A Report Prepared for the Indiana Fiscal Policy Institute:

CONSIDERING SALES TAXATION OF SERVICES IN INDIANA

By John Mikesell
Chancellor's Professor of
Public and Environmental Affairs
Indiana University
Bloomington, IN

March 29, 2017

CONSIDERING SALES TAXATION OF SERVICES IN INDIANA

PUBLISHER'S NOTE

Indiana's sales tax has remained largely a tax on goods and not services since it was first enacted more than 50 years ago. The rate has changed, but the General Assembly has rarely considered increasing the relatively few services subject to the tax. Two years ago, the Indiana Fiscal Policy Institute published this report by Indiana University Professor John L. Mikesell, one of the nation's foremost experts on sales taxation. The IFPI has decided to reissue the report to help members and the public better understand the increasing discussion of extending the state's sales tax to additional services. House Ways and Means Chair Tim Brown often makes reference extending the sales tax and during the 2105 session asked that a bill be drafted to do so. The bill never was introduced, however, as the Speaker of the House declined to move it.

This year Brown introduced House Resolution 3, which asked the Legislative Council to assign the matter to a study committee. The resolution, which is scheduled for a hearing in the Ways and Means Committee on April 3, asks the Legislative Council to "assign the topic of examining whether to expand the sales and use tax base to include services to the appropriate interim study committee." The resolution notes that nearly half of Indiana's tax revenue flows from the sales tax and recent trends documented by the Bureau of Economic Analysis indicates the sales tax base is narrowing as consumers shift purchases from consumable goods to services. The resolution also notes, "a key principle of sound tax policy is to tax the broadest possible tax base at the lowest possible tax rate; and … expanding the sales and use tax base to include services could allow for a substantial reduction in the sales and use tax rate while maintaining revenue neutrality."

In the Senate, Appropriations Committee Chair Luke Kenley moved Senate Bill 545 to the House, which has heard the bill. Kenley, who has worked for many years on a federal Streamlined Sales Tax effort, seeks to require online retailers who are outside of Indiana to collect and remit the sales tax if their annual gross revenue from Hoosiers is $100,000, or if they have more than 200 transactions a year. The bill also includes language that calls on the courts, either state or federal, to consider the issue and determine the appropriate scheme for collecting and remitting sales taxes from online purchases. Currently Hoosiers are supposed to declare their untaxed online purchases on their income tax return and pay the sales tax that way. Compliance, however, is very low. Estimates of the state's lost revenue range from $77 million to $195 million a year.

Mikesell's comprehensive paper examines these issues and more, and places Indiana in the context of other states on the sales tax. He notes the Hoosier State has among the highest sales tax rates and lags many others in the number of services that are taxed. He also notes, however, that many other states have made poor attempts to increase the number of services that are taxed and why those efforts failed.

The fiscal policy implications for Indiana are dramatic as detailed in this paper. With renewed interest in the sales tax, specifically on services, reissuing this paper is the IFPI's contribution to the public policy debate. **–John Ketzenberger, IFPI President**

EXECUTIVE SUMMARY

The precursor tax to the Indiana retail sales tax, the gross income tax, applied to gross receipts from sales of both tangible personal property and services. The reformed tax, the gross retail sales tax, followed the prevailing practice for retail sales taxes then and applied only to tangible personal property and a limited group of services. It continues that structure now.

Evidence shows several probable consequences from extending the Indiana retail sales tax to include consumer purchases of services:

(i) Base expansion from taxing services would depend on what services were taxed. Taxing services associated with motor vehicles, recreation, consumer professions, personal care, and household maintenance would increase the base by over 20 percent. Adding financial services and insurance other than life would add over 15 percent more. Adding health care and education would increase the base by almost 50 percent more.

(ii) Taxing services would both reduce regressivity of the tax and reduce difference in sales tax burdens borne by households of similar income. However, the tax would continue to be regressive.

(iii) Adding services to the sales tax base would increase the rate of growth of sales tax revenue and increase responsiveness to changes in state personal income. The expansion would not clearly make the sales tax base more stable over time and would not insulate the base from the impact of recessions.

(iv) Adding services to the tax base would treat all household purchases equally, eliminating distinctions created because one way of satisfying household wants has been classed as a purchase of a good and a similar way has been classed as a service. Businesses would have no tax incentive to bill separately for parts and labor.

(v) Adding services to the tax base would require considerable attention to insuring that the tax not apply to services purchases made as business inputs. This problem would be particularly acute for services that may be purchased by either households or businesses (dual-use services).

There are some administrative concerns:

(i) Services could be taxed either by redefining the tax to apply to sales both of tangible personal property and services, except those specifically exempt, or by selectively adding certain services to the short list now already taxed. Neither approach is without problems, as experience in Florida, Michigan, and Massachusetts illustrates. The experience does show the problems associated with trying to include services predominantly purchased by businesses in the expanded base.

(ii) Small business retailers may have compliance problems. Making the expanded tax as simple to comply with as possible matters for all businesses, especially small entities.

(iii) Many vendors who would face obligations to collect and remit sales tax on services already are in the state retail sales tax system because they sell taxable tangible personal property. Much of the new tax base undoubtedly is with these existing registered vendors. Special attention, however, would be warranted to assist the transition of new vendors into the sales tax system.

CONSIDERING SALES TAXATION OF SERVICES IN INDIANA AN INDIANA RETAIL SALES TAX OVERVIEW

The history of the Indiana retail sales tax begins in 1963 when the state legislature amended the 1933 gross income tax law that had been enacted as a Depression-era revenue producer, splitting that tax into separate sales and use tax and individual income taxes.[1] This precursor tax was a tax unique to Indiana that encompassed a broad business gross receipts tax with an individual gross income tax.[2] Dividing the tax into standard retail sales and individual net income taxes was a considerable reform of the state revenue system. The new sales tax primarily taxed purchases of goods, as most other state retail sales taxes did then and continue to do now. It was not a luxury tax or a punitive tax or a tax designed to pay for only particular government services. Rather it was a broad tax for support of general services provided by the state. That is the tax that continues today.

THE LEGAL NATURE OF THE INDIANA TAX

Along with other state general sales taxes, the Indiana sales tax is an ad valorem tax on transactions. It applies at the retail level and excludes transactions when product is sold by manufacturer to wholesaler or by wholesaler to retailer. By taxing all individual retail purchases, the accumulated base of the tax equals total retail sales during the year. Along with other state retail sales taxes, the tax (i) removes certain business purchases from the tax base by means of a suspension certificate provided by purchaser to vendor, (ii) allows retailers to add the amount of tax owed to the transaction value without having that tax added to the gross amount to which the legal tax rate applies, and (iii) is accompanied by a compensating use tax that applies when a taxable item that has been purchased without payment of the Indiana sales tax is used in the state. These are the general distinguishing features of an American retail sales tax, even

---

[1] The Indiana Gross Income Tax was almost certainly the broadest tax ever levied in a developed country. Its nature is described in Howard D. Hamilton, "Recent Developments in the Indiana Gross Income Tax," *National Tax Journal* (September 1958). The economic defects of the tax clearly demonstrate that breadth of base by itself does not assure good tax policy results. The base must measure either taxpayer ability to pay or benefit from government services as well as simply being broad. Some out-of-state observers have categorized this earlier tax as a retail sales tax but it was always regarded as a sort of income tax in Indiana, despite its coverage of gross receipts. The gross receipts component included an annual $1,000 exemption. [2] Although the service sector was not a major component of the Indiana economy during the life of the gross income tax, the tax included services in its base and even taxed service receipts at a higher tax rate. (Arthur H. Northrup, "The Indiana Gross Income Tax," *Indiana Law Journal* 25(Issue 2, 1949-50): 148 – 167 and William H. Andrews, "The Indiana Gross Income Tax – a Curious Hybrid," *Proceedings of the Fifty-first Annual Conference on Taxation of the National Tax Association* (Harrisburg, Pennsylvania: National Tax Association, 1959): 139 -150.)

those which legally have some other name, such as the New Mexico gross receipts tax or the Hawaii general excise tax.[2] True gross receipts taxes, like the Ohio commercial activity tax or the Washington business and occupation tax, lack mechanisms to exclude business purchases from tax and do not facilitate inclusion of tax in the price charged the purchaser. They apply to the gross receipts of all businesses, without regard to whether sales are to individuals or other businesses. If the latter, then a particular product being sold to a household will likely have embedded in its price the gross receipts tax paid on all inter-business transactions involved in the supply chain bringing the product to market. Keeping as many business purchases as possible out of the sales tax base is always a legislative challenge but is necessary if the retail sales tax is to avoid needless damage to the prospects for growth and development of the state economy and if a considerable share of the tax is not to be hidden from households. The old Indiana gross income tax lacked the critical features of a retail sales tax, although it did include service receipts along with goods receipts in its base. The specific provisions of the Indiana tax are these:

1. The state gross retail tax is imposed on retail transactions in Indiana and a complementary use tax is imposed on the storage, use, or consumption of tangible personal property in the state. The use tax applies when a tax comparable to the Indiana sales tax has not been paid on the purchase being used in the state.

2. The tax is measured by gross retail income received by a retail merchant. Tax will be paid as a separate amount added to the transaction and the tax collected by the retailer will not be part of the merchant's gross retail income.

3. Gross retail income means total consideration for which tangible personal property is sold, leased, or rented, without deduction for costs, charges by the seller necessary to complete the sale, or delivery charges. It does not include separately stated installation charges.

4. The tax employs suspension certificates to remove selected business purchases of otherwise taxable items (particularly sales inventory, component parts of product for resale, and machinery for direct use in direct production) from the tax.

5. The tax does include by specific identification in the law some transactions beyond tangible personal property:

   a. Water softening and conditioning business sales
   b. Renting or furnishing rooms, lodging, or other accommodations (less than 30 days)
   c. Sales of electric energy, natural or artificial gas, water, steam, or steam heating services
   d. Intrastate telecommunications

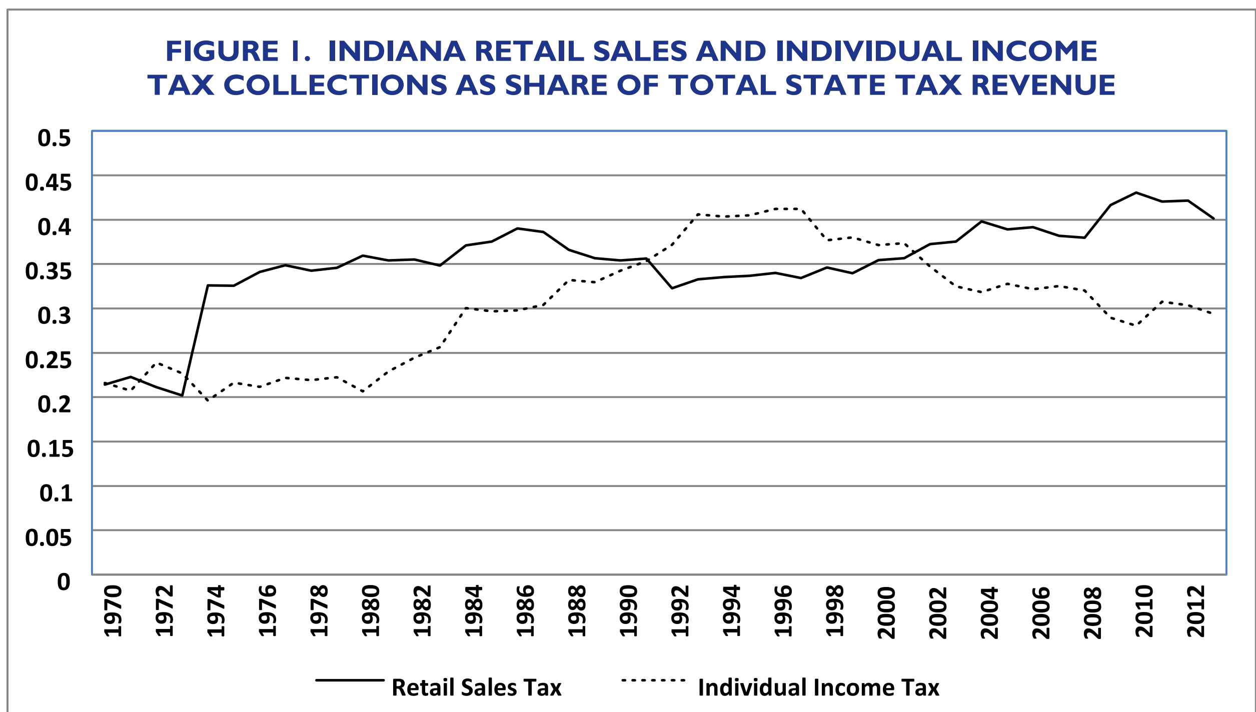
[2] The Hawaii general excise tax differs from the others by including any tax collected by the vendor from the purchaser in the taxable base but it passes the other tests and is included with the retail sales taxes. It is, however, much broader in coverage than the others.

e. Private or proprietary activities by government entities if taxable when performed by retail merchant (but not activities related to festivals, etc.)
f. Rental or leasing of personal property
g. Cable and satellite television or radio
h. Prepaid telephone service
i. Aircraft leasing or renting and flight instruction services
j. Digital products electronically transferred to end user.

It is a tax on purchases of tangible personal property. Any extension of coverage beyond purchases of goods, particularly the taxation of services, would require specific identification of those transactions or would require a fundamental revision of how the tax base is measured by the tax law. In the current law, services are excluded from taxation because they are not mentioned in the provisions defining the tax base.

THE RETAIL SALES TAX IN INDIANA STATE FINANCES

The Indiana state retail sales tax is important. It yielded more than $7.2 billion in fiscal 2016, foughly 48 percent of total Indiana state tax revenue, over a third more than yielded by the second most productive tax (the individual income tax), and more revenue than from any source outside of federal aid. Figure 1 traces the share of total Indiana state tax revenue from retail sales and individual income taxes over the years since 1970.[3] The general trend is toward greater sales tax reliance, as the retail sales



[3] Data for the figure come from U. S. Bureau of Census, Governments Division, *Annual Survey of State Government Tax Collections* (annual series). Reported sales tax revenues for early years are adjusted to remove collections from remnants of the gross income tax.

tax share increased from around 20 percent in 1970 to around 40 percent currently. The dramatic shock to sales tax reliance in 1974 was the result of increasing the sales tax rate from 2 to 4 percent when food for at home consumption was removed from the tax base.

The long economic expansion – generally from the early 1980s through the early 1990s – produced a considerable increase in the individual income tax share and for most of the 1990s, the individual income tax share was greater than that of the retail sales tax. Because the response of the individual income tax base to economic activity is generally greater than that of the retail sales tax, it is not surprising that an era of economic growth would boost the relative individual income tax share. In the early 2000s, however, the retail sales tax share again exceeded that of the individual income tax and the gap between the shares has widened through the first decade of the twenty-first century. Given that the retail sales tax rate has increased twice since 2000 and the state individual income tax rate has not increased, the widening is not surprising.

Whether by design or by political accident, Indiana has substantially shifted toward heavy reliance on the sales tax for support of state services, making it the foundation for the state revenue system. There is much to be said in support of the retail sales tax as a mechanism for distributing the cost of government. In the first instance, it is reasonable to base payment for government services according to the household's self-evaluated ability to make purchases from the private sector. As Kaldor put it some years ago, "…each individual performs this operation [identifying tax capacity] for himself when, in light of all his present circumstances and future prospects, he decides on the scale of his personal living expenses. Thus, a tax based on actual spending rates each individual's spending capacity according to the yardstick which he applies to himself."[4] Household consumption expenditure is a good measure of economic capacity to bear the cost of government services.

The consumption base has economic efficiency advantages as well. A general consumption tax avoids the extra burden on saving that income taxation involves. While the standard income tax applies to income that is saved and then also applies to the economic proceeds from that saving, a consumption tax applies only when that income is spent. That eliminates a distortion against saving and prospectively improves the chances for economic growth.

The retail sales tax approach to consumption taxation also has the advantage of removing compliance responsibility from the individual household. The tax uses the business enterprise as the mechanism for transmitting payment from the individual purchaser to the taxing government. The business is generally more adept at the bookkeeping responsibilities of tax compliance than are individuals, so the tax can be collected somewhat more smoothly than an individual income tax that requires

[4] Nicholas Kaldor, *An Expenditure Tax* (London: George Allen & Unwin, 1955): 47.

individual taxpayer filings. The retail vendor functions as a useful collector in the revenue process.

There is, however, a problem. Sullivan observes that the problem with retail sales taxes is "how far they stray from true consumption taxation."[5] The Indiana problem is that a large portion of household consumption expenditure, the portion spent on services, is generally outside the scope of the sales tax. That makes the tax a more-or-less general tax on consumption expenditures of tangible personal property only. That base does not necessarily provide a good measure of the economic capacity of the household or a good overall indicator of the ability of the household to bear a share of the cost of government. Purchases of services represent part of household consumption as well.

Taxing Services: Indiana Compared with Other States

States design their own retail sales taxes. Although states do copy each other, each state adopts its own sales tax without any national template that might serve as a guide for uniformity and without any comparable federal tax that they might copy. Each state levies a retail sales tax on its own, structured by the particular preferences and interests of its lawmakers, the interest groups that influence them, and the population. With few exceptions, state retail sales taxes seldom provide much coverage of service purchases. This pattern represents a carryover from the earliest retail sales taxes that were adopted during the depths of the Great Depression. At that time, tax administrators feared that a tax that extended to services could not successfully be administered because services created no audit trail of inventory purchases that could be tracked. Besides, the services sector was then a relatively small component of the total economy, so the omission did not matter much. That pattern continued over the years, producing the narrow taxes of the present and, as will be shown, the problems that this pattern produces.

There are three general groups of states in regard to how their retail sales tax treats purchases of services:

1. States taxing all services unless the service is specifically identified as exempt: Four states (Hawaii, New Mexico, South Dakota, and West Virginia). For instance, the West Virginia "consumer sales and service tax" (W. Va. Code Section 11 – 15) applies to purchases of tangible personal property and services except for those identified as exempt for reason.[6]
2. States generally not taxing services: Four states (Indiana, Alabama, California, Illinois).
3. States taxing only specified services. The remaining 37 states plus the District of Columbia. Coverage is thus like that of a selective excise on services, rather than

[5] Martin A. Sullivan, "Can States Swap Sales Taxes for Income Taxes?" *Tax Notes* (February 18, 2013): 789.

[6] It should be noted, however, that West Virginia lists a wide swath of services, e.g., personal services and professional services, as being exempt from the tax, making the coverage substantially less general than it might seem. South Dakota uses similar language to define the base but has few service exemptions.

being a general tax. The number and range of services that these states tax is varied, with some lists long (Iowa lists over one hundred services) and other lists relatively short (Texas lists seventeen). And some of the service categories listed for taxation are surely not terribly productive of revenue, e.g., locksmiths in Connecticut.

For the first group of four states, the presumption is that a service is taxable unless specifically exempt by statute. For the other 41 states, a service is taxable only if the sales tax statute specifically identifies it as being taxed.

Table 1 provides greater detail in regard to the taxability of a number of services sold to households in Indiana relative to their taxability in other states. The information comes from a survey directed to state tax administrators by the Federation of Tax Administrators, with some updating from legal references. The narrowness of Indiana coverage is apparent in the table. Indiana does tax utilities and television provided residential customers, services associated with rental of tangible personal property (diaper service, video tapes, etc.), landscaping, and water softening but little else. States with selective service coverage are much more aggressive in including purchases by households in their tax base.[7]

TABLE 1. TAXATION OF SERVICES IN RETAIL SALES TAX

Selected Services	Taxability in Indiana	Number of States Taxing the Service
Veterinary service	E	5
Horse boarding and training (not race horse)	E	9
Pet grooming	E	18
Landscaping service (incl. lawn care)	T	21
Intrastate transportation of persons	E	11
Local transit buses	E	5
Taxi operations	E	8
Household goods storage	E	13
Marina service	E	17
Residential intrastate telephone & telegraph	T	41
Residential interstate telephone &telegraph	E	27
Residential cellular telephone service	T	44
Residential electricity	T	22
Residential water	T	12
Residential natural gas	T	22

[7] Counting the number of services included in the sales tax base by states is not useful indication of breadth of coverage. Some services represent a modest component of household spending, e.g., massage, while others are much more significant, e.g., electricity. It is definitional scope of coverage, not count, of services that matters for breadth.

TABLE 1. *continued from previous page*

Selected Services	Taxability in Indiana	Number of States Taxing the Service
Residential sewer and refuse	E	11
Investment counseling	E	6
Barber shops and beauty parlors	E	7
Carpet and upholstery cleaning	E	19
Dating service	E	8
Debt counseling	E	7
Diaper service	T	23
Funeral service	E	12
Fishing and hunting guide service	E	11
Garment service (altering & repairing)	E	20
Health clubs, tanning, reducing salons	E	22
Laundry and dry-cleaning (coin op)	E	6
Laundry and dry-cleaning (non-coin op)	E	22
Massage services	E	11
Personal instruction (dance, golf, etc.)	E	6
Shoe repair	E	20
Swimming pool cleaning & maintenance	E	17
Tax return preparation	E	6
Tuxedo rental	T	39
Water softening & conditioning	T	13
Photocopying	E	43
Tire recapping and repairing	E	28
Auto washing & waxing	E	21
Auto road service & towing	E	19
Auto service, exc. Repairs	E	25
Parking lots & garages	E	21
Auto rustproofing & undercoating	E	25
Pari-mutuel racing events	E	29
Amusement park admissions & fees	E	36
Bowling	E	27
Cable television	T	26
Direct satellite television	T	24
Circus & fair admission & games	E	34
Membership fees in private clubs	E	23

TABLE 1. *continued from previous page*

Selected Services	Taxability in Indiana	Number of States Taxing the Service
Admission to cultural events	E	31
Admission to professional sports events	E	37
Rental of video tapes for home viewing	T	45
Dentists	E	4
Medical test laboratories	E	4
Nursing services out-of-hospital	E	4
Physicians	E	4
Labor charge, motor vehicle repair	E	21
Labor charge, electronic equipment	E	24
Labor charge, other tangible personal property	E	24
Installation by person selling property	E	23
Installation by others	E	18
Custom meat slaughtering, cutting, wrapping	E	14
Taxidermy	E	26

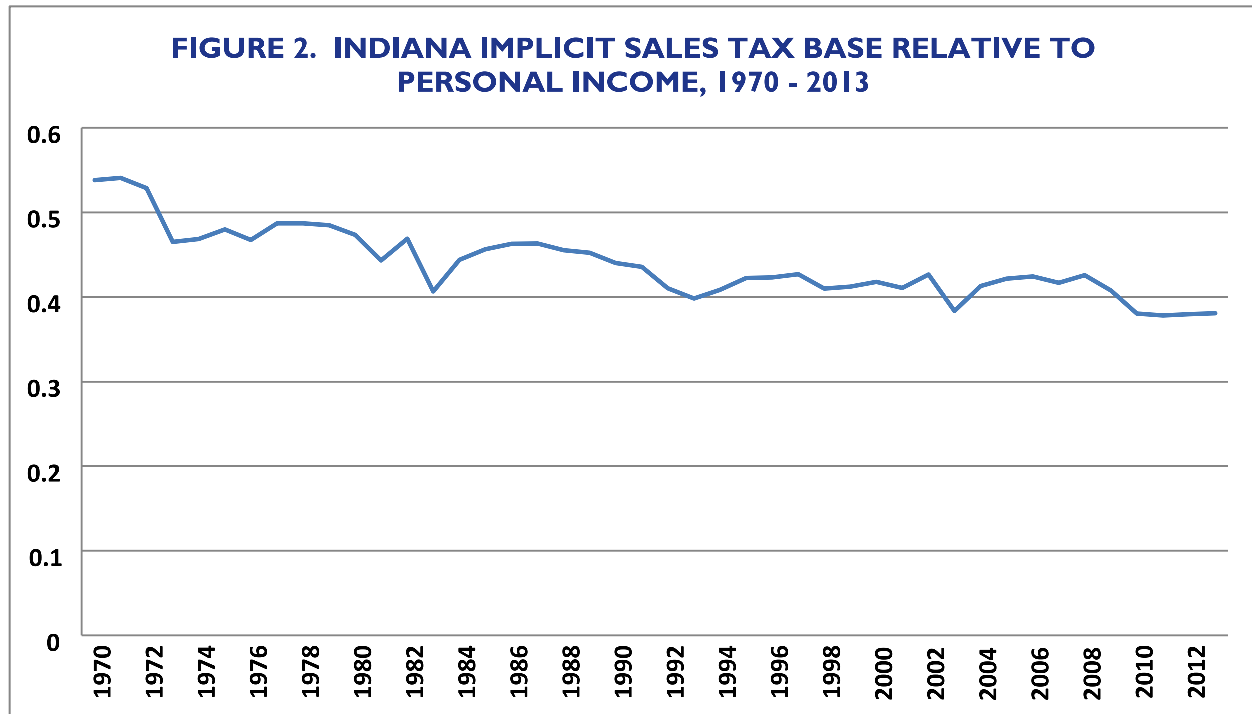
SOURCE: Federation of Tax Administrators, Survey of Services Taxation, 2007 edition (2010 updates) RIA Guide to Sales and Use Taxes 2014

A number of states tax services whose purchases are predominantly if not exclusively made by businesses as an input to their operations. These include such services as advertising, typesetting, graphic design, commercial linen supply, and armored car service. These purchases are not household consumption expenditure and are not appropriate components of the retail sales tax base. To include them in the tax renders the tax burden less visible to final customers (the tax gets embedded in product prices), discourages and distorts economic activity, and discourages efficient outsourcing of service supply. It is particularly damaging to economic growth because of the disadvantage it creates for small enterprises: a big firm can avoid the tax by assigning work to an internal department, e.g., legal, while a small firm must purchase the service from outside and thus must pay the tax on the purchase. These purchases should be exempt for the same reasons that business purchases of inventory and production equipment are exempt in the taxation of tangible personal property.

Services and the Disappearing Indiana Sales Tax Base

The Indiana problem, shared with most other states, is that the retail sales tax base has been disappearing. Figure 2 shows that over the period from 1970 to 2013 the relationship between the sales tax base (estimated by dividing retail sales tax collections by the statutory sales tax rate) and the total Indiana economy as measured

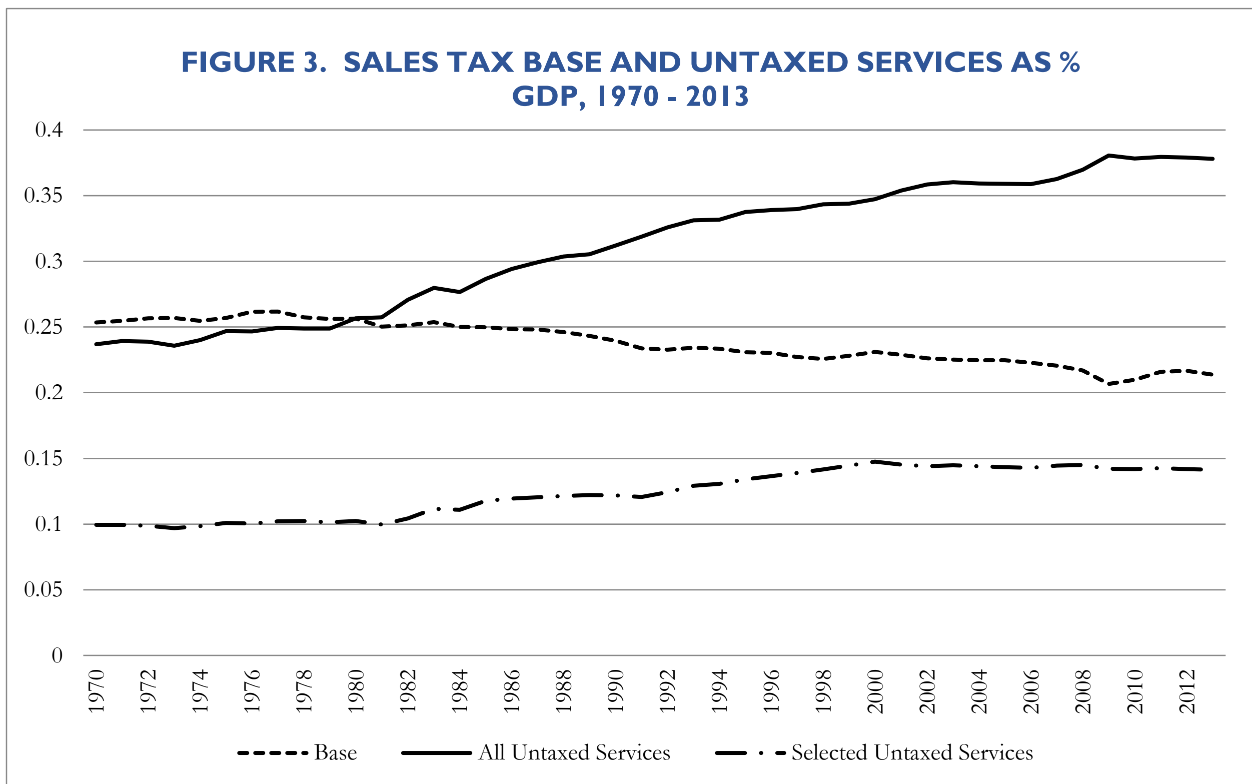
by state personal income has been falling persistently. At the beginning of the period, the sales tax base amounted to around 55 percent of state personal income.



By 2013, it was somewhat below 40 percent. That means that the sales tax base is now only around 70 percent as large a component of the state economy as it was in 1970. One large shock to the breadth of the base was the exemption of food for at home consumption in the early 1970s, when the coverage share fell from 53.3 percent in 1972 to 46.8 percent in 1973, a 12 percent reduction in share in a single year. But the decline since then has been driven by changing patterns in spending behavior by households. And the decline is not the result of total household spending being a smaller share of economic activity (gross domestic product). Data from the National Income and Products Accounts compiled by the Bureau of Economic Analysis of the U. S. Department of Commerce show that, for the nation household consumption spending increased from 60.2 percent of gross domestic product in 1970 to 68.6 percent in 2012. Indiana data on consumption are not available for such a long period, but for 1997 to 2012 the percentage did increase from 66.2 to 69.1 percent, suggesting a pattern similar to that seen for the nation. The base is not disappearing because households are spending less.

The problem is that, in recent decades, household consumption expenditure has shifted away from taxed goods and toward untaxed services. This pattern is clear in Figure 3, a graph of personal consumption spending as a share of gross domestic product from 1970 to 2013. The figure plots shares of gross domestic product for three categories of personal consumption expenditure: (i) purchases of taxed goods plus services taxed in the current Indiana sales tax, (ii) purchases of all currently untaxed services, and (iii)

purchases of untaxed services other than purchases of health care, education, life insurance, and housing.[8] While there is no fundamental reason why these latter services could not be included in the tax and considerable economic and equity support for taxing them, many discussions presume that they would not be taxed, so they are omitted here. The secular paths of the spending categories stand in stark contrast: the share of gross domestic product spent on taxed purchases (mostly tangible personal property plus some limited services) persistently falls from 25.3 percent of gross domestic product in 1970 to 21.3 percent in 2013 and the share of gross domestic product spent on both services measures persistently increases, from 23.7 percent to 37.8 percent for the broader measure and from 9.9 percent to 14.1 percent for the narrower. The increase is considerably greater if health care, housing, and education spending are included, but even the narrower measure is increasing over the years in



stark contrast to the path of spending on currently taxed goods and services.

The evidence shows that disappearance of the Indiana sales tax base is not a mystery. It is the product of changing household behavior within the legal structure of the tax base over the years. The untaxed service share has increased while the goods share

[8] The estimated Indiana tax base includes household spending on durable goods, non-durable goods less food and non-alcoholic beverages purchased for off-premises consumption and pharmaceutical and other medical products, household utility purchases, food services and accommodation purchases, and telecommunications purchases. Untaxed service spending includes household consumption spending on services less food services and accommodations, household utilities, telecommunications, and net foreign travel. The second

has fallen, so household behavior has brought the general decline in the relative size of the sales tax base. This base decline combines with the increasing reliance on the retail sales tax for state revenue to push the sales tax rate ever-upward. In 1970, the 2-percent Indiana sales tax rate was the lowest in the nation. By 2014, the 7-percent service category subtracts spending on housing, health care, education, and life insurance from the broader service category.[10] Unfortunately, Bureau of Economic Analysis data on state personal consumption expenditure do not provide the subcategorization necessary for an analysis comparable to that done with national data. rate is the second highest state tax rate. That is a natural consequence of the disappearance of the tax base that is driven by the exclusion of service purchases from the base.

Policy Issues in Sales Taxation of Services

Consumption services purchased by households belong in the sales tax base because failing to tax them distorts economic choice in favor of the services industry at the expense of the goods industry and favors those households with greater preferences for services over goods. Excluding them is at odds with the idea of using household consumption as a measure of taxable economic capacity for distribution of the cost of government services. While revenue impact is a critical element in taxation of service purchases, collateral impacts of raising that revenue on the economy and on the population, matter as well. In particular, it is important to consider how such an expansion of the tax would impact the growth potential of the tax base, the manner in which the tax burden would be distributed across households of differing economic status, and the extent to which the expansion might distort and discourage desirable economic behavior. Very importantly, a well-designed tax should minimize the extent to which it distorts the choices made by individuals and businesses from the ones they would have made in the absence of the tax.

Potential Revenue from Tax Alternatives

Expanding the retail sales tax base to include some or all services purchased by households would give choices: produce more tax revenue from the current statutory sales tax rate, allow current revenues to be generated at a lower tax rate, or allow some combination of more revenue and lower rate. How much the base would expand depends on exactly what services are included in the new tax base.

The estimates of revenue potential are speculative because available data on household purchases of services do not coincide with how tax law would define a service tax base. There are obviously no reports available in the existing Indiana retail sales tax system because services are not included in taxable sales. The data that are available are primarily from the National Income and Product Accounts and, as a result, can only provide a general idea of what impacts would result from extending the tax base. The approach starts with estimates of total personal consumption expenditure in the state of Indiana (2011 is the most recent year for which estimates are available) from the U. S. Department of Commerce Bureau of Economic Analysis. National shares

of total personal consumption expenditure on service categories are used to divide the Indiana total expenditure into amounts spent on these categories. These totals are then divided by total taxable sales reported on Indiana sales tax returns for 2011 to estimate what the impact on the tax base might be from these service expansions. The resulting estimates are presented in Table 2.

TABLE 2. ESTIMATED INCREASE IN INDIANA RETAIL SALES TAX BASE FROM TAXING SELECTED SERVICES, 2011

Type of Personal Consumption Expenditure	Base Increase (%)
Motor Vehicle Services	5.29
Recreation Services	9.48
Professional Services	3.93
Personal Care and Clothing	2.84
Household Maintenance	1.46
Group A Total	22.99
Financial Services	11.62
Insurance other than Life	4.98
Group B Total	16.6
Health Care	41.91
Education	5.95
Group C Total	47.86

SOURCES: C. Awuku-Buda *et al.*, "A First Look at Experimental Personal Consumption Expenditures by State," *Survey of Current Business* (August 2013); Bureau of Economic Analysis, National Income and Product Accounts; and Stats Indiana

The first group of services includes those most frequently considered in state tax expansion discussions: motor vehicle services, recreation services, professional services, personal care and clothing services, and household maintenance services.[9] These services amount to a total equal to 23 percent of the existing tax base.

The second group includes financial services and casualty insurance purchases. It excludes life insurance because this insurance includes a strong savings component, not consumption expenditure. These services amount to a total equal to 16.6 percent of the existing tax base.

[9] The table does not include household utility, telecommunications services, food services, and transient accommodations because the Indiana tax already includes such purchases. It also excludes housing rentals and public transportation.

The final group includes health care and education purchases. The base-expanding potential is large but could be difficult to tax for social and other reasons. Nevertheless, these services amount to a total equal to 47.86 percent of the existing tax base.

The estimates present a clear message: potentially taxable services purchases by households amount to a fiscally significant total. If the retail sales tax were extended to services, the expansion would provide a substantial increase in revenue generated at the current tax rate or would permit current collections to be produced at a substantially lower tax rate. Expanding the base to include household service purchases, an expansion that is entirely consistent with the idea of distributing the cost of government, according to the same standard that distributes the cost of purchases from the private sector, presents a considerable increase in the fiscal options available to the state of Indiana.

Impact on Distribution of Tax Burden

State retail sales taxes are characterized by a regressive distribution of tax burden. In other words, the effective tax rate (measured by sales tax burden paid as a percent of annual household income) is higher for low income households than it is for higher income households. This burden distribution is the result of household consumption behavior: higher income households tend to spend less of their income on taxable purchases than do lower income households because they save, i.e., do not spend, more of their income and because they choose to spend more of their income on purchases that are not subject to the sales tax. The legal structure of the tax – what purchases are taxable and what purchases are exempt – helps determine the burden distribution but the realities of household behavior are such that it is extremely difficult to design an administrable tax that exempts and taxes in such a manner as to make the effective burden anything other than regressive. States try to reduce the regressivity by exempting purchases of food for at home consumption (lower income households generally spend a higher share of their annual income on such purchases than do higher income households, so the exemption provides greater relative relief to lower income households) or by providing refunds through income tax credits for tax on food paid by lower income households. The provisions reduce but do not eliminate the regressivity. However, choices about tax structure, like adding certain services to the tax base, can have marginal impact on the distribution.

Table 3 provides data on the average share of income before taxes that quintiles of consumer units (households) spend on particular classes of goods and services, the data coming from the 2012 Bureau of Labor Statistics Consumer Expenditure Survey microdata interview file. The data are for the current Indiana retail sales tax base and for several categories of consumer service purchases. These are all estimates because the classifications used by the Bureau of Labor Statistics do not entirely match the definitions used in the sales tax law. Nevertheless, these are the best data available for examination of the distribution of consumption tax burdens and, despite their limitations,

the patterns that they show are clear enough to allow conclusions about the impact of adding certain consumer service purchases to the sales tax.

TABLE 3. DISTRIBUTION OF CONSUMER EXPENDITURES AS SHARE OF BEFORE TAX INCOME ACROSS INCOME QUINTILES, 2012

	First Quintile	Second Quintile	Third Quintile	Fourth Quintile	Highest Quintile
Estimated Current Indiana Base	0.795	0.443	0.341	0.279	0.198
Maintenance, Repairs, Insurance	0.046	0.029	0.020	0.018	0.015
Personal Services	0.009	0.006	0.004	0.005	0.007
Other Household Services	0.032	0.019	0.014	0.011	0.010
Vehicle Finance Charges	0.005	0.004	0.004	0.004	0.002
Auto Maintenance and Repair Service	0.034	0.023	0.015	0.014	0.009
Vehicle Insurance	0.057	0.030	0.021	0.017	0.009
Health Insurance	0.113	0.070	0.047	0.036	0.021
Medical Services	0.036	0.019	0.014	0.013	0.009
Fees and Admissions	0.012	0.008	0.008	.008	0.010
Personal Care Services	0.029	0.016	0.011	0.009	0.007
Educational Services	0.086	0.017	0.012	0.012	0.018
Legal Services	0.030	0.015	0.012	0.010	0.008

SOURCE: Estimates based on public use microdata file from U. S. Bureau of Labor Statistics, *Consumer Expenditure Survey, 2012.*

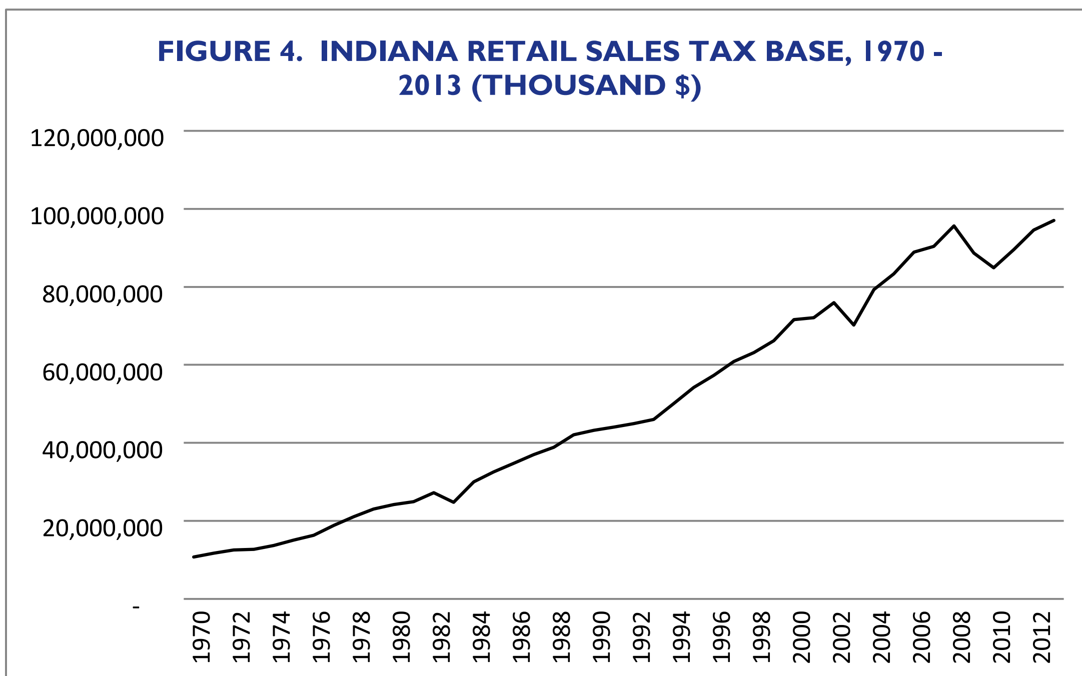
The current Indiana retail sales tax shows a regressive burden distribution: the share of household income before tax that is covered by the sales tax declines through each of the income quartiles. The share of annual income spent on taxable purchases declines as annual income is higher, from almost 80 percent in the lowest quintile to around 20 percent for the highest quintile, translating to an effective retail sales tax rate that is around four times higher for the lowest quintile than for the highest quintile. Data in the table also make it apparent that the share of household income spent on each of the identified service expenditure categories declines as household income is higher, meaning that the burden of a tax levied on these service categories separately would be regressive. However, the current retail sales tax is levied on a base that excludes these services, so the question is whether adding these services would make the tax more or less regressive than it is already. The share of household income spent on each of these service categories falls as household income rises at a less rapid rate than does the current Indiana retail sales tax base. As a result, applying the tax to these services would make the resulting tax on both goods and services less regressive than is the current tax limited primarily to goods. The tax would still be regressive but it would be somewhat less regressive than without the services being taxed. In addition to reducing the vertical inequity of the tax, adding services would correct the horizontal inequity associated with having households that spend less of their income on services and relatively more on goods being taxed more heavily than equivalent households with a greater preference for services.

Growth and Stability of Yield

Because the retail sales tax is an important revenue source for Indiana government, its behavior over time matters for state fiscal security. When sales tax collections fell by almost a quarter of a billion dollars from fiscal 2009 to fiscal 2010 during the Great Recession, it was a matter of considerable concern. With this recent history, it is reasonable to consider what expanding the sales tax base to include services might do for the stability and cyclical reaction of retail sales tax collections in the future. However, that should not be the only dynamic behavior of the tax to be considered. Both economic history and prospects for the economic future suggest that the state will be in economic expansion and growth far more often than it will experience recession. Therefore, it is important to consider the growth profile of the tax. It would be poor public policy to structure a tax to manage an infrequent event (a recession) without attention to the more typical economic climate (an expansion). The question is whether broadening the tax base to include household service consumption might both improve growth of the sales tax base over time and increase revenue stability in the short term. The goods portion of consumer spending is dominated by big-ticket durable goods, expenditures that are subject to considerable swings with economic change. That gives some reason to think that adding services might improve stability.

Figure 4 shows the pattern of the implicit Indiana retail sales tax base over the years since 1970. It is apparent that the base has been growing over those years – the base is nine times larger in 2013 than it was in 1970 – and that, in most years, there has been an increase. However, the national recessions of 1982, 2001 and 2007-2009 (but not 1991) produced discernable disruptions of the growth pattern. One important consideration for including household consumption purchases of services should be what impact that might have on the dynamic performance of the tax base.

The dynamic impacts from adding household consumption of services to the sales tax are estimated from National Income and Product Accounts data for consumption expenditures. (Indiana-specific data are not available.) Three variables are estimated from the data: the current estimated Indiana retail sales tax base, the current base plus all consumer service purchases, and the current base plus all consumer service purchase except for health care, housing, and education. Data for the actual Indiana implied sales tax base are included for comparison.[10] The dynamic analysis has three components: growth, stability / volatility, and Great Recession reaction.



Growth

The potential impact on the sales tax over longer periods is measured in two ways: the growth rate and the long-term income elasticity. The growth rate is estimated here from the regression equation ln B = a + b TIME where TIME is a count variable for years with 1970 starting at one, B is the sales tax base, and b equals the growth rate. This growth

[10] Around one-third of the Indiana retail sales tax base consists of purchases made by businesses. Therefore, the measures reported for the present implicit sales tax base are not comparable to measures for consumer expenditures reported in the National Income and Product Accounts.

rate measures the annual percentage change in the tax base for the 1970 – 2013 period. Table 4 presents the evidence from this analysis. Adding consumer service purchases to the Indiana sales tax base would increase the rate of growth of the base. For the broadest expansion, the increase would be a full percentage point, from 5.8 to 6.8 percent per year, and for the narrower expansion, from 5.8 to 6.4 percent per year. Such an increase in growth rates would produce a considerable difference in revenue potential over time.

The second measure of growth dynamics of the tax base is the long-term income elasticity. This measure is estimated from the regression equation $\ln B = c + d \ln PI$ where PI is personal income (either Indiana or United States, depending on the estimate) and d equals the elasticity coefficient. This long run elasticity of the tax base measures the percentage point response of the tax for each one percent change in personal income. If the elasticity is greater than one, the base increases more rapidly than does personal income. If it is less than one, the base responds less than the change in personal income. Evidence from other states indicates that retail sales taxes tend to change at about the same rate as does personal income and that is the evidence here. Table 4 shows both the Indiana implicit sales tax base, derived from state tax collections data, and a comparable base estimated from National Income and Product Account data on personal consumption expenditure. Both show long run elasticities of around 0.90, meaning that a one percent increase in personal income would result in a 0.90 percent increase in the base. The table also shows that adding services, either generally or broadly but selectively, would increase the long run responsiveness. The elasticity increases to 1.055 when all services are taxed and to 0.989 when all services except housing, education, and medical care are added. Adding services to the Indiana tax base promises a greater growth response to the tax, correcting at least part of the disappearing base problem.

TABLE 4. GROWTH RATES AND INCOME ELASTICITIES OF INDIANA RETAIL SALES TAX BASE

	Growth Rate (%)	Long Term Elasticity
Estimated Current Indiana Base	5.828	0.906
Estimated Current Indiana Base Plus All Consumer Services	6.817	1.055
Estimated Current Indiana Base Plus Selected Consumer Services	6.378	0.989
Current Implicit Indiana Base	5.202	0.894

Stability / Volatility

A second dynamic concern is the degree to which there are substantial year-to-year fluctuations in the sales tax base. Even if the tax base is growing substantially over the long term, large fluctuations around that growth path can significantly disrupt state finances. Such fluctuations can require troublesome adjustments in state fiscal programs to maintain a sustainable financial profile. There is no single measure that analysts employ to compare tax base stability but rather the question is examined with a variety of measures. Two standard approaches include the coefficient of variation (CV) of the tax base, and the Williams-Anderson-Froehle-Lamb stability z (WAFLz) coefficient.[11] Each measure is reported for the Indiana tax bases in Table 5.

The CV of the tax base measures the dispersion (or spread) of the tax base over several years relative to the average of the tax base. The higher the CV, the greater the variation in the annual value of tax base and, hence, the less stable / more volatile is the tax. Table 5 shows that the CV is higher for the sales tax base with services added than for the current tax base. Expanding the base to include services will not reduce the CV, i.e., improve the measured stability, of the tax.

The WAFLz measures stability in terms of divergence from the growth rate of the tax base. Operationally it equals the inverse of the standard error of the equation used to calculate the growth rate. A higher WAFLz value means that yield growth is more stable. Table 5 reports the index values for the current base and the base expanded by the addition of services. The evidence from this measure is that there is little impact on stability from adding services—the WAFLz for current and current-plus services are all around 6.5. By this measure, imposing the tax on services would make little difference for the stability of the tax.

TABLE 5. STABILITY / VOLATILITY OF INDIANA RETAIL SALES TAX BASE

	Coefficient of Variation	WAFL z
Estimated Current Indiana Base	0.62	6.551
Estimated Current Indiana Base Plus All Consumer Services	0.70	6.511
Estimated Current Indiana Base Plus Selected Service	0.66	6.484
Current Implicit Indiana Base	0.57	7.555

[11] William V. Williams, Robert M. Anderson, David O. Froehle, and Kaye L. Lamb, "The Stability, Growth, and Stabilizing Influence of State Taxes," *National Tax Journal* XXVI (June 1973): 267 – 274.

It may be surprising that adding services to the sales tax base has so little impact on improving the stability of the tax. Table 6, a table of year-to-year percentage change in the estimated state tax base with and without services, gives some insight into why this is true. The problem is that the annual percentage changes move together: the correlation between the base without services and broadly including services is 0.951 and between the base without services and narrowly expanded service coverage is 0.983. The percentage changes are closely correlated, the bases move together over the years, so adding services cannot have much impact on tax stability. Expanding the base certainly would not insure greater stability for the tax.

TABLE 6. ANNUAL PERCENTAGE CHANGE IN ESTIMATED CURRENT BASE

Base Plus All Consumer Services, and Base Plus Narrow Consumer Services, 1971 - 2013

	Current Estimated Base	Base Plus All Consumer Services	Base Plus Narrow Consumer Services
1971	9.1%	9.4%	8.9%
1972	10.7%	10.1%	10.3%
1973	11.5%	10.8%	10.9%
1974	7.4%	8.9%	8.2%
1975	10.0%	11.0%	10.6%
1976	13.2%	12.2%	12.5%
1977	11.1%	11.7%	11.6%
1978	11.2%	12.0%	11.7%
1979	11.2%	11.4%	11.0%
1980	8.8%	10.5%	9.1%
1981	9.6%	11.0%	9.5%
1982	4.5%	7.1%	5.7%
1983	9.8%	11.2%	11.8%
1984	9.4%	9.6%	9.8%
1985	7.5%	9.6%	9.5%
1986	5.1%	6.8%	5.8%
1987	6.0%	7.1%	6.2%
1988	7.1%	8.3%	7.6%
1989	6.3%	7.5%	7.0%
1990	4.1%	6.3%	4.6%
1991	0.8%	3.4%	1.3%
1992	5.5%	7.1%	6.8%
1993	5.8%	6.4%	7.0%
1994	6.0%	6.2%	6.5%
1995	3.6%	5.5%	5.0%
1996	5.6%	5.9%	6.4%
1997	4.8%	5.8%	6.0%
1998	4.8%	6.0%	5.9%
1999	7.5%	6.9%	7.8%
2000	7.7%	7.6%	8.1%
2001	2.3%	4.1%	2.0%
2002	2.2%	3.7%	2.3%
2003	4.4%	5.0%	4.8%
2004	6.4%	6.4%	6.3%
2005	6.7%	6.6%	6.4%
2006	4.9%	5.4%	5.1%
2007	3.4%	4.8%	4.4%
2008	0.0%	2.3%	0.8%
2009	-6.6%	-1.9%	-5.6%
2010	5.3%	3.9%	4.7%
2011	6.7%	5.0%	5.7%
2012	4.6%	4.2%	4.2%
2013	2.3%	3.1%	2.7%

SOURCE: Computed from National Income and Product Accounts

The Great Recession

The fiscal impact of the Great Recession still hangs over tax policy discussions, even though the nation and Indiana are both in recovery and an immediate repeat of a recession as severe as that one is not likely. Nevertheless, it is useful to consider how a

retail sales tax base with broader coverage of personal consumption of services would have fared in the recession environment and its aftermath. Table 7 indicates the percentage change in each base measure from 2007 (the national recession began in December 2007, in the middle of Indiana's 2008 fiscal year and the end of calendar 2007) to 2008, 2009, 2010, 2011, and 2012. It is apparent that the base with all consumer services was least impacted by the recession. In no year was the base below its pre-recession level and, by 2012, it was 14 percent above its 2007 level. The base with narrower inclusion of services was somewhat less impacted than the current base, but the difference was minor and, by 2012, its recovery was exactly the same as for the current base. The change in impact from a broader base is not great. This indicates that a deep recession has a broad impact on consumer expenditures, leaving little spending free from impact.

TABLE 7. GREAT RECESSION IMPACT AND RECOVERY: BASE RELATIVE TO 2007 LEVEL

	2008 to 2007	**2009 to 2007**	**2010 to 2007**	**2011 to 2007**	**2012 to 2007**
Estimated Current Indiana Base	1.000	0.933	0.983	1.050	1.097
Estimated Current Indiana Base Plus All Consumer Services	1.023	1.003	1.042	1.095	1.140
Estimated Current Indiana Base Plus Selected Services	1.008	0.952	0.996	1.053	1.097
Current Implicit Indiana Base	1.029	0.981	0.939	0.991	1.047

In summary, adding services to the retail sales tax base would certainly improve growth and long run revenue elasticity of the tax. The impact on growth is substantial, adding from one-half to one percent to the long-term annual rate of growth. An expansion would have a less clear impact on stability / volatility, of the tax. It almost certainly would not have a large impact. Finally, a tax base expanded to services would not have completely insulated the retail sales tax from the impact of the Great Recession, but the evidence suggests that an expanded base would have suffered a somewhat lesser impact.

Business Discrimination and Distortion

A retail sales tax that applies to purchases of tangible personal property but not to purchases of services creates strange, inconsistent, and discriminatory treatment of some household purchases. If close substitutes are not treated the same by the sales tax, choices will be distorted and households will be treated differently by the tax structure for no logical reason. Table 8 illustrates a few of those irrational distinctions – different tax treatment of comparable consumer purchases caused by Indiana law defining one as purchase of a service and the other as purchase of tangible personal property. Why should buying a carpet cleaning machine and cleaning solution be taxed but hiring a company to do the cleaning be exempt? Why should hiring a tax preparer to do an individual income tax return be exempt while buying a tax preparation instruction book to help an individual do her own return be taxed? Why should admission to a movie theater be exempt while renting a movie is taxed? There is no logical reason for these or the other pairs in the table.

TABLE 8. TAXABILITY DISTINCTIONS CREATED BY EXCLUSION OF SERVICES FROM THE SALES TAX BASE

EVENT	UNTAXED SERVICE	TAXED GOOD
Improving Personal Appearance	Caps on front teeth	New wardrobe from Jos. A. Bank
Improve Lifestyle	Hire architect to design new family room	Buy a BMW
Income Tax Preparation	Hiring H&R Block to do return	Buy J.K. Lasser's tax preparation guide from local bookstore
Improve the House	Hire carpet cleaners	Buy carpet cleaning machine
Improving golf game	Get a lesson from course pro	Buy new golf clubs
Family business	Hire a telephone answering service	Buy an answering machine
Get Better Looking	Get hair dyed at beauty shop	Buy Clairol for hair dying at home
Get Healthy	Buy membership in health club	Buy treadmill for the basement
Romance	Junior buys membership in dating service	Junior buys flowers for his date
Entertainment	Go to movie at Multiplex Cinema	Rent movie from Redbox
Preparing to retire	Hire an investment planner	Buy a book on investment strategies
Death	Hire a lawyer to draft Grandma's will	Buy a casket for Grandma

Beyond ending such silliness (or discrimination and economic distortion, if one seeks technical terms for it), taxation of services purchased by households would provide a level playing field between consumption alternatives. When there is considerable substitutability between a good or a service, then it is incumbent that the sales tax treat both alternatives the same. Similar approaches to providing a consumer demand should not be taxed differently according to whether they are defined as good or service. That is a basic standard for insuring a level playing field for economic activity and the allocation of economic resources.[12] The medium should not matter for taxability.

A sensible treatment of services purchased by households would also simplify business practices. Businesses would no longer need separate accounting and reporting for sales of tangible personal property and services. Separation of parts from labor on automobile repair invoices would become irrelevant because both would be taxable. And such taxation would not represent a "tax on labor income" – the amount appearing on the invoice is not the amount being paid to the mechanic but rather is a separate price being charged by the establishment, including costs associated with the mechanic's work plus profit to the firm. A significant amount of the cost of goods represents payment for the labor involved in producing and bringing the good to market. And most services involve use of equipment along with work effort. Hence, taxing services purchases is no more a tax on labor than is the tax applied to goods and neither is a labor income tax.

Extending tax coverage to service purchases would not add many reporting entities to the system because most businesses selling services to households that would become taxable are already registered because they also sell taxable goods and collect tax on those sales. They would simply be revising the base to which the tax applies. And strategies to define some purchases as services rather than as goods would no longer be worth the effort. Entities selling services should collect tax on their sales to households and should be able to purchase any inputs to their operations without paying sales tax.

Preventing Tax Pyramiding

Business purchases of inputs used to produce other things should be exempt from tax, not because businesses deserve special treatment but because taxing business inputs, both goods and services, produces tax pyramiding and because what businesses purchase has little to do with either the capacity of the business to bear tax burden or the benefits received by the business from government. The pyramiding problem occurs when the sales tax applies several times in a supply chain, with the result that the effective rate of tax is considerably higher than the publicized statutory rate of tax.

[12] There is some evidence that exemption from sales taxation has contributed to the growth of the service sector of the U. S. economy. (David Merriman and Mark Skidmore, "Did Distortionary Sales Taxation Contribute to the Growth of the Service Sector?" *National Tax Journal* LIII (March 2000): 125 – 142.) The service sector growth is at the expense of decline in the goods retail sector.

When this happens, in addition to the overall inflated effective tax rate, the tax rate on particular purchases will differ according to the supply chain used for the product (the more transactions in the chain, the higher the effective rate), businesses will have an incentive against economically sensible out-sourcing activities (vertically integrated firms can avoid tax on inputs by producing the input in-house), there will be an incentive favoring purchase of product from producers in jurisdictions that have less sales tax embedded in their products, and the general public will be deceived about how high the sales tax actually is.[13] Even purchases and purchasers intended to be exempt (food purchased for at home consumption or purchases by religious organizations) end up bearing a sales tax burden because of tax embedded in prices paid for inputs used in producing the products being purchased. Applying the sales tax to purchases made by business, including both purchases of inventory for resale and of equipment used in business operations, will be unfavorable for economic growth and development.[14]

Exemptions of business purchases of tangible personal property – goods for resale, materials that will become parts of goods for resale, equipment used directly in the production process, etc. – are in the retail sales tax law to prevent pyramiding. An extension of the sales tax base to include services would require similar exclusion of business purchases if it is to avoid a repetition of the pyramiding problems from taxation of tangible personal property. As with other elements of retail sales tax policy, the standard is clear: tax purchases that are household consumption expenditure and exempt purchases that are made by businesses. In an economic sense, all business purchases, services and tangible personal property, are purchases made for resale and, accordingly, none should be included in the sales tax base.

There is a problem. Politicians may prefer that a portion of the actual cost of government service be hidden in taxes imposed on business purchases, but that certainly is at odds with a desire for transparency and clarity in the operations of government. The problem is rendered more difficult by the political objective of avoiding taxation of people by taxing businesses, thus causing proposals to tax services heavily if not exclusively purchased by businesses, e. g., public relations, advertising, accounting, information systems, etc., to be frequently made. Not only is taxation of those sort of services clearly the most damaging for the economy, their burden is almost certainly reflected in prices charged by businesses for their product, meaning that people still pay the tax, but in a concealed fashion.

Implementation of the anti-pyramiding policy standard presents challenges. If an extension of the tax to service purchases is general, in other words, it is done in the

---

[13] Robert Cline, Andrew Phillips, and Thomas Neubig, "What's Wrong With Taxing Business Services?" *State Tax Notes* LXVIII (April 22, 2013): 311 – 328 explain the argument against including services purchased by businesses in considerable detail.

[14] One advantage of the value-added tax (VAT) over the retail sales tax is that the VAT almost entirely removes business purchases from the tax base. The tax applies to purchases of both goods and services without creating the economic distortions, discouraged development, and hidden tax burden that a pyramided retail sales tax does.

manner of the tax applied to purchases of tangible personal property, it will be necessary to distinguish between service purchases made by businesses and service purchases made by households. This exemption can be done either by specific identification of certain services as not taxable (for instance, West Virginia lists advertising services as always exempt) or by requiring presentation of an exemption certificate for purchases made for business use. If the extension to service purchases is selective, then the services listed for taxation would need to be those purchased by households and not businesses. While the distinction is clear for some categories, e. g., services provided by barbers and beauticians, it is not so clear for others, e. g., the services of landscape architects, lawyers and accountants. There will be difficult distinctions if the law is to avoid the adverse economic and transparency effects of taxing service purchases made by businesses while extending the base in a meaningful way to services purchased by households. The ideal is to tax household purchases of consumption services on the same basis as their purchases of tangible personal property are taxed and to exclude business purchases of services so that the taxed base is only total household consumption expenditure. To achieve that ideal, an extended tax requires an effective anti-pyramiding approach, either by an effective exclusion of business purchases from a general extension of the tax to service purchases or by careful selection of service categories to be taxed in a selective extension.[15]

Questions of Law and Administration Defining Services for Taxation

The Indiana gross retail sales tax applies to total consideration received for retail transactions involving tangible personal property plus a small list of identified services (cable television, utilities, rental of tangible personal property, etc.). An extension of the tax to services could follow either of two paths: apply the tax to all retail sales unless specifically exempt (i.e., a retail sale is a sale of tangible personal property, service, or a combination of the two, so taxing all sales by definition encompasses services on the same basis as goods) or apply the tax to the current base plus an enumerated list of taxed service purchases (i.e., the tax applies to theater admissions, dog boarding, massage, and so on in addition to tangible personal property). The former approach is logically the one taken by the current Indiana tax in its coverage of tangible personal property and by the states with the broad service coverage. The latter approach, rather like the logic of a selective excise tax, has been widely used by states expanding their coverage to services in the past few decades and is the approach used for the modest list of services now taxed in Indiana. As with many elements of tax structure design, the principle is clear but its implementation gets difficult.

[15] Excluding business purchases of services has the added advantage of minimizing administrative issues from out-of-state transactions. Businesses are more likely than households to cross state lines on expensive service transactions and taxing these transactions would potentially create problems of nexus and allocation. Keeping these transactions, correctly, out of the tax base would simplify compliance and administration.

Neither approach is without its problems. If the expansion is broad with identified exemptions, there will be disputes about boundaries. For one example, if health services are exempt from general expansion of tax to service purchases, there could be disputes about whether therapeutic massage is included or excluded or if educational services are excluded, there could be disputes about taxability of tennis or dance lessons. Every exemption creates disputes around its boundaries. However, the biggest economic issue in defining the general expansion of service taxation is that of excluding sales of service between businesses. To tax such transactions is to introduce a bias into operational choices made by the business, with accompanying distortion and loss to the economy. It distorts the choice between doing work within the business (no transaction, so no sales tax) versus hiring an outside firm to do the work (a purchase, so tax applies). Such operational choices should be made on the basis of efficiency and inserting a tax wedge can influence the choice for no fundamental economic purpose. And, to the extent that tax is paid on such transactions, the operating cost of the business increases and likely gets reflected in prices paid by customers. The final customer is paying the intermediate tax in a hidden way and not seeing the true cost of government. If the extension of the tax to services is general, then there should be some accompanying mechanism to exclude service purchases by businesses, something approximating the suspension certificate system used with purchases of tangible personal property for use in production. Using a narrow concept of resale of the service is not sufficient (exempting subcontracted service work by a furniture restorer, for instance) because the concern is to prevent pre-retail taxes from entering business cost and, hence, pyramiding through the production and distribution chain. The objective is to exclude all services purchased by the business from taxation so that the tax can narrowly and uniformly apply when consumption purchases are made by the household. Business-to-business transactions do not belong in the retail sales tax base. Getting intermediate purchases out of a general tax on services is a challenge.

If the approach is to include services selectively, there are significant coverage problems and there will again be boundary problems. There is also the concern that picking out only certain services is unfair to some segments of the public. Here is an example of the boundary problem: if massage is included on the list, does it also include reflexology? And there are always concerns about why one service gets included and another does not, one of the most famous examples being the choice in a Michigan attempt at service expansion that taxed ski lift charges but exempted golf course greens fees.[16] There are problems in organizing the list and defining the services to be covered in a way that is legally unambiguous and that can be administered. The problem of excluding business-to-business service transactions also remains. While some services are almost exclusively purchased by households (the services of tanning salons, dentists, hairstylists, etc.) and others are almost exclusively purchased by businesses (process serving, advertising, armored car, etc.), a considerable group of services may be purchased by either households or businesses (legal, landscaping, architectural,

[16] One can only speculate about the preferred recreational activities of those who wrote the tax law.

exterminating, bank safety deposit boxes, accounting, etc.). Proper selection of services to be taxed can handle the first two groups of transactions, but not the third. In other words, the work of an accountant hired to handle the finances of a small business would properly be exempt but the work of the same accountant hired to prepare an individual income tax return would be taxable. That is a difficult line to draw and it is a problem whenever a particular service may he purchased by either a business or a household.

States successfully expanding their sales tax to include service purchases in recent years have usually used the approach of selective addition of services, rather than general expansion. Unfortunately, not all expansions have been limited to services unambiguously purchased for direct household consumption. Each expansion gets criticized as unfair by those having to pay the tax.[17] And there is a universal problem when establishing the "hit list" of services to be taxed. Quick and McKee note that the "resulting battles over selection for the hit list whipsaws legislators among every mom-and- apple-pie business interest in the state."[18] Creating a logical and non-discriminatory service expansion is a great challenge.

Problems of the Small Business

Operators of small businesses are often less sophisticated in tax compliance, whether the tax is an income tax, a retail sales tax, a personal property tax, or whatever. Even though the sales tax on services is likely to be reflected in the prices charged and not directly in profits of the firm selling the service, the firm still must face the obligations of compliance.[19] The small business is not large enough to support a dedicated tax compliance operation and hiring an outsider to do the work may be prohibitively expensive. Although the bulk of tax revenue will be generated from large businesses (80 percent or more of total collections in sales taxes typically comes from less than 10 percent of total registered vendors), small businesses cannot be ignored if a strong compliance climate is to be maintained. Compliance that is simple as possible is an important general objective in the operation of any tax but it is particularly critical for the tax situation of small businesses. They should be included in the compliance system but their inclusion should not place an extraordinary burden on them. This is a particularly important concern for expanding the tax to firms providing services because a higher share of these firms is small than is the case for all businesses.[20] It may be appropriate

[17] For example, in 2014, Washington, D. C., expanded its sales tax base to include a few services: water delivery services, storage lockers, carpet cleaning, health clubs and tanning studios, car washes, and bowling and billiards. The expansion was cast as an attack on trying to stay healthy by its opponents.

[18] Perry D. Quick and Michael J. McKee," Sales Tax on Services: Revenue or Reform?" *National Tax Journal* 41 (September 1988): 399.

[19] A sales-tax induced increase in price of the service will cause some reduction in service sales, so there will be some loss of profit here. But the increased compliance cost is normally of greater concern.

[20] The 2011 County Business Patterns survey (U. S. Bureau of Census) report for Indiana shows that 56.2 percent of all establishments in the state have 9 or fewer employees. For service providers (other than

to provide a special compliance structure for smaller entities if the basic productivity of a general sales tax on service purchases is to function.

Casual providers of services should be protected from compliance complexity.[21] It would be reasonable to provide an exemption for informal and small service providers, possibly giving them the option of registering as a business and allowing them exempt purchase of supplies or of continuing operation without collecting tax (and without the purchase exemption) so long as their operations remain small (below an annual gross receipts limit) and informal. Not much revenue would be lost and both compliance and administration would be simplified. A similar approach could be applied to small sellers of goods, e.g., participants at farmers' and flea markets, so long as the threshold for optional registration is kept small. Providers could also be removed by expansion of the casual sale provision currently in the state tax: "The Indiana gross retail tax is not imposed on gross receipts from casual sales except for gross receipts from casual sales of motor vehicles and sales of rental property. A casual sale is an isolated or occasional sale by the owner of tangible personal property purchased or otherwise acquired for his use or consumption, where he is not regularly engaged in the business of making such sales." (45 IAC 2.2-1-1(d)) It would be important to avoid creating a flurry of tax delinquencies being created when small service providers go into hiatus or out of business entirely without informing the Department of Revenue.

Cost of Administration and Compliance

The operation of a retail sales tax depends on the cooperation of vendors. Tax authorities cannot directly collect the tax, but must rely on work done by those vendors. Tax collection is essentially privatized to these vendors. The tax functions best when this vendor compliance is easy and administrative work by tax authorities is limited to encouraging compliance by the vendors. A successful and fiscally responsible extension of the retail sales tax to services requires efforts to make the cost of administration and compliance as modest as possible.

For many vendors, an extension of the retail sales tax to services will entail minimal additional cost after initial transition to a different base. These are firms which are already registered retail merchants with the Department of Revenue because they sell taxed goods. They would need to reprogram their systems to include the broader base but they would no longer need to maintain a distinction between sales of goods and sales of services in their accounting and tax reporting systems. After the transition, their compliance cost could be expected to be somewhat reduced because the need to distinguish between goods and services is no longer present. As Hendrix and Zodrow point out, "…taxing all consumption products, including consumer services, tends to

---

education, health care, arts, and real estate), the measure is 81.7 percent. And the payroll of these small establishments constitutes only 28 percent of total payroll paid by firms in that category.

[21] Very small informal service providers are likely not to comply with the tax and amounts of revenue are not likely to be sufficient to merit much Department of Revenue enforcement effort.

simplify the tax system by eliminating distinctions between taxable and non-taxable products that are often arbitrary and in practice difficult to draw."[22]

Other vendors will have no experience with sales tax collection. The numbers involved would depend on the coverage of the extension. However, a tax extended to professional services provided by attorneys, architects, engineers, etc., and a tax extended to services frequently provided informally, like daycare, lawn maintenance, etc., would likely include more non-registered vendors. Compliance could be an issue for these more informal providers and as much simplification as possible would be warranted. Such provisions as exempting services-only vendors below a specified gross receipts ceiling, exempting services-only vendors making sales fewer than a set maximum number of days per month, allowing services-only vendors to sell on a tax-included basis, and requiring services-only vendors to file exclusively on an annual basis are all mechanisms that can provide some simplification to compliance without significant harm to revenue production, that make administration somewhat easier, and that accommodate inclusion of services into the sales tax base. However, smaller retailers will still incur relatively higher compliance cost relative to sales than will larger retailers.[23] The fact that the collection cost would be high relative to revenue collected for some providers (babysitters, housekeepers, gardeners, etc.) is not an argument for failing to tax any services, including those provided by large business establishments (daycare businesses, professional housecleaning services, professional landscapers, etc.). It is an argument for providing a minimum threshold for collection of the tax, an approach that would lose little revenue while preventing outlandish ratios of collection (and administrative) cost to revenue collected, and for making compliance as simple as possible for all vendors.

Enforcement of a sales tax on services requires some different approaches from the tax on goods. In particular, it is not possible to verify claims about sales of product by checking against purchases of inventory from suppliers. That audit trail is largely closed so other accounting records and indicators of sales operation will need to be employed to verify claims. Broad coverage of sales should, however, reduce the difference between total and taxable sales by the vendor. Initial efforts will involve getting services-only vendors into the registration system, the size of the effort dependent on the breadth of the extension and the extent to which the structure removes small operators from the tax. Informal, intermittent, and seasonal service providers create the potential for generation of unnecessary delinquency notices and the system should be designed to allow accounts to become officially inactive when no revenue is owed.

---

[22] Michele E. Hendrix and George R. Zodrow, "Sales Taxation of Services: An Economic Perspective," Florida State University Law Review 30 (2003-2003): 420.

[23] Robert J. Cline and Thomas S. Neubig, "Masters of Complexity and Bearers of Great Burden: The Sales Tax System and Compliance Costs for Multistate Retailers," Ernst & Young Economics Consulting and Quantitative Analysis, September 8, 1999.

Experience from Expanding the Base to Services: Some (Mostly Bad) Lessons

Most state sales tax structures begin with the Great Depression-era design of a tax on purchases of tangible personal property, either directly or by copying from the tax in neighboring states. The omission of service purchases is obvious and state tax restructuring programs regularly consider broader coverage from a desire for additional revenue, for lower rates, for greater balance between sectors of the state economy, or some combination of those objectives. Florida, Massachusetts, and Michigan passed legislation to significantly expand the sales tax base to include purchase of services, but the expansion was almost immediately repealed. These experiences are worth some consideration.

Florida

Discussions of extending state sales tax coverage to service purchases in the past two decades always reference the Florida experience. In the space of a few months in 1986 – 1987, the tax was broadly extended to service purchases, and then the extension was repealed. It is useful to understand how the extension was approved, its problems, and how the extension was so quickly ended.[24]

Broad coverage of services resulted from 1986 repeal of a long-standing exemption for "professional, insurance, or personal service transactions" and was characterized as a sunset bill in the fashion of earlier deregulations of various professions. The action cast a broad and general net across all services. A service could be exempt only by specific action. That changed the political dynamic of the process – particular service sectors had to argue for special treatment from taxation as opposed to working to be excluded from a developing list of taxable sectors. Services were included generally with no regard to whether they might be primarily (or even exclusively) inputs to business operations or whether they were mostly purchased for household consumption. Because coverage included services purchased by businesses and because many such transactions are multistate in nature, the law had to have rules for apportionment of such purchases to establish the base to which the Florida tax would apply. These rules and their application were complex and this complexity added to the case for repeal of the entire service expansion.[25]

The extension did not, however, totally ignore the pyramiding problem associated with taxing purchases by businesses but the exemption for such purchases was limited. The approach used a narrow definition of final sale so that a business was considered the final consumer if the purchase was not the object of consumption of a subsequent customer. In effect, the business purchase exemption for services was limited to those purchased on behalf of the final customer (e.g., an automobile repair shop hiring

---

[24] A good source for the Florida experience: James Francis, 1988, "The Florida Sales Tax on Services: What Really Went Wrong," in *The Unfinished Agenda for State Tax Reform*, edited by Steven Gold (NCSL, Wash. DC), pp. 129-152.

[25] The rules for determining taxability of such services are explained in Walter Hellerstein, " Florida's Sales Tax on Services," *National Tax Journal* XLI (March 1988): 1 – 18.

another firm to straighten the frame of a customer's vehicle). This narrow approach copied the Florida standard for exempting business purchases of tangible personal property and that left many services that were seldom if ever purchased for anything other than business use added to the tax base. The dispute was over the facts that distinguished purchases for internal consumption by the business from purchases the business purchased on behalf of the business's customers, not unlike the distinction between purchases of tangible personal property by a business necessary for its general operation and purchases of tangible personal property that will become component parts of what the business sells or of machinery directly used in producing what the business sells. It made legal sense but there is no economic distinction – all are part of the input cost of what the business sells.

Repeal of the extended coverage to services in December 1987 was an exercise in politics. The media was much opposed to the extension. Because of the method of broadening the tax and the limited anti-pyramiding mechanism, the extension brought advertising purchases into the sales tax base. One could argue that this represented a policy mistake because advertising is almost exclusively a business purchase and should be exempt – but not according to the narrow standard used by the Florida tax. In any case, the media was opposed and took that opposition heavily to the public with "public service" messages that characterized the expansion of the tax to be a massive tax increase that endangered the state economy. Legal services were taxable and the State Bar Association also sued the state, claiming that the service expansion was unconstitutional. This message, coupled with what appeared to be a wavering position from the governor and a concern that the tax would become a major issue between the political parties in the next election, assured the end to the tax. It was clear that without a consensus from the parties, general service expansion will not succeed.

The Florida service base expansion was not explicitly presented as a means of generating revenues that would allow for the statutory sales tax rate to be reduced. However, the Governor's budget proposal for 1987-88 did include revenue from the base expansion and would have reduced the sales tax rate from 5 to 4.5 percent. With the failure of the expansion to services, the state did increase its tax rate from 5 to 6 percent, effective Feb. 1, 1988, a rate increase that likely would not have been necessary with the expanded base.

Massachusetts

Massachusetts passed an expansion of its sales tax coverage to previously excluded services, but the legislature repealed the tax retroactively two days after it went into effect. The program represented an effort to close a substantial budget deficit and was signed into law in July 1990 after the governor had received an opinion from the Supreme Judicial Court of Massachusetts that such an expansion was constitutional (excises were limited to "commodities" and it had to be established that services could be commodities under the framework of the constitution). The expansion was quickly

aborted because of severe administrative complications and great concern about competitive impact.

In contrast to the Florida program, the law imposed the standard tax rate to 23 identified services, mostly by 1987 U.S. Standard Industrial Classification (SIC) coding:

> "telecommunications services; photographic studios (SIC 7221); commercial photography services (SIC 7335); credit reporting and collection services (SIC 732); commercial art and graphic design services (SIC 7336); building services (SIC 734), not including property used exclusively for residential purposes; computer maintenance and repair services (SIC 7378); detective, guard, and armored car services (SIC 7381); security systems services (SIC 7382); other miscellaneous services provided to businesses (SIC 7389), not including auctioneers, notaries, public and advertising services; miscellaneous repair services (SIC 76), provided to businesses; automobile repair services (SIC 753), provided to businesses; surveying services (SIC 8713); flight instruction; piped-in music; landscaping services (SIC 078), excluding those services with a sales price of one hundred dollars or less; court reporting and stenographic services; miscellaneous amusement and recreation services [of more than $30]…(SIC 799); admissions and box rentals to entertainment events [of more than $30]; legal series (SIC 81); accounting, auditing, and bookkeeping (SIC 872); engineering (SIC 8711); and architectural services (SIC 8712), provided to businesses."[26]

Most were taxable only when sold to businesses and that was apparently the primary intent of the expansion. Services used outside Massachusetts were exempt, the portion of services used outside of Massachusetts when the service was used both within and outside the state was exempt (subject to apportionment if the service could not be directly allocated to segments of the entity's business), and services used inside Massachusetts were taxed, sometimes by use tax. Businesses with five or fewer employees were exempt from paying the tax and business could purchase the first $20,000 of the four professional services categories on the list (legal services; accounting, auditing, and bookkeeping services; architectural services; and engineering services) without tax in each calendar year. (Because vendors collect tax on each transaction, it is not clear how the exemption limit would have been administered.) Legislators were not entirely unaware of the pyramiding problem that this base expansion created but protection was minimal: sale of services for resale in the ordinary course of the purchaser's business and services that became an integral, inseparable component part of taxable services that are sold were exempt.

It became apparent that the program had fatal operational and economic flaws. There was a definitional problem, particularly in regard to the professional services categories,

[26] Acts of 1990, Chapter 121, Section 42. The SIC codes were created to classify business entities, not necessarily goods or services being sold.

because SIC codes for business firms do not align completely with types of services being provided. Not all services performed by those in the professional group are exclusively performed by those people and not all services performed by those in the professional group are strictly services of that profession. For instance, accounting firms provide management consulting and do tax preparation, not just accounting, auditing, and bookkeeping and lawyers provide advice on employee benefits and pensions and tax preparation. The Department of Revenue tried to sort out the problems in its regulations, but it was not clear that the system would have been fully functional. The program sought to tax services provided within the state and, where there was no basis for determining exactly whether the service was entirely inside or outside the state, used apportionment according to business activity.

The expansion was repealed because of perceived problems of compliance and administration and concerns about the impact on both existing and new businesses. With its determined focus on services purchased by businesses, it is no surprise that the program was regarded as anti-business. The narrowness of the anti-pyramiding provision would have created difficult development incentive issues and an intensive search for avoidance mechanisms.

Michigan

Michigan passed an extension of its use tax act in October 2007 to apply to the use or consumption of specified services as a reaction to a budget crisis that threatened a government shutdown. The tax would have been implemented from Dec. 1, 2007. The law identified a list of services, some according to North American Industry Classification System (NAICS) category codes (the successor to SIC codes), with the provision that the tax applied according to the service described in the code, not the establishment classification. The services taxed were these:

> Carpet and upholstery cleaning services (56174); Business service center services (56143); Consulting services (5416); Investigation, guard, and armored car services (56161); Investment advice services (52393); Janitorial services (56172); Landscaping services (56173); Office administration services (56111); A list of personal services [astrology, baby shoe bronzing, bail bonding, balloon-o-gram, coin-operated blood pressure testing machine, bondspersons, check room, coin-operated personal service machine, comfort station operation, concierge, consumer buying, credit card notification, dating, discount buying, social escort, fortune-telling, genealogical investigation, house sitting, social introduction, coin-operated rental locker, numerology, palm reading, party planning, pay telephone, personal fitness trainer, personal shopping, coin-operated photographic machine, phrenology, porter, psychic, rest room operation, shoeshine, singing telegram, wedding chapel but not churches, wedding planning]; other travel and reservation services (56159), scenic transportation services (487); skiing services (71392), tour operator services (56152); warehousing and storage services (4931); packaging and labeling

services (56191); specialized design services (5414); transit and ground passenger transport services (4853); courier and messenger services (492); personal care services (8121), except hair care services; service contract services; security system services (56162); document preparation services (56141); mini-warehouse services and self-storage unit services (53113).[27]

The services included those sold exclusively to individual consumers, those sold exclusively to businesses, and those sold to both individuals and businesses. The tax had no anti-pyramiding provisions at all.

The law was repealed on the very day it took effect, primarily because of opposition from business groups of all sizes and types, accompanied by an effort to place a repeal referendum on the 2008 ballot. The revenue that would have come from the tax on services was replaced with a surcharge on the new state general business tax.

Concluding Observations

Programs to extend state retail sales taxes to purchases of services emerge from a simple idea. As John Due observed, "From an economic standpoint, the distinction between a service and a commodity is not a very significant one, since both satisfy personal wants."[28] The case for taxing all household service purchases is three-fold. First, these purchases are a considerable component of household consumption spending. If the tax is to divide the cost of government according to what households purchase from the private sector, then to exclude services represents a serious omission. Consumption, not consumption of tangible personal property, provides a good indicator of self-assessed household well-being. Second, it is important to treat all prospective purchases in the same way so that decisions are not distorted and that households do not face discrimination solely on their spending choices. To provide that balance, then both goods and service purchases need to face the same tax treatment. Finally, it is important to include all reasonable transactions in the tax base so that the tax rate can be kept as low as possible while still providing budgeted revenue. Because services are a reasonable component for the tax base, in this example they should be taxed.

Evidence shows several probably consequences from extending the Indiana retail sales tax to include consumer purchases of services:

1. The Indiana retail sales tax base would expand, the amount of that expansion would depend on what services were included in the base. A selective expansion to services associated with motor vehicles, recreation, consumer professions, personal care, and household maintenance would increase the base by over 20 percent. Adding financial services and insurance other than life would increase the base by over 15 percent more. Adding health care and education would increase

[27] Michigan Public Acts of 2007, Act Number 93.

[28] John F. Due, *Sales Taxation* (Urbana, Illinois: University of Illinois Press, 1957): 374.

the base by almost 50 percent more. The base increase would provide the state the option of some combination of a general rate reduction and expanded revenue.

2. Taxing services would reduce regressivity (the extent to which effective tax rates fall as household income group is higher) of the tax and improve horizontal equity (the variation in effective tax rate across household with equal incomes). Taxing services would still leave the sales tax burden distributed in a regressive fashion.
3. Adding services to the sales tax base would promise to increase the rate of growth of sales tax revenue and to increase responsiveness to increases in state personal income. The expansion would not clearly make the sales tax base more stable over time and would not fully insulate the base from the impact of recessions.
4. Adding services to the tax base would treat all household purchases the same, eliminating distinctions that have emerged simply because one way of satisfying household wants has been classed as a purchase of a good and a similar way has been classed as a service. Businesses would no longer have an incentive to bill separately for parts and labor.
5. Adding services to the tax base would require considerable attention to ensuring that the new tax does not apply to services purchases made as business inputs. This problem would be particularly acute for services that may be purchased by either households or businesses (dual-use services).

There are some administrative concerns:

1. An extension of the tax to services could be accomplished either by redefining the structure of the tax to encompass sales of tangible personal property and services or by selectively adding identified services to the short list already taxed. Neither approach is without problems, as experience in Florida, Michigan, and Massachusetts illustrates. The experience does show the problems associated with trying to include services predominantly purchased by businesses in the expanded base. Not only is that expansion bad economic policy, it has the potential for creating severe administrative problems as well.
2. Small businesses may have compliance problems with an expanded sales tax. Making the tax as simple to comply with as is feasible is important for all businesses, but special compliance programs may be needed to prevent special issues for small entities.
3. Many vendors who would face obligations to collect and remit sales tax on services already are in the state retail sales tax system because they sell taxable tangible personal property. Much of the new tax base undoubtedly is with these existing registered vendors. Special attention, however, would be warranted to assist with the transition of the new vendors into the sales tax system.

It is sometimes argued that extending sales tax coverage to service purchases is impractical and possibly not feasible for administration and compliance. Evidence indicates that this assertion is wrong. First, a number of states do successfully apply their tax to services either generally or selectively and the selection of services taxed in some states is extensive. Second, it should be noted, the old Indiana gross income tax

included receipts from service sales, as well as sales of goods, so there is undeniable evidence of feasibility of the tax. Barriers are more political than technical.

-30-

About the Author

John L. Mikesell is Chancellor's Professor of Public and Environmental Affairs at Indiana University, Bloomington. He is a leading academic expert in sales tax policy and administration, and is co-author of *Sales Taxation, State and Local Structure and Administration* (Urban Institute Press), a standard reference on the tax. His textbook *Fiscal Administration* (now in its ninth edition) is a widely-used textbook in graduate public administration programs. He has been a David Lincoln Fellow in Land Value Taxation with the Lincoln Institute for Land Policy, and a Senior Research Fellow, Peking University – Lincoln Institute Center for Urban Development and Land Policy, Beijing, People's Republic of China. He holds a BA from Wabash College and MA and PhD in economics from the University of Illinois-Urbana.

About the Indiana Fiscal Policy Institute

The Indiana Fiscal Policy Institute (IFPI), formed in 1987, is a private, non-profit government research organization. The IFPI's mission is to enhance the effectiveness and accountability of state and local government through the education of public sector, business and labor leaders on significant fiscal policy questions, and the consequences of state and local decisions. The IFPI makes a significant contribution to the important, on-going debate over the appropriate role of government. The IFPI does not lobby and does not support or oppose candidates for public office. Instead it relies on objective research evidence as the basis for assessing sound state fiscal policy.

Contact

John Ketzenberger
President
Indiana Fiscal Policy Institute
One American Square, Suite 150
Indianapolis, IN 46282
Phone: 317-366-2431
www.indianafiscal.org