6	99.6%	44	0.6	0.6	0.6									
District of Columbia	0.6	99.8%	45	0.6	0.6		0.6		0.6	0.6	0.6	0.6		0.6	
Wyoming	0.5	100.0%	46	0.5	0.5		0.5		0.5	0.5	0.5				
Sum of Population, Each Service, Except California	246.1	N.A.	N.A.	164.7	142.9	124.1	135.5	128.0	113.8	107.8	105.5	111.6	71.2	54.6	91.6
Share of All States With Sales Taxes, Except California	100.0%	N.A.	N.A.	66.9%	58.1%	50.4%	55.1%	52.0%	46.2%	43.8%	42.9%	45.4%	28.9%	22.2%	37.2%
U.S. Population (excluding California)		253.3													
Percent With Sales Taxes:		97.2%													

1/ States with sales taxes.

2/ New York City has a population of 8 million people which comprises 41.2% of the State of New York, beauty shops are only taxed within the city of New York.

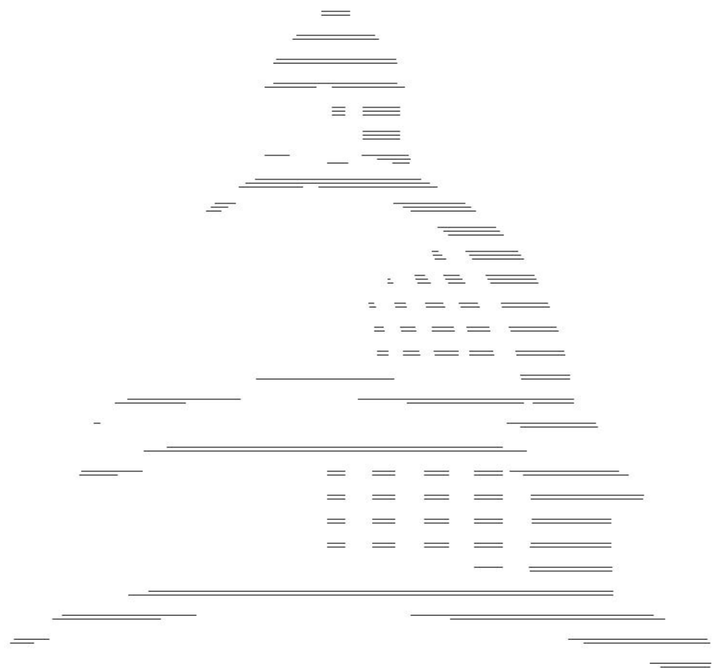
* The majority of these service providers currently have sales tax permits as they make some taxable sales.

October 23, 2003

Sales Tax on Services

L E G I S L A T I V E A N A L Y S T ' S O F F I C E

Presented To: California Commission on Tax Policy in the New Economy



LAO Sales Tax on Services—Introduction 60 YEARS OF SERVICE

Regarding extending the sales and use tax (SUT) to services, there are two separable principal issues:

Should the SUT base be broadened on basic tax policy grounds?
Should applying the SUT to services be considered as an option for addressing state budget problems?

Regarding the first issue, we have long been on record in favoring broad tax bases with low rates.

Extending the SUT to services would constitute a change to the state's basic tax system and make it more reflective of the state's economy.

The specific issue of taxing services in the context of base broadening has arisen due to declining taxable consumption, as services and intangible goods have become a larger and larger component of the economy.

This is not related to budget conditions, and applies in both good times and in bad.

Regarding the second issue of taxing services to help address the budget problem, we have identified this as one of a variety of options that the Legislature could consider.

For example, we have noted that the application of the SUT to certain entertainment purchases could raise in the mid to high-hundreds of millions of dollars annually.

If a revenue-raising approach is taken, it should be taken in a manner that minimizes distortions or tax pyramiding.

LAO

Effects on Consumers

60 YEARS OF SERVICE

Economists generally assume that an attempt is made to pass the SUT along to the consumer in the form of higher prices.

- Depending on the supply and demand characteristics for the product or service involved, there may be some decrease in production and consumption if a new tax is put into place or the rate on an existing tax is increased.
- Eventually this could also affect employment and wages in the industries directly affected.

. • However, the ultimate impacts in such areas as overall jobs will also depend on the purposes for which any new SUT revenues are used, such as infrastructure spending.

☑ **The SUT is viewed as a regressive tax, in that as those with lower incomes pay a greater proportion of their incomes in taxes than do those with higher incomes.**

. • Some studies have found that taxable consumption in California ranges from something over 40 percent of income for those earning $30,000 or less, to somewhat over 20 percent for those earning $100,000 or more.
. • The incidence of the tax will vary depending upon the exemptions allowed for various items (such as food) as well as individual consumption patterns.

Effects on Consumers (Continued)

☑ **Generally, studies have suggested that expanding the SUT base to include a wide range of services would not significantly alter the regressive impact of the tax.**

. • For example, a study of Florida's sales tax on services detected only a very slight decline in the regressivity of the SUT.
. • Taxes placed on particular services—as opposed to a broad-basedtax on all services—could have some impact on the regressivity of the tax, depending on the nature of the services selected for taxation.
. • Employment impacts of taxing services will also vary by service type and by sector, and thus result in different impacts on various income classes.
. • Although an expansion to services would not generally affect the overall incidence of the SUT, the state's overall tax system itself could become less progressive. This would occur to the extent that SUT revenues constitute a larger share of total revenues.

Effects on Businesses

☑ **Approximately one-third of the SUT is currently paid directly by businesses in the state, with two-thirds paid by individual consumers.**

. • Any SUT imposed on services would also be paid by both businesses and individuals, although their relative shares would be dependent on the specific services taxed.
. • Even the portion of the SUT directly paid by businesses, however, could eventually be shifted to consumers and other parties (such as wage earners or

shareholders), depending on market conditions.

Applying the SUT to services raises the issue of tax pyramiding (or "cascading") if services typically purchased by businesses are included.

. • Taxing business inputs—such as accounting or legal services—as well as the goods or services sold by the business, can lead to tax pyramiding and higher consumer prices.
. • Tax pyramiding can already occur with respect to the tax on intermediate personal property purchased by businesses— the services from which are then incorporated (directly or indirectly) in consumer products.

LAO Effects on Businesses (Continued) 60 YEARS OF SERVICE

Many economists suggest that business purchases be exempted from the SUT—including the purchase of any services by businesses.

. • While such an approach would eliminate tax pyramiding, it also would reduce revenues substantially.
. • Thus, the approach would probably need to be thought of from the perspective of long-term tax reform, and in the context of the entire tax system.

Taxing services purchased by businesses could also result in some administrative and equity issues. These issues apply to the current SUT on tangible goods, but would likely be a greater problem if services are taxed.

. • Businesses that could, might shift their consumption of externally provided services to internal sources, and thus avoid the tax. This would encourage inefficiencies if such integration occurred onlyfor tax reasons, and could disadvantage smaller businesses who cannot achieve such intergration.
. • Exempting services purchased by businesses could result in additional enforcement issues associated with the SUT, due to increased need to distinguish the purchase of personal services from business-related purchases.

LAO

Effects on Businesses

(C ont

- Applying the tax to "occasional labor" and other activities could also raise enforcement and compliance problems, suggesting that a de minimisamount of services be exempt.
- The taxation of the services used by multistate companies would require additional enforcement and auditing activities in order to appropriately allocate the amount of the service "consumed" in California.

Other Issues

☑ **Federal deductibility is an issue.**

. • Unlike other state taxes—such as the personal income tax and the property tax—the SUT is notdeductible from income for federal tax purposes for individual taxpayers.

. • For business taxpayers, the SUT isgenerally deductible—as a business expense—for federal income tax purposes, along with all other state and local taxes.

. • For a business in the 35 percent marginal tax bracket, approximately one-third of any increased SUT that is eligible for immediate deduction would be "paid for" through a reduction in the amount of federal and state income taxes owed by the business.

☑ **Activities in other states.**

. • California taxes very few services compared to other states— as shown in the attached table (although many services are indirectly taxed to the extent their value is incorporated into the final value of any taxed product).

.• According to Commerce Clearing House, an organization that tracks tax developments, limited changes to services taxation have been enacted this year to date. However, certain changes are being considered. For example:

. •In **Illinois**—sales taxes on services are under legislative discussion.

. •In **Montana**—a proposal has been introduced to tax selected services.

.• In **New Hampshire**—the Governor has proposed a

.7.3 percent tax on amusement and entertainment services.

. •In **New Jersey**—a statewide occupancy tax has been proposed.

Expected Revenues Generated from Extending the Sales & Use Tax to Selected Services

Service	Estimated 2002-03 Receipts	Estimated Sales Tax Revenue: State 5%	Local 2.25%	Special District 0.67%	Total
	(all figures in millions of dollars)				
Amusement Parks	1,661	83.0	37.4	11.1	131.5
Sporting Events	2,119	106.0	47.7	14.2	167.8
Bowling Alleys	271	13.5	6.1	1.8	21.4
Appliance and Furniture Repair	1,810	90.5	40.7	12.1	143.3
Golf	970	48.5	21.8	6.5	76.8
Vehicle Repair	14,113	705.7	317.5	94.6	1,117.7
Laundries	3,152	157.6	70.9	21.1	249.7
Shoe Repair	29	1.5	0.7	0.2	2.3
Parking	1,067	53.3	24.0	7.1	84.5
Arcades	223	11.1	5.0	1.5	17.6
Funeral Homes	829	41.5	18.7	5.6	65.7
Security	1,657	82.9	37.3	11.1	131.2
Beauty Shops	3,074	153.7	69.2	20.6	243.5
Real Estate Management	3,906	195.3	87.9	26.2	309.3
Bailbonds	111	5.6	2.5	0.7	8.8
Veterinarians	1,607	80.3	36.2	10.8	127.3
Billboards	688	34.4	15.5	4.6	54.5
Crop Services	256	12.8	5.8	1.7	20.3
Total	37,542	1,877.1	844.7	251.5	2,973.3

Selected Services

Service	Majority Currently Permitted
Amusement Parks	Yes
Sporting Events	Yes
Bowling Alleys	Yes
Appliance and Furniture Repair	Yes
Golf	Yes
Vehicle Repair	Yes
Laundries	No
Shoe Repair	Yes
Parking	No
Arcades	Yes
Funeral Homes	Yes
Security	No
Beauty Shops	Yes
Real Estate Management	No
Bailbonds	No
Veterinarians	No
Billboards	No
Crop Services	No

From: Pickler, Roger [Roger.pickler@ci.sj.ca.us]
Sent: Thursday, September 18, 2003 4:56 PM
To: ‘Graves, Marshall’
Subject: RE: House ban on taxing Internet access

Thanks for the articles. Here is a copy of an article from the Washington Post.

Thought you might be interested.

www.washingtonpost.com

House Approves Internet Tax Moratorium

By Brian Krebs, washingtonpost.com Staff Writer
Wednesday, September 17, 2003; 11:42 AM

The U.S. House of Representatives today passed a bill to extend and expand the five-year-old Internet tax moratorium, demonstrating the special status technology and the World Wide Web continue to enjoy with Democrats and Republicans in Congress.

The tax moratorium, set to expire in November, bans state and local government from taxing Internet access -- the digital subscriber line (DSL), cable, satellite or dial-up services Americans use to access the Internet.

The House bill approved by voice vote today would make the moratorium permanent and expand the law to plug a loophole that at least 13 states are currently using to justify taxing some forms of Internet access. In addition, the proposal would end an exemption that allowed 10 other states to keep Internet access taxes on the books after the original moratorium was passed.

Rep. Christopher Cox, the California Republican who is the lead sponsor of the moratorium bill, touted the measure as a way to make Internet access more affordable for consumers.

“We want to keep Internet access affordable, and in many places the difference between dial-up and broadband is ten bucks a month,” Cox said.” If ten dollars a month is already a barrier for people to embrace broadband, adding an increment on top of that is only going to keep the digital divide wide open.”

Senators have yet to vote on the moratorium, though the Senate Commerce Committee approved a nearly identical bill in July. The full Senate is expected to take up the matter before November.

The House bill includes a provision sought by most major telecommunications companies, including Verizon and AT&T, that would make clear that states cannot tax

DSL and dial-up Internet access service that telephone companies often bundle with traditional voice services.

Traditional voice telecommunications services have long been taxed by states and localities, a precedent that led Maryland, Virginia and 13 other states to pass laws to tax Internet access when it is bundled with voice services. Another six states are poised to enact similar legislation. Alabama, Florida and Kentucky charge sales taxes on DSL Internet service, commonly referred to as DSL, because it is considered a telecommunications service.

Under the bill approved by House members, states would be barred from taxing Internet access regardless of the how consumers go online, be it through wireless, satellite, DSL or cable modem.

The bill also would phase out an exception that allows about 10 states --and several local jurisdictions -- to continue taxing Internet access because they already had a law in place before the ban was enacted. The 10states are Hawaii, New Hampshire, New Mexico, North Dakota, Ohio, South Dakota, Tennessee, Texas, Washington and Wisconsin.

The telecom industry has lent its considerable support to the bill to ensure that all forms of Internet access are treated equally, said AT&T spokeswoman Claudia Jones.

“This bill takes away the uncertainty that’s out there now for DSL providers and makes all forms of Internet access subject to the same rules,” Jones said.

According to a study released by the Congressional Budget Office (CBO) in May, ending the grandfather clause could cost those states from $80 million to $120 million annually. The CBO said changing the definition of what constitutes Internet access could also affect tax revenues, though it did not estimate the costs associated with such a change.

That revenue loss could hit Texas particularly hard. The Lone Star State falls under the grandfather clause, bringing in roughly $45 million annually in Internet access charges.

“Extending this moratorium simply solidifies special treatment for this particular communications medium,” said Billy Hamilton, deputy comptroller for the state. “Our notion has always been we don’t need [the moratorium] because we’re talking about an industry that is no longer in its infancy but has matured.”

But Rick White, president and chief executive officer of TechNet, a bipartisan lobbying group for high-tech CEOs, said many in Congress support the moratorium because they’re wary of applying traditional telecommunications regulations to the Internet.

“I think Congress learned its lesson with the whole telecom regulatory experience of the past two decades, where you ended up with pricing situations that didn’t respond to market forces,” White said. “So there’s definitely a reluctance to burden the Internet with some of the problems that we've spent years trying to extricate ourselves from on the telecom side."

The Senate Commerce Committee's version of the bill would also ban taxes on bundled voice and Internet services, though lawmakers on the panel remain at odds over exactly how to define "Internet access."

It's Not About Internet Sales Taxes

The moratorium legislation being debated in Congress does nothing to advance a plan by a coalition of states to get congressional approval to collect sales taxes on purchases made online.

Under federal law, Internet merchants must charge applicable sales taxes only if the buyer is located in the same state where the seller has a store or distribution center. But that rule captures relatively few Internet sales, and fails to address how states would enforce collection. Most states require consumers to pay taxes on items they buy online, but such laws are difficult to enforce and are usually ignored.

Nearly 40 states have joined the Streamlined Sales Tax Project in a bid to level the sales tax playing field, concerned that failing to tax all online sales would put main street stores at a disadvantage and cut into state and local revenues. The states not only need congressional approval for their plan, but they also must modify their disparate sales tax laws to comply with the national proposal.

The states initially hoped to hitch their sales tax effort to the access moratorium extension, but the coalition later decided to unhitch the Internet sales tax agreement from the moratorium to avoid confusion, according to Neal Osten, director of commerce and telecommunications for the National Conference of State Legislators.

"It's a complicated topic that when you combine them confuses everyone," Osten said in an interview in July. "The access tax moratorium gets into a whole nest of issues that outside the scope of what we want to do."

Roger J. Pickler, Revenue Manager

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Finance Department Mission Statement:

> To manage, protect, and report on the City of San Jose's financial resources for our residents, businesses and investors.

-----Original Message-----
From: Graves, Marshall [mailto:MGraves@commerce.ca.gov]
Sent: Thursday, September 18, 2003 4:44 PM
Subject: House ban on taxing Internet access

Three perspectives on the recent house vote. This is not the same issue as taxing internet transactions, but they are related.

House Votes Unanimously to Permanently Ban Internet Access Taxes Los Angeles Times http://www.latimes.com/business/la-fi-tax18sep18,1,1689981.story?coll=la-T

Headlines-business
San Francisco Chronicle http://sfgate.com/cgi-bin/article.cgi?f=/c/a/2003/09/18/MN257079.DTL>

San Jose Mercury http://www.bayarea.com/mld/mercurynews/business/6800512.htm>

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