California's Tax System – Report #2a

Sales and Use Tax Weakness & Possible Remedies:

The Tax Base is Too Narrow and Should Be Broadened

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This is one in a series of reports on weaknesses in California's tax system. Report #1 lists several structural weaknesses and policy issues that exist in most of California's taxes and the system overall. Subsequent reports provide further details on each of the weaknesses and issues, along with possible remedies. The purpose of this series of reports is to help promote serious discussion on the need to and the ways to bring California's tax system into the 21st century so it may best promote economic growth, be more equitable, efficiently meet state revenue needs, reduce taxpayer frustration, and be understandable and transparent. Work on this series began through a two-year fellowship with the New America Foundation. A blog accompanies these reports to enable online discussion. To access the reports, articles, and the blog, please visit:

http://www.21stcenturytaxation.com

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I. Introduction

One of the weaknesses in California's sales tax is that the tax base is too narrow. A sales tax is a consumption tax, yet many types of consumption by individuals are exempt from the sales tax. For example, the California sales and use tax does not apply to the following consumer purchases: grocery store food, theater tickets, haircuts, storage fees, pet care, dry cleaning, and software and music purchased and downloaded online.

Some of the exempt consumption today is a digital substitute for taxable tangible personal property. For example, if a consumer buys a CD at a music store, sales tax is owed. If the consumer instead downloads the same music from a computer, no sales tax is owed. Since the sales tax was enacted in the 1930's, consumption of intangibles (such as digital items) and services has increased while the consumption of tangible personal property has decreased. This leads to a shrinking tax base for the state. It also creates another form of a digital and class divide in that consumption of non-taxable services, entertainment and intangibles is more significant for higher income consumers while consumption of taxable tangible personal property can be more significant for lower income consumers.

It is not the intent of this report to call for the taxation of all types of consumption as there may be policy reasons to make some items (such as basic medical care) tax exempt. Also, to prevent making the pyramiding problem worse, the sales tax base should not be broadened to include consumption by businesses. The purpose of this report is to point out and explain tax base weaknesses with the sales and use tax, describe the advantages and disadvantages of broadening (modernizing) the base, and explain how this can be accomplished. For example, broadening the sales tax base would not only make the system more equitable, it would also allow for California's high tax rate to be lowered (which would also make the tax more equitable). Broadening the base to include today's types of consumption (rather than only 1930s types of consumption) would enable the tax revenues to move along with the economy.

Data is provided to explain the tax base weakness. Information on a few other states is provided as well to provide some context in understanding ways that California's sales and use tax is out of sync with states that have made changes to modernize their sales and use tax. Recommendations for change are provided and a tax policy analysis is included to indicate how addressing the tax base weakness would help the sales tax to better meet the principles of good tax policy.

> ***Weakness***: The sales and use tax base is too narrow in that many types of personal consumption are exempt.
>
> ***Remedy***: Broaden the base, lower the tax rate, and address issues of compliance by small businesses and adverse impact to low-income individuals.

II. How the Proposal Satisfies Tax Reform and Modernization Goals

In October 2008, Governor Schwarzenegger established the Commission on the 21st Century Economy. The commission is to recommend law changes that meet six goals. Following is an explanation of how a broadened sales tax base helps meets the six goals as laid out by the governor.[1] Background on the sales tax and the rationale for broadening the sales tax base are further explained after the following chart.

Goal	Effect of a broadened sales tax base
1. Establish 21st century tax structure that fits with state's 21st century economy	Most of the current base for the sales tax dates back to the 1930s when a greater portion of personal consumption was of tangible personal property. Today, there is greater consumption of intangible items (such as digital downloads) and services. The sales tax base has eroded and become outdated as consumption has shifted from taxable items to non-taxable items.
2. Stabilize state revenues and reduce volatility	A broader tax base tends to be a more stable base. Also an expanded tax base that includes consumption in various forms (rather than only tangible personal property) would allow sales tax revenues to track better with economic growth. For example, today, the growth in digital consumption results in a decline in sales tax revenues, rather than an increase.
3. Promote the long-term economic prosperity of the state and its citizens	A broader sales tax base will allow for a lower tax rate. A lower rate should help lower income taxpayers. A broader tax base will distribute the sales tax burden more fairly among income groups.
4. Improve California's ability to successfully compete with other states and nations for jobs and investments	California is more likely to attract businesses with a lower sales tax rate made possible by broadening the tax base.
5. Reflect principles of sound tax policy including simplicity, competitiveness, efficiency, predictability, stability and ease of compliance and administration	A broader tax base with fewer exemptions is simpler in that complex definitions are eliminated. Taxing similar forms of consumption similarly will make the sales tax more neutral. Today, the tax structure encourages consumption in digital form if possible (such as music downloaded onto an mp3 player) rather than the equivalent tangible form (such as a CD). Base broadening will cause more businesses to be subject to tax collection which presents an opportunity (and need) for the BOE to design simpler compliance methods.
6. Ensure that tax structure is fair and equitable	A broader base with a lower rate will likely reduce the tax burden on lower income individuals by shifting part of the tax from taxable tangible personal property to currently non-taxed intangible property and services that are more likely to be purchased by higher income individuals.

III. Brief History of the California Sales and Use Tax

California's sales tax was created in 1933 with the Retail Sales Act. The tax was to be imposed on retailers for the privilege of selling tangible personal property. In 1935, the use tax was enacted to complement the sales tax to ensure that in situations where a retailer was not obligated to collect sales tax (such as because it was not located in California), the California consumer would be obligated to pay use tax at the same rate. While the sales tax is imposed upon the retailer (although they can add it to what the buyer pays), the use tax is legally imposed upon the purchaser.

In the 1940's, some cities began assessing a local sales tax. By 1954, about half of California cities imposed a sales tax which produced significant revenue for them. Each city administered its sales tax on its own. In response to complexity concerns raised by businesses, the legislature enacted the Bradley-Burns Uniform Local Sales Tax Act in 1955. The Act allowed counties and cities to impose a sales tax with a base similar to that of the state and administered at the state level.

Effective July 15, 1991, the legislature repealed the exemption for food snacks making them subject to sales tax. Challenges with defining "snack" led to consumer and vendor frustration. Proposition 163 was placed on the ballot in November 1993 and passed. This proposition repealed the snack tax and amended the California Constitution, effective 12/1/92. Following this change, Article XIII, Section 34 of the California Constitution reads:

> "Neither the State of California nor any of its political subdivisions shall levy or collect a sales or use tax on the sale of, or the storage, use or other consumption in this State of food products for human consumption except as provided by statute as of the effective date of this section."

The combined state and local sales tax rate in California is 8.25%. Some areas also have district sales tax(es), with the result that the rate varies among counties from 8.25% to 10.25%. The 8.25% California sales tax rate is composed of the following elements:

Rate	Jurisdiction
6.00%	State (General Fund) (prior to 4/1/09, it was 5%)
0.25%	State (Fiscal Recovery Fund)
0.50%	State (Local Revenue Fund)
0.50%	State (Local Public Safety Fund)
1.00%	Local (County/City) (City and county operations + County transportation funds)
8.25%	Total Statewide Base Sales/Use Tax

District taxes range from 0.125% to 0.50% per district. A county may have more than one district within it or it may have no districts. For example, the tax rate in Santa Clara County is 9.25%, comprised of the standard 8.25% and two district taxes of 0.50% each.

Prior to April 1, 2009, the state sales tax rate was 5% rather than 6%. As part of the plan to close a $41 billion budget shortfall, the rate was temporarily raised one percentage point.

IV. Imposition of the California Sales & Use Tax

California's sales and use taxes are imposed by different provisions of the California Revenue & Taxation (R&T) Code. The sales tax is imposed by R&T Section 6051:

> "For the privilege of selling tangible personal property at retail a tax is hereby imposed upon all retailers … "

The use tax is imposed by R&T Section 6201 on "the storage, use, or other consumption in this state of tangible personal property purchased from any retailer."

Thus, the sales tax is legally imposed upon the seller of the taxable items while the buyer of taxable items is legally obligated for the use tax. Generally, sales tax applies when the seller has nexus in California (usually a physical presence via property, or an employee or representative). The use tax applies when the seller does not have nexus in the state (such as when a person living in California purchases from a seller via the Internet and the seller does not have nexus in California).

R&T §6203 provides: "every retailer engaged in business in this state and making sales of tangible personal property for storage, use, or other consumption in this state…shall, at the time of making the sales or, if the storage, use, or other consumption of the tangible personal property is not then taxable hereunder, at the time the storage, use, or other consumption becomes taxable, collect the tax from the purchaser and give to the purchaser a receipt therefor in the manner and form prescribed by the board." This provision also explains when the retailer has a collection obligation, such as because it has an office or employee soliciting sales in the state.

V. The Tax Base and Exemptions

The California sales and use tax rules specifically apply to tangible personal property. California R&T Section 6016 defines "tangible personal property" as "personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses." Generally, sales and purchases of services and intangibles are exempt from the California sale and use tax. However, there are a few exceptions. If the service is embedded in the goods or if an intangible (such as a film) can be viewed as tangible, it will likely be taxed. The California Revenue & Taxation Code has many rules that explain taxable tangible personal property. For example, where the consumer directly or indirectly provides materials to a business that fabricates an item from them, that labor is included in the sales price and taxable (R&T Section 6006). Similarly, a restaurant's prices may not be separated between services and food; instead, the entire restaurant bill is subject to sales tax.

In addition to items or services that are not subject to the sales and use tax because they are not tangible personal property, California law provides several exemptions where an item of tangible personal property is not subject to tax. The law may address a specific item, such as ice used to pack food for transportation (R&T Section 6359.7). Or, the exemption benefits a seller such as because they are a charitable organization (for example, R&T Section 6360 provides that a charitable organization selling certain prisoner of war bracelets is not subject to sales tax on the bracelets).

The Board of Equalization (BOE) has categorized the reasons underlying exemptions and exclusions to the sales and use tax in its Publication 61, *Sales and Use Taxes: Exemptions and Exclusions* (http://www.boe.ca.gov/pdf/pub61.pdf). The categories used are:

1. Necessities of life (including food and certain medicines)
2. General public benefit (including certain sales to museums and certain charitable items, such as the bracelets mentioned earlier)
3. Industry benefit (including certain sales of transportation items for interstate use, custom computer programs, certain racehorse breeding stock, and certain periodicals)
4. Exclusions by definition (such as cash discounts, intangibles, admission charges, and lodging)
5. Other exclusions, exemptions and credits (such as occasional sales, sales for resale, and the first $400 of tangible personal property purchased outside of the U.S. and brought in by an individual within 30 days)

The categories and some examples from each are listed in the following chart. The chart also includes other BOE information on the revenue that is "lost" (as estimated by the BOE) due to the exclusion or exemption. The California Department of Finance also publishes an annual report of tax expenditures which summarizes the sales and use tax exemptions and their estimated "cost" to the state.[2] The figures below are based on the state sales tax rate prior to it being increased one percentage point on April 1, 2009.

Exemption/Exclusion Examples	Estimated Annual Revenue Loss (in millions)*
Necessities of Life	
Food products**	$4,990.1
Candy, snack foods, bottled water	$318.8
Food sold in vending machines	$13.9
Prescription medicines	$1,829.5
Professional health services	Not measured
Gas, electricity, water, steam delivered through pipes to homes	$2,344.4
Other	$464.6
General Public Benefit	
Various	$1.8
Most items in this category are not measured. They include certain alternative energy projects, items sold by charitable organizations and schools (such as school meals or items sold by the PTA).	Not measured
Industry Benefit	
Fuel sold to air common carriers	$51.0
Rentals of linen supplies	$46.2
Other	$113.9
Most of the items in this category are not measured. They include certain fuel sold to air carriers, master records in the entertainment industry, and certain vehicles in the leasing industry.	Not measured
Other Industry or General Business Exemptions and Exclusions	
Certain farm equipment and machinery	$86.0
Periodicals	$24.9
Printed sales messages	$43.0
Custom computer software	$77.2
Worthless accounts	$74.8
Other	$35.5
Exclusions by definition	
Intangible personal property in form of technology transfers	$75.3
Diesel and use fuel tax	$40.0
Again, most of the items in this category are not measured.[3]	Not measured
Other Exemptions, Exclusions, and Credits	
All items in this category are not measured. They include interstate and foreign commerce, occasional sales, sales for resale and vehicles sold to a family member.	Not measured
Total of the *measured* revenue loss	$10,630.9

* The revenue loss refers to revenue that is not realized by state and local governments due to an exemption or exclusion. Data is based on the latest available to the Board of Equalization as of January 2007 (the date of Publication 61).

** When the California sales tax was enacted in 1933, food was not exempt. The exemption for food was added in 1935.[4]

Context: The *measured* revenue loss from exemptions and exclusions in the California sales and use tax law totals $10.6 billion annually. If some of these exemptions and exclusions were to be removed, the tax rate could be lowered and relief for low-income taxpayers provided through other means, such as a *refundable* income tax credit. The specific changes in base and rate that could be made would be within the purview of the legislators and governor, as would the decision as to whether the changes would be made to not only broaden the base and reduce the tax rate, but to also generate additional annual revenue. To give the $10.6 billion annual revenue loss figure some context, consider the comparisons in the following chart.

Item	Amount	Revenue Loss as % of the Item	
		Tax rates used in Pub 61	75% of tax rates used in Pub 61[a]
2005/6 CA state and local sales tax revenue[b]	$32.2 billion	32.9%	24.7%
2005/6 CA corporate income tax revenue[b]	$10.3 billion	102.9%	77.2%
2005/6 CA personal income tax revenue[b]	$51.2 billion	20.7%	15.5%
2005/6 General Fund spending on K-12[c]	$34.6 billion	30.6%	23%

[a] Thus, if the rate used to measure the revenue loss in Pub 61 was 8%, then the rate used in this column would be 6% (75% of 8%).

[b] Source: Legislative Analyst's Office, *California's Tax System: A Primer* (2007); available at http://www.lao.ca.gov/2007/tax_primer/tax_primer_040907.aspx.

[c] Source: Legislative Analyst's Office, *2007-08: Overview of the Governor's Budget* (1/07); available at http://www.lao.ca.gov/2007/budget_overview/07-08_budget_ov.htm.

Observations: Caution should be exercised in reviewing the revenue loss figures. They do not realistically represent revenue that could be raised if the exemption or exclusion were removed. For example, if the exemption for food were to be repealed, there would need to be some type of relief provided for low income households which would use some of the revenue generated from the base broadening. Also, a broadening of the base should be accompanied by a reduction in the tax rate to avoid an unneeded revenue windfall to the state and a significant tax increase to all taxpayers. In addition, application of the sales tax to currently untaxed items might lead to some drop in purchases or price reductions by sellers.

The revenue loss of many of the items in the list of exemptions and exclusions was not measured by the BOE. For example, the exemption for most services was not measured. Because California's sales tax only applies to tangible personal property, there is no need to measure "lost revenue" from not taxing services because such a figure is not due to a statutory exemption. There is no need to have an exemption for services in the R&T code because services are not defined as part of the tax base.

Many states, do tax personal services, such as haircuts and lawn care. Also, entertainment services, such as theater and movie tickets were not measured and several states today tax these items. Thus, if the list of exemptions and exclusions is used to identify revenue sources, it is important to also consider the items not measured or included.

Also, in reviewing how the sales tax base could be broadened to include more types of personal consumption, it is important to note that several of the items listed by the BOE are ones that arguably should not be in the base, even a broadened one. For example:

- The Board's list of exemptions and exclusions includes cash discounts offered by the seller. Arguably, these are really not part of the sales price of an item. When a cash discount is given, the tax should be imposed on the discounted price since that is the true retail price.
- The list also includes items that are not sourced to California under California's destination approach. That is, if the item is sold to a person residing outside of California, the California sales tax would not apply. Instead, the sales tax of the jurisdiction where the buyer resides (the destination) would apply.
- Another listed exemption is on the local and district sales tax imposed on an item. This is a decision to be made in designing the law – should the state tax be imposed on the tax inclusive or tax exclusive price of the item. To avoid imposing a tax on a tax, it is likely that most people would argue for not imposing the state sales tax on the retail price with the local sales tax included.
- There are often transactions where the cost of collecting the tax may outweigh the revenue collected. For example, assume a small non-profit school organization generates funds by selling t-shirts to students at the school. If it were required to collect sales tax and complete the forms, the compliance cost might outweigh the funds raised. If the non-profit is required to pay sales tax when it buys the t-shirts (rather than treating them as a non-taxable sale for resale), the lost tax revenue would only be on the mark-up, and likely, minimal. This is a policy decision for lawmakers: should certain organizations with a specified amount of minimal sales be allowed to sell tax exempt or should a simplified compliance method be created to aid them?

In 2006, New Jersey expanded its sales tax base to include more services as well as "digital property." The legislature estimated the revenue to be generated for the first nine months of this change. Following is their data annualized (in millions):[5]

Digital property.	$12.8
Delivery charges	$43.6
Flooring and carpeting installation	$11.7
Storage space.	$13.6
Tanning, massage and tattooing	$11.7
Information services	$16.4
Limousine service	$36.1
Membership fees	$99.6
Parking	$9.3
Non-clothing cleaning services	$5.9
Landscaping services	$108.9
Magazines and periodicals	$16.0
Investigation and security services	$57.3
Total	$443.1

VI. The Need to Periodically Review Tax Systems

Ways of living and doing business continually change. These changes often call for changes in the tax system so that the system continues to serve its function and makes sense given current types of transactions. This need for review was stated well in a 1967 report of the Ohio Tax Study Commission:[6]

> "Relationship to the Modern Economy - Insofar as possible, a tax or tax structure should be capable of growing with the economy of the state and should be revised from time to time so as to correspond with the true makeup of that economy as it develops and changes. Some products, habits of

consumption, and classes of enterprise decline, while others rise to take their place. Ideally, a tax structure should be reviewed and revised as necessary so as to bear a relationship to the way people are doing things, regardless of whether additional revenues are needed at a given time."

VII. Changes in Consumption

In the 1930's when California's (and most other state's) sales taxes were created to be imposed on tangible personal property, that was the significant consumption item. Consumption of digital items did not exist and consumption of personal services and entertainment was likely much less than it is today.

Life has changed dramatically since the 1930s. More types of entertainment are available today than in the 1930s including television, participant and spectator sports, indoor playgrounds, and a variety of digital entertainment. Growth in the number of two-earner families leads to greater need for services such as child care, housecleaning and gardening.

The closing of Tower Record stores in 2006 is a good example of recent changes in consumption patterns as digitally downloaded music becomes the preferred way to purchase music.[7] The ability and convenience of downloading software programs via the Internet rather than purchasing them on tangible media is also leading more of this consumption item to move from the taxable personal property category (off-the-shelf software on a CD) to a non-taxable category even though, like the music, the consumer ends up with the same result – the ability to listen to their favorite music or use software. In addition, changes in technology have created some new products and services that didn't even exist a decade ago, such as ring tones for mobile phones, or the ability to play a game with people who are not in the same room with you. The following data illustrate some of the changed and changing consumption patterns. Data on broadband deployment is also included since that type of powerful Internet access is needed to enable more types of consumption to occur digitally (such as software, music, games, and movies). Greater use of broadband will lead to a further decline in consumption of taxable tangible personal property and an increase in non-taxable consumption with the consumers obtaining the same end result.

- Changes in consumption have led to a drop in sales that are subject to the California sales tax. The Center on Budget and Policy Priorities reports that from 1990 – 2003, the percentage of sales subject to sales tax in California dropped by 13.4 percentage points. The median decline in the U.S. was only 8 points.[8]
- The Legislative Analyst's Office (LAO) noted that in 1981, 48% of consumption represented items subject to the California sales tax, but that amount dropped to 38% by 2005.[9]
- A 2002 legislative research study in Minnesota reported that in 1967, about 40% of personal consumption was of services and in 1999 that percentage had increased to 60%.[10] The Center on Budget and Policy Priorities reports that from 1970 to 2001, consumption of tangible personal property minus groceries dropped from 39% of household consumption to 33%. In addition, from 1970 to 2001, consumption of services increased from 31% of household consumption to 44%.[11]
- Household consumption data collected by the Bureau of Economic Analysis from 1970 to 2006 represents total US consumption. Thus, these figures would naturally grow during this time period due to increases in population. However, comparison of percentage changes among categories indicates that some categories grew more than others. For example, total consumption of food and non-alcoholic beverages grew by 66% from 1970 to 2006, clothing and footwear increased 394% and recreation and culture grew the most at 863%.[12]
- In the 1990's, spending in the U.S. on media and information services increased from $365 to $641 per person.[13]
- The opportunities for and use of micropayments has grown and likely will continue to grow, making it even more commonplace to download digital content.

- The U.S. Census Bureau estimated that for 2003, 41% of households with income under $25,000 had a computer, compared to 94.7% for households with $100,000 or more of income. The Bureau also estimated that in 2003, 30.7% of households with income under $25,000 had Internet access compared to 92.2% for households with $100,000 or more of income.[14]
- Adoption of broadband in U.S. households increased 40% from March 2005 to March 2006 which was double the growth rate from the prior year.[15]
- In March 2006, 21% of households with income below $30,000 had broadband access while 68% of households with income over $75,000 had such access.[16]
- A 2004 press release by Nielsen//NetRatings was entitled, "Affluent Americans Power Internet Growth." The report noted that at the income level of $150,000 or more, 69% of Internet users used broadband while 31% used narrowband. In contrast, in households with income under $25,000, broadband use was 25% which narrowband use was 75%.[17]
- The U.S. Census Bureau E-Stats Program data indicates that a growing percentage of software purchased via electronic shopping and mail-order are e-commerce sale as indicated by the data for 2001 through 2006 below.[18]

% of total electronic shopping and mail-order house sales via e-commerce for software					
2001	2002	2003	2004	2005	2006
29.9	35.2	42.6	49.6	53.0	52.0

- It has become more common to use certain software tools, such as those for tax preparation and bookkeeping, online rather than purchasing the software on a CD and loading it on a personal computer. [19] This marketing technique tends to make the transaction more of a service rather than a distribution of goods.
- Jupiter Research reports that in 2006, downloads of digital music increased more than 30%. They estimate that spending on digital music in the U.S. will be $2.5 billion by 2011. They also estimate that by 2011, 22% of music spending by U.S. consumers will be digital, and ring tones will represent 12% of such spending.[20]
- Growth of iTunes: In April 2007, Apple Computer's sales of iPods reached 100 million (sales started in 2001). Apple also reported that its iTunes Store has sold downloads of over 2.5 billion songs, 50 million TV shows and 1.3 million movies.[21]

  As reported in February 2008, Apple's iTunes Store is the second largest music retailer in the U.S. This data, from NPD Group also noted that in 2007 about 1 million people stopped buying CDs.[22] In June 2007, iTunes was ranked third with about 10% of the market. The largest music retailer in June was Wal-Mart (15.8%) followed by Best Buy (13.8%).[23]

  On April 3, 2008, Apple announced that iTunes sales had passed those of Wal-Mart making iTunes the largest music retailer in the U.S. (based on data from the NPD Group). Apple noted that iTunes has over 50 billion customers and has sold more than 4 billion songs in less than 5 years.[24]
- In 2007, eMarketer estimates that individuals in the US spent $1.1 billion for music to be listened to on their mobile phones. The research firm estimates that this amount will be $2.8 billion in 2011.[25]
- There is increased use of computers to play video games, rather than using game consoles and purchasing games on tangible media. A 2004 report indicated that revenues from online games would triple by 2008 to $1.1 billion. The study also expected revenues from multi-player online games to more than double from 2004 to 2008.[26] The ability to play games online without purchasing a tangible product (other than the computer) has generated a market that consists of both digital items, as well as services – connecting people across the globe to play together ("massive multiplayer online role-playing game" or MMORPG) and creation of tournaments that people can pay a fee to

enter and play. The fee structure and revenue models vary such that it may look like the purchase of a game, an entry fee, or a subscription fee.

VIII. Why Broaden the Tax Base

Ten reasons are explained next as to why the California sales and use tax base should be broadened.

1. *Opportunity to lower a high tax rate:* The California sales tax rate is already high (roughly 9%, but varies from county to county). Broadening the base would enable the rate to be lowered.

   California's state rate of 6.25% (prior to 4/1/09) was the 8th highest among state tax rates, as of January 1, 2007. The highest state rate at that time was 7% and the lowest (not counting the few states that do not impose a sales tax) was 4%. Selected state sales tax rates:[27]

Massachusetts	5.0%
Michigan	6.0%
Mississippi	7.0%
Nevada	6.5%
New Jersey	7.0%
New York	4.0%
Washington	6.25%

   Proposals to increase the sales tax rate to raise revenue are common and a one percentage point increase was enacted to balance the budget in early 2009. Given the already high sales tax rate in California and the changes in consumption to include more non-taxable intangibles and services, a rate increase is not the ideal technique to generate more sales tax. (This is further explained in the tax policy analysis at the end of this report.)

2. *Equalize varying forms of personal consumption*: Economically, there is no rationale for taxing some forms of personal consumption while exempting others. That is, there is no reason to tax laundry detergent, but not dry cleaning services. Similarly, there is no reason to tax a game in a box but not one played only on the Internet, or to tax a movie rental, but not a movie theater ticket, or to tax software purchased on a CD to load onto a computer hard drive, but not when downloaded directly from the Internet to the hard drive.

   Today's exemption for intangibles and services seems to be primarily based on history in that when the sales tax was created in 1933, tangible personal property was the key consumption item.

   The current sales tax base creates odd results where similar consumption it not taxed similarly. Consider the following example:

Individual A	Individual B
Music CDs	Music downloaded over the Internet Tickets to live concerts
Household cleaning supplies	Housekeeper
Movie rentals	Movie theater tickets

   While it appears that both individuals A and B have similar end results of the consumption they enjoy and can afford, the consumption noted above for Individual B is not subject to sales tax while that of Individual A is all subject to sales tax. This inequity is made worse by the reality that B's consumption items generally all cost more than the consumption items for A (further discussed below at item #5).

3. *Tax relief for low income individuals could be better targeted*: Some exemptions reach beyond the intent of the exemption. For example, the exemption for food includes milk and vegetables, but also a $30 block of cheese purchased at a gourmet grocery store, candy, and bottled water. Assuming the food exemption is to benefit purchases that are necessities of life (as described by the BOE), it is too broad and not targeted to the taxpayers needing relief. Another option is to tax all food but then provide relief to low-income individuals through other means such as a refundable income tax credit. The exemption for utilities has the same flaw – it is not targeted to provide relief to individuals who most need it. Instead, everyone, regardless of income level and the size of their home does not have to pay sales tax on their utility bills.

   Another flaw with many of the exemptions is that they provide a greater benefit to higher income individuals because generally, they spend more on average than lower income individuals. Thus, exemptions provide a far greater savings of tax dollars for higher income individuals relative to lower income individuals. For example, the US Bureau of Labor Statistics reports the following average annual expenditures for 2006:[28]

Item	All consumer units	(A) Consumers under $70,000 income	(B) Consumers with $150,000 and higher income	(B) / (A)
Food at home	$3,417	$2,784	$5,736	2.06
Utilities, fuels and public services	$3,397	$2,881	$5,738	1.99
Entertainment	$2,376	$1,500	$7,606	5.07
Personal care products and services	$585	$422	$1,322	3.13

4. *Address base erosion*: As consumers have increased their consumption of services and intangibles (such as digital downloads) and decreased their consumption of tangible personal property (see data at Section VII), the sales tax base becomes outdated and generates less tax revenue.

   California's tax base will continue to erode. For example, more types of items will be shifted to digital form, such as books and movies. If the sales tax base is not broadened, then to preserve revenue, we will soon end up with a very high rate applied to a small amount of items. That situation must then cause us to ask why we'd continue such an inequitable and unstable tax. It would be difficult, if not impossible though, to find a replacement for the sales and use tax, which generates roughly 25% of general fund revenues.

5. *Improve the distribution of the tax burden:* As noted in the data presented earlier, some changes in consumption patterns are not consistent across income groups. For example, consumption of digital goods and services are more significant for higher income individuals than for lower income individuals raising issues of fairness and equity with the current narrow tax base. In addition, given the high cost of many entertainment and professional sports activities, they are more likely to be consumed by higher income individuals. For example, an adult ticket to see the San Jose Sharks hockey team play at the HP Pavilion in March 2009 ranged in price from $20 to $175. A "VIP" ticket cost $299. In March 2009, individual tickets to see Billy Joel and Elton John 8 months later ranged in price from $200 to $1,525. A single ticket to see the musical Wicked in San Francisco on a Saturday evening in July 2009 ranged from $75 to $214. To exempt these types of luxury consumption items from sales tax while taxing tangible personal property such as books, music CDs and shoes makes the system unfair.

6. *Make the sales tax more stable*: A broader base can make a tax more stable (less volatile). For example, in an economic downturn, people may purchase fewer tangible goods, such as cars and

household appliances. However, consumption of food and some services may not drop as quickly enabling tax collections to not be as severely affected as could happen with a narrower tax base.

Also, if more types of consumption are subject to the tax, changes in consumption patterns will have a lesser impact on collections. For example, if the tax base had originally been defined to include personal consumption other than basic medical care, shifts from purchasing music or software on tangible media to digitized format would not have eroded the tax base.

7. *Reduce complexity and improve fairness*: A broader tax base can improve the ability of a tax to meet the principles of simplicity, efficiency and fairness. Tax laws are complicated whenever something is exempt from the tax or subject to a special rule. Exceptions require special definitions which are not always easy to write or enforce. For example, several years ago, California started taxing snack food but then found it was very difficult to define a snack and the tax was later repealed. A tax base with few exceptions not only allows for a lower rate, it can also improve compliance and administration, and lead people to view the tax as more fair (because everyone is paying the tax or all consumption items are subject to the tax). Application of the sales tax to all non-real property consumption of individual consumers can simplify the law by eliminating the need for defining exemptions. Relief for necessities of life, such as food, can be provided through other means, such as a refundable income tax credit.

8. *Improve economic development at the local level*: California cities tend to be fairly dependent on the sales and use tax. Today, one technique for increasing local revenues is to bring large retailers into the city or a corporate sales office in order to generate sales tax revenue. A broader base would likely lead cities to be more equitable in decisions regarding economic development by also making it desirable to have businesses that do not sell tangible personal property.

9. *Improve California's ability to compete with other states for businesses*: States compete among themselves for businesses by offering special tax deductions and credits, low tax rates for businesses and non-tax attractions such as a high quality infrastructure. A state that has broadened its tax base to stop erosion is better able to offer incentives to attract businesses to locate in the state. California's action of increasing the sales tax one percentage point in early 2009, rather than broadening the base to cover more types of personal consumption, further harmed the state's ability to compete for businesses because businesses will now have to pay the higher sales tax on their equipment and R&D materials and supplies.

Other states tend to have a broader sales tax base than does California. A majority of states tax off-the-shelf software whether transferred on tangible media or electronically. These states include Arizona, Massachusetts, Michigan, Minnesota, New York, North Carolina, Ohio, Texas, Washington, and Wisconsin. In addition, other states tend to tax more types of services relative to California.

In 1990, the Federation of Tax Administrators (FTA) began studying the sales tax treatment of 160 services by the states. Changes in some states expanded the FTA's list of services tracked in the survey to 168 in 2004. Hawaii and New Mexico tax the greatest number of services. Of the 168 types of services studied, at 7/1/07, the FTA found the following:[29]

State	# of services taxed
California	21
Florida	63
Hawaii	160
Massachusetts	18

Minnesota	66
Nevada	18
New Mexico	158
New York	57
Ohio	68
Texas	83

Per the FTA: "most states tax services to a certain degree. Despite the political rhetoric, there are many services that do not pose controversy and are widely taxed." The FTA observes that utilities are taxed in most states are as admissions and repair services.[30]

Most of the 21 "services" taxed by California are ones that many might think of as being tangible personal property. For example, these services include tuxedo rental, gift wrapping and photocopying.

Some states have recently expanded their sales tax base to include digital items. As noted earlier, New Jersey began taxing specified digital purchases of consumers in 2006. Other states that expanded their sales tax base to include specified digital goods, starting in 2009 include:

- Wisconsin[31]
- Mississippi[32]
- North Dakota[33]

Other states are considering broadening their sales tax system to include some digital goods. For example, S 487 and H 558 (2009) in North Carolina propose to "modernize the sales and use tax statutes by treating music, movies, books, and computer software that are delivered electronically the same as those that are purchased in a tangible medium."[34]

Again, an important point about differences in the sales tax base among states is that it can mean that other states have more leeway to offer reduced taxes to businesses to encourage them to remain in or to locate in the state. Businesses have called for reductions in the corporate and personal income tax rates to improve the competitiveness of businesses in California. They have also called for removing sales tax from business inputs[35] (such as by exempting sales tax on manufacturing equipment as many states already do). Other tax changes will be needed to achieve these important goals. They are unlikely to be achieved without broadening the sales tax base to include more types of personal consumption (other changes would be needed to other existing taxes and new sources, such as an oil severance tax or carbon taxes might also be needed).

10. *Need for periodic review*: Exemptions and exclusions for any tax should be reviewed periodically to determine whether the original reason for their creation remains valid. Also, as the economy changes, tax systems need to be updated/modernized. As noted by Governor Schwarzenegger in establishing the Commission on the 21st Century Economy:[36]

> "The California economy has changed significantly since our tax code was designed for the economy of the last century, shifting from a primarily manufacturing- and agriculturally-based economy to an information- and innovation-based economy."

IX. Challenges to Broadening the Sales & Use Tax

Change in general: While in theory, it may seem simple to broaden the sales tax base and lower the tax rate, in reality, such a change is complicated and politically challenging. First, any change is difficult in that people are very used to what they currently know. Consumers are likely to view any change as a tax increase (even if the rate is lowered) if something they did not pay tax on before, such as digital downloaded items, becomes taxable. Businesses will also face challenges of learning new rules to determine what is taxable and what is not taxable. Also, some businesses that currently have no sales tax filing obligations will have increased compliance costs of filing returns. Of course, businesses that have been collecting sales tax and filing returns are unlikely to be sympathetic to such concerns.

Also, once an exemption exists, it is difficult to remove. A comprehensive study of California taxes in 1964 also noted the challenge of removing exemptions, noting that what usually happens is the exemption grows once in the law.

> "Once an exemption is adopted, efforts are made to enlarge its scope. Experience has produced the expression "exemptions beget exemptions." When individuals and businesses can choose between items subject to tax and those not subject to tax, manipulations result which invite pressures from others for broadening of exemptions to eliminate unfair competition."[37]

Finally, there are likely some consumption items people will strongly object to paying tax on, particularly those in the "necessity of life" category such as food. Legislators may determine that public policy or administrability considerations may call for some types of consumption to remain exempt, such as perhaps, medical care.

Yet, change is possible, and arguably required given economic and societal changes that have occurred since the 1930's. Many states have broadened their sales tax base from what it was when first created decades ago and there are ways to transition in changes to alleviate concerns. In addition, emphasizing the benefits of a modernized sales tax system may encourage taxpayers to embrace change and progress.

Constitutional constraints - food: The constitutional change from the passage of Proposition 163 in 1992 prohibits application of sales tax to most food products (it added Section 34 to Article XIII of the California Constitution). Efforts to reform this large exemption, such as to better target it to low income taxpayers, will require a constitutional change – not an easy thing to do, but not impossible. If voters understand that removal of the constitutional prohibition against taxing food would include legislation for a refundable credit for low-income individuals (on a sliding scale depending on income), they would likely see the change as better targeting this exemption that provides a bigger benefit to higher income individuals relative to lower income taxpayers.

Constitutional constraints – state and local vote requirements: The California Constitution, Article XIIIA, Section 3 provides: "any changes in state taxes enacted for the purpose of increasing revenues collected pursuant thereto whether by increased rates or changes in methods of computation must be imposed by an Act passed by not less than two-thirds of all members elected to each of the two houses of the Legislature, except that no new ad valorum taxes on real property, or sales or transaction taxes on the sales of real property may be imposed."

Per Article XIIIC, Section 2: "No local government may impose, extend, or increase any general tax unless and until that tax is submitted to the electorate and approved by a majority vote." If the local tax is a "special tax", a 2/3 vote of the electorate is required (Article XIIIA, Section 4; Article XIIIC, Section 2(d)).

Broadening of the tax base should be viewed as a tax increase as it would apply to consumption items not currently taxed, even if the rate is lowered in a revenue neutral proposal.

The sales tax base is defined by state statute thus, perhaps a base broadening should not be considered a tax imposed or increased by local government. It is unclear if a vote of local voters is needed to broaden the sales tax base.

Privilege versus sales tax: R&T Section 6051 that imposes the sales tax literally refers to the tax as imposed upon the "privilege of selling tangible personal property at retail." In contrast, the companion to the sales tax – the use tax, is imposed as an "excise tax" "on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer." Thus, some may argue that the California sales tax is not a tax on consumption, but a tax on doing business as a retailer selling tangible personal property. This appears to be more of a form over substance position. The tax return used by sellers is called a sales and use tax return, rather than a privilege tax return. Also, retailers add the sales tax to the amount they charge the customer and it appears on their invoice as a separate item they were charged. R&T §6203 calls upon the retailer subject to tax to collect it from the customer and show the amount on the invoice. When a retailer opts not to collect the sales tax, it is typically presented as a special promotion, such as "no sales tax on purchases this weekend." For accounting purposes, the sales tax is not included in revenues, but is treated as a balance sheet item only.

Thus, it appears that the better argument is that while in form, the sales tax is a privilege tax, in substance it is a tax on the consumption of tangible personal property (unless the property is exempt).

Concerns about taxing services: Any talk about applying sales tax to services will lead many to raise the past instances in Florida and Massachusetts, and more recently – Michigan, as to why it cannot be done despite the reality that several states successfully tax many types of services. In 1987 and 1990, respectively, Florida and Massachusetts began to tax some services and soon thereafter, repealed that tax.

Issues that arose in the states where an expanded sales tax failed are ones that can be prevented, as evidenced by the application of taxes on some services in other states today, such as Minnesota and New Jersey.[38] For example, advertising was one of the services covered under Florida's expanded sales tax. This was problematic because it can be difficult to determine where advertising services should be taxed. If the services were provided from outside of the state, arguably, the in-state user would need to self assess. What if the advertising services benefited a taxpayer with operations in more than one state – how would such services be allocated to Florida and should any be allocated there. This problem is not one that should translate into believing that a tax on services is unworkable. Florida should have prevented the advertising problem by not subjecting services used by businesses to sales tax. When businesses pay sales tax, it is added into their pricing structure and consumers indirectly pay the tax. If the items sold are subject to sales tax, then there is a tax on a tax (known as pyramiding).[39]

A problem with the failed Michigan sales tax on services is that the implementation period was only 2 months! HB 5198 was signed into law on October 2, 2007 and tax was to be collected on 23 services starting December 1, 2007. Two months is not enough time for the state tax agency to provide outreach and training to service businesses that become subject to sales tax collection. It doesn't provide time for the services businesses to get their systems in place to be able to collect the tax. The enacting legislation also provided no financial assistance to the businesses.

Use tax collection: A broadened sales tax base will increase the amount of uncollected use tax. That is, many of the items in a broadened sales tax will be purchased from vendors who have no physical presence (nexus) in California, thus no sales tax will be collected (unless the vendor has voluntarily registered to collect it). However, the California buyer will need to self-assess and pay use tax on the purchase. Use tax collection is weak and a broadened sales tax base will lead to a greater amount of uncollected use tax. Efforts can be made though to address this collection problem.[40]

Effect on businesses: Businesses that become subject to sales tax collection under a broadened sales tax will need to start filing sales tax returns and implementing accounting systems to enable them to properly assess and collect the tax. The state can help by offering refundable tax credits and training. Some argue that a sales tax on personal services will burden independent contractors and small businesses, such as a personal trainer or pet walker. This concern can be alleviated by making compliance as simple as possible. The federal government has provided a good example of this simplicity in the ability of individuals to report payroll taxes for household employees on a form attached to their income tax form rather than dealing with quarterly and annual payroll tax reports.[41] For small businesses and independent contractors, a similar system can be established with training and instructions provided by the BOE.

Some service providers already collect sales tax and file sales tax returns because they also sell goods. Examples of such businesses include beauty salons, auto repair shops and veterinary clinics.

Concerns are also likely to be raised that the burden of taxing services will fall more on small business than larger ones because larger businesses may start to hire more employees rather than pay sales tax on outside or contracted services. This is unlikely in all cases in that businesses often need certain services on a sporadic schedule or need an independent service provider (such as for accounting or legal services). This and the related issue of tax pyramiding should be avoided by not having businesses subject to the broadened sales tax base.

Another concern likely to be raised is that businesses will find it cheaper to contract for taxable services with providers located outside of California who are not required to collect the sales tax, thus leading to a drop in business for California service providers. However, California taxpayers would still be required to self-assess and pay use tax on such services. In addition, for many of the services, such as theater admission, haircuts, lawn care and veterinary services, taxpayers will not obtain the service from out of state to avoid the sales tax. Ideally, this issue and the related issue of tax pyramiding should be avoided by making businesses exempt from the broadened sales tax base.

Effect on local governments: Broadening of the sales tax base accompanied by a rate reduction intended to achieve revenue neutrality, will result in winners and losers among local government. For example, some cities have a strategy of attracting retailers that generate sales tax for the city. A drop in the tax rate may lead to a greater decrease in tax collections from the retailers than will be made up by the taxes collected on items newly subject to the sales tax. This issue can be addressed by gradually expanding the tax base and lowering the rate rather than doing it all at once. Other transitional relief might include measuring city sales tax revenue for the three years preceding the change. If the tax change results in reduced collections of a certain percentage, the city would be compensated from a pool of funds gathered for this purpose. The percent of compensation would be phased out over a few years to give cities time to adjust to sales tax revenue changes.

Some argue that application of sales tax to some types of services will encroach on tax bases that local governments use such as on utilities. However, of the 480 cities and 58 counties in California, only 145 cities and 4 counties apply a utility user tax to gas and electricity.[42] Discussions of base broadening though, should not ignore concerns and transitional needs of local governments.

Ease of finding reasons not to tax: It is easy to find reasons not to tax something. These reasons must be carefully scrutinized to determine whether principles of good tax policy and public policy considerations warrant not taxing something. For example, a government will likely find it inefficient to impose an income tax on food stamps that it distributes. However, an argument that imposing a sales tax will harm or terminate an industry is questionable. For decades, sales tax has been collected by retailers of tangible personal property without argument (or evidence) that it would put them out of business.

Many of the arguments raised in opposition to taxing certain items are just distracters from the important work that needs to be done to reform and modernize California's tax system. Dubious arguments should be addressed professionally and not allowed to prevent improvement of California's tax system. Appendix A to this report lists some of the arguments raised as to why services should not be subject to sales tax with counterarguments noted.

X. Implementation Recommendations

To be viable and effective, the California sales and use tax needs to be brought into the 21st century. One significant change is to address the changed consumption patterns from the 1930's to today. Broadening the tax base would also enable the high tax rate to be reduced and would also provide opportunities for revenues to address state and local needs, if desired. No doubt, changing the base would be a major change.

California would not be alone in broadening and modernizing its sales tax base. Several states already tax more consumption items than does California and several states are broadening their base to include digital items (particularly where they are substitutes for tangible items, such as music). For example, starting October 2006, New Jersey's expanded its sales tax base to include more services and "digital property" defined as "electronically delivered music, ring tones, movies, books, audio and video works and similar products, where the customer is granted a right or license to use, retain or make a copy of such item. Digital property does not include video programming services, including video on demand television services, and broadcasting services, including content to provide such services." The base was also extended to prewritten software delivered electronically unless used directly and exclusively in the conduct of business.[43]

How to make base broadening workable: Listed below are some recommendations for implementing changes to the sales and use tax base.

1. *Public education:* Find ways to increase understanding of the sales and use tax among California taxpayers. Information provided should cover the nature of the tax (a consumption tax), its role in providing state and local revenues, what it applies to and what is exempt, the cost of exemptions and exclusions, the significant tax savings enjoyed by higher income individuals who enjoy significant sales tax breaks today, and the adverse affects to the tax and budget systems of not updating the base. In addition, information about changes in consumption patterns over the past few decades should be provided.

2. *Lower the rate:* <u>Be sure that base broadening is accompanied by a tax rate reduction.</u> The key reason for broadening the sales tax base should be to make it more fair and stable, not to raise revenue.

3. *Transition in the changes:* Do not make all changes at once. The base should be broadened over a period of years to provide an opportunity for taxpayers to adjust to the changes and for the BOE to be able to provide the necessary assistance to businesses that become subject to sales tax collection and filing responsibilities. However, to aid both businesses and consumers, the broadening plan should ideally be enacted at once, but with effective dates that span a period of one to three years.

   Sufficient lead time must be provided to enable businesses that become subject to sales tax collection have time to implement the necessary systems and train employees.

4. *Start with items we are used to paying tax on:* Start with areas where consumers are already used to paying sales tax, such as on digital items that are the equivalent of the tangible item. Purchases of digital items by businesses should be exempted in order that our current pyramiding problem is not worsened. The changes made in New Jersey in 2006 can serve as an example of exempting business purchases.

   In broadening the sales tax to include more services, start with those provided by businesses that also sell tangible personal property and thus already collect sales tax file sales tax returns. For example, veterinary clinics collect sales tax on products they sell, as do many repair businesses and hair salons.

5. *Avoid consumption by businesses:* To broaden the coverage of services, start with ones that are primarily used by consumers rather than also businesses. This will lessen the pyramiding problem that already exists in the sales tax system. In addition, these types of services are ones that are unlikely to pose use tax collection problems because they are obtained from California-based providers. Examples of personal services include pet services, shoe repair, car washes, hair styling, diaper service, health clubs, dry cleaning, parking, bowling alleys, admission charges to entertainment events, self storage fees, personal instruction, and veterinary services. To avoid exacerbating the pyramiding problem that already exists in the California sales tax system, purchases of services and digital items by businesses should be exempt (even if not for resale). Eventually, California should work towards eliminating pyramiding in the sales tax system.

6. *Avoid definitional exemptions whenever possible*: The "all or nothing" approach is the simplest way to define a tax base. California learned this lesson in the 1990s when it expanded the sales tax to snack foods. Because non-snack food was exempt, it was necessary to define snack food, which proved to be too difficult, making the tax unworkable. If California had instead applied tax to all food (or no food), there would be no need for special definitions that lead to added compliance costs and errors. For example, if the sales tax is expanded to cover veterinary services, the tax should apply to all charges by veterinarians (the tax already applies to tangible personal property sold by a veterinarian). Should the state not want to apply the tax to the cost of getting a rabies shot, for example, relief should be provided outside of the tax system in order to avoid the need to complicate the law by having to define "services related to a rabies vaccination."

7. *Include any necessary relief for low-income individuals:* If consumption items added to the base are ones likely to impact low-income taxpayers, also enact a refundable income tax credit (or similar type relief) for such taxpayers. That is, provide *targeted* relief. Such a credit can be based on the federal earned income tax credit (EITC) to help working families; other types of relief is needed for low-income individuals who do not work, such as senior citizens (which could be done through a refundable income tax credit based on age and income).

8. *Use new simplified compliance measures:* Simplified compliance techniques should be developed, particularly for small businesses of under a certain amount of gross receipts (such as $1 million). For example, instead of quarterly filing, consider annual filing and provide paper and online recordkeeping tools to businesses. Allow small businesses to remit the sales tax on their income tax form (a concept similar to how the federal government allows individuals with household employees to pay employment taxes on their income tax forms) . The use of technology should be included in the compliance and administration of the broadened sales tax to improve compliance and reduce vendor costs.[44]

9. *Compensate vendors:* Base expansion will cause more businesses to be subject to sales tax compliance. California should provide a refundable tax credit to alleviate start-up costs for these businesses and ideally, provide compensation for all businesses that collect sales tax.

10. *Perform necessary legal analysis beforehand:* Federal and state rulings should be reviewed for help in properly defining the expanded tax base. A 1987 Florida ruling provides insights on reducing the likelihood of legal challenges. Among other findings, the court noted that imposition of sales tax on legal services was permissible. Per the court, states have flexibility and discretion in selecting items to be taxed "provided that the classification is reasonable, nonarbitrary, and rests on some ground of difference having a fair and substantial relation to the object of the legislation." (*In re Advisory Opinion to the Governor*, 509 So 2d 292, 303 (FL 1987))

    Case law should also be reviewed to aid in drafting rules on nexus and determining the tax on services performed and/or delivered to more than one state.

11. *Learn from other states*: Other states have already broadened their base, such as Minnesota and New Jersey, and California can learn from their experiences. In addition, most states tax off-the-shelf software regardless of the delivery mode and lessons can be learned from these states as well.
12. *Don't create or exacerbate tax and budget system problems:* Avoid creating or exacerbating other weaknesses in the tax system. For example, the revenues should not be earmarked for special purposes. Also, pyramiding should be avoided by only taxing services used personally (not by businesses) or exempting businesses from the tax.[45] In addition, given the importance of sales and use tax to local governments, the state legislature should work with local governments in broadening the base.

XI. Tax Policy Analysis[46]

The following chart explains how a sales and use tax with a broadened base would satisfy the principles of good tax policy. The rating in the last column indicates whether base broadening would improve the current system.

Principle	Application and Analysis	Rating
Fairness		
Equity and Fairness Similarly situated taxpayers should be taxed similarly.	Broadening the sales tax base will make the system fairer because all taxpayers would have their consumption subject to tax regardless of whether it is tangible personal property, intangible or services. Some of the currently untaxed consumables, such as digital items, entertainment and personal services, are more significant consumption items to higher income individuals than for lower income individuals. Thus, broadening the base will lead to higher income individuals paying their "fair share." "Experience demonstrates that generally broad-based taxes using lower rates tend to be more equitable than narrow-based taxes with higher rates. Exemptions reduce the base. Consequently, higher rates are required to produce a given amount of revenue."[47] Any adverse effects base broadening (with a rate reduction) has on low-income individuals can be compensated through a refundable income tax or similar transfer.	+
Transparency and Visibility Taxpayers should know that a tax exists and how and when it is imposed upon them and others.	Broadening the base should have no appreciable effect on transparency. Assuming the sales tax continues to be separately reported on invoices, taxpayers will know it exists and its amount.	No effect
Operability		
Certainty The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined.	Broadening the tax base should improve the ability of the sales tax to meet the principle of certainty. Exemptions require detailed definitions so it is clear what is taxable and what is not. However, the rules can become outdated with changes in transactions. When more items transferred to individual consumers are taxable, there is less uncertainty as to whether something should be taxed. Also, even if a few broad categories of items, such as perhaps basic medical care, remained exempt, there would be fewer rules and more certainty as to whether something was subject to sales tax.	+

Convenience of Payment A tax should be due at a time or in a manner that is most likely to be convenient for the taxpayer.	The basic operation of the sales tax will not change with a broader base. The sales tax would continue to be imposed on the seller who can collect it from the buyer. When this process is followed, the buyer knows the total cost of the purchase before finalizing that purchase. A broader base will increase the number of transactions where the buyer owes use tax because the vendor has not physical presence (nexus) in California. Better education of the public as to the existence of the use tax and how to pay it will help buyers to know that a purchase from a remote vendor is not tax-free, but that they will need to pay use tax on the purchase.	No effect
Economy in Collection The costs to collect a tax should be kept to a minimum for both the government and taxpayers.	While a broadened sales tax base will lead to more businesses with sales tax compliance obligations, it should be possible for the BOE to implement techniques to keep compliance costs low for taxpayers. However, administrative costs for the BOE will increase with more taxpayers in the system although the additional costs should be minor relative to the amount of tax collected.	Not significant
Simplicity The tax law should be simple so that taxpayers can understand the rules and comply with them correctly and in a cost-efficient manner.	Broadening the base of a tax and removing exemptions and exceptions should make the law simpler because fewer definitions are needed. Compliance tools and techniques can be created by the BOE to keep compliance costs down for taxpayers, particularly small businesses.	**+ / -**
Minimum Tax Gap A tax should be structured to minimize non-compliance."	Base broadening will result in more businesses that have sales tax collection and return filing obligations. The addition of more taxpayers will likely lead to a greater amount of tax that is not collected. On the other hand, a lower rate tends to reduce non-compliance. In the early years of implementing base broadening, it is likely that some portion of the tax on the expended consumption items will not be collected due to confusion about the change, some taxpayers looking for loopholes and perhaps some tax protesters. With more types of consumption items subject to tax, the existing use tax gap will increase.	**+ / -**
Appropriate Government Revenues The tax system should enable the government to determine how much tax revenue will likely be collected and when.	A broadened sales tax base should not pose any problems for the government in determining its tax collection amount because it already has data on consumption by individuals. A broadened base should reduce volatility of the tax which will benefit governments. The growth of the Internet and the many new possibilities for businesses to generate revenue did not lead to an increase in sales tax collections. This is because many types of new products and services possible with the Internet are not the types of consumption subject to the California sales tax. A broadened tax base that includes consumption in various forms (rather than only tangible personal property) would allow sales tax revenues to track better with economic growth.	+
Appropriate Purpose and Goals		
Neutrality The effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.	Broadening the tax base to impose sales tax on digital or intangible items that are the equivalent of a taxable tangible item will better enable the sales tax to meet the neutrality principle. For example, today, a taxpayer may be inclined to obtain software or music or a movie online rather than on a CD in order to avoid paying sales tax on the transaction. Broadening the sales tax to include all or several types of services may lead businesses to hire employees to do work that otherwise would have been contracted out; such action will avoid sales tax on the transaction. Taxation of services might affect the decision of some businesses as to	**+ / -**

	how they hire some workers (employees or contractors). This issue would not exist though if businesses were exempt from paying sales tax which is necessary to avoid pyramiding where a tax is paid on a tax.	
Economic Growth and Efficiency The tax system should not impede or reduce the productive capacity of the economy.	Application of the sales tax to more types of personal consumption along with a rate reduction could benefit industries that today seem to bear the full brunt of the sales tax if they sell tangible personal property. Spreading the sales tax out among more types of consumption should make the tax more efficient. There could be concern about a drop in business activity for some businesses that become subject to sales tax collection due to the price increase from passing the tax onto their consumers. It is not clear how true this is and will likely vary depending on the particular item involved. A broadened tax base that includes consumption in various forms (rather than only tangible personal property) would allow sales tax revenues to track better with economic growth.	+ / -

XII. Additional Reading

California Board of Equalization, Staff Legislative Bill Analysis, AB 9, 4/18/05.

California Commission on Tax Policy in the New Economy, Final Report (Dec. 2003); recommendations for broadening the sales tax base (pages 12 – 21) and background on the sales and use tax (pp 115 – 119 and 132 – 136); available at http://www.library.ca.gov/crb/catax/ .[48]

California Legislative Analyst's Office (LAO), California's Tax System: A Primer (April 2007).

Governor Schwarzenegger, Budget Proposal for 2009-10 (see "Revenue Estimates," page 64). The sales and use tax was proposed to be extended to the repair of appliances, furniture and vehicles, as well as veterinarian services. It was also proposed to be expanded to "amusement parks, sporting events, and golf." The report noted the "ease of implementation as these services are generally provided by entities that already have a relationship with the Board of equalization."

Mazerov, Michael, Why Tax Services?

Nellen, Annette, "Obstacles to Taxing Services – Are They Insurmountable?" AICPA *Corporate Taxation Insider*, 2/28/08.

Nellen, Annette, "Lower the sales tax - but reform what gets taxed," *San Jose Mercury News*, 7/24/11.

California SB 8 and SB 1445 (2015-2017; Hertzberg) – proposal to broaden sales tax base to services.

More Information on California Tax System Weaknesses and Possible Solutions

http://www.21stcenturytaxation.com/california-tax-reform.html

This site has reports, short articles, links and the *21st Century Taxation Blog*.

Appendix A

Countering Arguments as to Why the California Sales Tax Base Cannot or Should Not Be Broadened

An Internet search will produce position papers on why state sales taxes should not be broadened. The details of the counterarguments below can be found in the body of this report.

Reason suggested for why the sales tax base cannot or should not be broadened	Counterargument
Base broadening failed in Florida, Massachusetts, Maryland and Michigan	In Florida, Massachusetts and Maryland, the base was broadened to primarily bring in services purchased by businesses. This approach should not be followed in California because it makes the pyramiding problem worse and it is difficult to source services purchased by businesses. The Michigan broadening covered 23 services primarily consumed by individuals. This law was enacted on October 2, 2007 and was to go into effect on December 1, 2007. Two months is not enough time for the tax agency and the businesses newly subject to collection to get ready to comply. Thus, this tax was doomed from the start. A longer period is needed between the enactment date and effective date. Base broadening has occurred in other states successfully, such as in New Jersey in 2006 when specified digital items and personal services were added to the base.
Taxing services will make the pyramiding problem worse. Taxing bunker fuel is problematic.	Do not include services only consumed by businesses when broadening the base. For items consumed by both businesses and individuals, such as software downloaded over the Internet, create an exemption for businesses. This will be a start in perhaps eventually moving the California sales tax to rely less on pyramiding. Do not broaden the base by repealing exemptions that only apply to business purchases.
A broader base will make the sales tax more regressive, harming low income taxpayers.	Broadening of the base should be accompanied by a rate reduction. That will address some of the regressivity inherent in the sales tax. If the base is broadened to include "necessities of life" such as food, a refundable income tax credit should be created for low-income individuals.
A broader base will increase the cost of family entertainment.	A bigger concern should be that not broadening the base, but continuing to increase the rate on a narrow base is a bigger harm because it increases the cost of clothing, gasoline, books and household supplies. It is possible that sellers of non-taxable consumption items factor that savings into pricing decisions making it easier to increase prices relative to what sellers of taxable tangible personal property are able to do. For example, sellers of taxable property must also factor in higher sales tax when determining price increases, while sellers of non-taxable items do not. Base broadening should be accompanied by a rate reduction.

	Significant entertainment dollars are spent by high income individuals as ticket prices for live theater, sporting events and concerts are often beyond the budgets of low and middle-income individuals. Thus, the exemption that exists today for the consumption of entertainment provides a significant benefit to higher income individuals that is inequitable and unfair.
A broader sales tax base will lead to a greater amount of uncollected use tax because some of the items to be included in the base will be purchased from sellers not legally obligated to collect sales tax in California.	This is not a reason not to improve the sales tax. Instead, it highlights reasons why it is important that the state find better ways to collect the use tax.
There is no data to support that consumption has shifted from tangible personal property to digital goods and services. Changed consumption patterns might be that we are consuming more items likely to remain exempt, such as health services.	Data is needed to justify this claim. Data on consumption noted earlier in this report, such as on sales of digital music, indicate that some consumption is moving from taxable tangible personal property to non-taxed intangible property and that trend is growing. Also, data indicates that one of the largest increases in consumption in the past few decades is in entertainment.
Patterns of consumption of tangible personal property have shifted up and down over the decades as evidenced by entertainment which was primarily non-taxed until the advent of video cassettes.	Given today's technology, it is unlikely that people will revert from digital music to CDs or even vinyl records. Also, entertainment in the form of tangible personal property has existed for as long as California has had its sales tax. In the 1930s, people purchased tangible records (LPs). This argument also distracts from the focus on making the sales tax a more fair and efficient tax by taxing more types of personal consumption - tangible, intangible or a service.
Expansion of the sales tax would impede on tax bases preserved for local governments, such as utility charges.	Of the 480 cities and 58 counties in California, only 145 cities and 4 counties apply a utility user tax to gas and electricity.[49] This is not a reason not to broaden the sales tax base. This might be a reason to delay in broadening the tax to cover utility charges. Cities should be involved in discussions on expansion of the sales tax base as it affects them in more ways than the utility user tax (UUT).
If "necessities of life" continue to be exempt, there is little revenue to be generated by broadening the sales tax base.	Personal consumption of other categories of currently exempt items is significant, such as entertainment, digital goods, and personal services. Revenue should not be the focus, rather equity, fairness and stability. Data from prior and current proposals to broaden the sale tax base indicate that significant sales tax revenues could be generated from taxing more types of consumption of individual consumers. This indicates that a rate reduction could accompany base broadening. The governor's budget proposal for 2009-2010 included broadening the sales tax base to include charges for repairing appliances, furniture and vehicles, as well as veterinary services. The proposal also included applying sales tax to amusement parks, sporting events

	and golf. These changes were estimated to generate $1.2 billion for 2009-2010, plus additional amounts for local governments.[50] A letter from the staff of the Commission on the 21st Century Economy to the commissioners notes that broadening of the sales tax base to include almost 40 services would generate about $5.3 billion from individuals. If the base were broadened to include about another 30 services, about $21 billion would be generated from individuals (not from business purchases).[51]
A broadened sales tax base will increase costs for state and local governments and agencies because they are subject to sales tax.	Broadening of the sales tax base should only include items purchased for personal consumption. Thus, broadening the base to include movie theater tickets, hair cuts, and veterinary services will not affect state and local governments. Where businesses are exempt from an item, such as software downloaded over the Internet, consideration must be given to whether governments should also be exempt.
Expanding the sales tax base will harm small businesses due to the costs of compliance and because large companies will avoid the sales tax by providing services in-house rather than hiring third party providers.	Simplified methods should be used for small businesses. For example, businesses with less than $1 million of sales could be allowed to report and remit the sales tax on their individual income tax forms and quarterly estimated tax payments. Technology-based compliance methods should also be employed. Broadening the tax base should not also expand the pyramiding problem. That is, businesses should be exempt from paying tax on any consumption items added to the sales tax base. Thus, there would be no incentive for a business to provide the service in-house rather than purchase it from a third party. The problem noted on the potential harm to small businesses is one that already exists with respect to some purchases of tangible personal property. For example, a business might find that providing food in-house is less expensive than hiring a catering company although that decision is unlikely to be based solely on the sales tax added to the catering bill.
A sales tax on services is a tax on labor which will harm the economy.	The tangible personal property and limited services (such as photocopying) that are taxable today also include labor costs – the labor to produce the item. Thus, the sales tax has applied to a limited category of labor since 1935. In today's service economy, it is a greater inequity to only tax labor that is included in tangible goods.
Expanding the sales tax base will hurt California's business climate.	Not addressing the tax base inequities and stability are likely to hurt the economy more. For example, to help address the $41 billion shortfall in early 2009, the tax rate was raised one point rather than broadening the base. This hurts the business climate more because businesses will have to pay 9 to 10% sales tax on equipment purchased for R&D or manufacturing in California. Broadening the base presents an opportunity to lower the sales tax rate and start addressing the excessive sales tax burden California companies face that they usually do not face in other states (since most states exempt manufacturing equipment from sales tax).

Endnotes

[1] Executive Order S-12-08 (10/30/08); at http://gov.ca.gov/executive-order/10928/.

[2] CA Department of Finance; http://www.dof.ca.gov/Research/Research.php.

3 Services are in the category of exclusions by definition (since services are not tangible personal property). In its 4/22/05 analysis of AB 9 (2005-2006), the Assembly Revenue & Taxation Committee noted that for fiscal year 2005-06, "sales tax on legal services alone would generate approximately $2.1 billion in total sales tax revenue." Available by search at http://www.leginfo.ca.gov/bilinfo.html. The BOE analysis of this bill included an estimate that taxing the 11 specified services would generate $4.693 million in revenue. It did not specify how much of this revenue would be generated by businesses (which reflects pyramiding – a problem area). BOE, Staff Legislative Bill Analysis, AB 9, 4/18/05; available at http://www.boe.ca.gov/legdiv/sutleg/pdf/ab0009-1ss.pdf.

[4] Assembly Interim Committee on Revenue and Taxation, *The Sales Tax – A Major Tax Study*, Part 4, written by Dr. Harold M. Somers, December 1964, published in Journal of the Assembly, 1964 Session, Vol. 1, p. 13 (hereinafter *1964 Report*).

[5] Legislative text and revenue estimates can be found at http://www.njleg.state.nj.us/Default.asp, by searching in the 2006-2007 legislative session for either A4901 or S1996. The enacted law is L. 2006, c. 44, enacted on July 8, 2006. Definitions used for the expanded base can also be found at http://www.state.nj.us/treasury/taxation/salestaxbase.htm.

[6], 6/8/67, pg. viii; http://tax.ohio.gov/taxstudy/taxstudy.stm.

[7] The closing of record stores is likely not due only to sales of digital music, but also to overall drop in music sales, music piracy, and increased competition from low-cost stores, such as WalMart. Ethan Smith, "Sales of Music, Long in Decline, Plunge Sharply," *Wall Street Journal*, 3/21/07, p. 1; available at http://online.wsj.com/article/SB117444575607043728.html.

[8] CBPP, report on California; available at http://www.cbpp.org/states/5-17-05sfp-fact-ca.pdf.

[9] Analysis of AB 9 (2005-2006), the Assembly Revenue & Taxation Committee (4/22/05); available by search at http://www.leginfo.ca.gov/bilinfo.html.

[10] Minnesota House of Representative, *The Minnesota Sales Tax Base* (Nov. 2002); available at http://www.house.leg.state.mn.us/hrd/issinfo/ssmstb.htm.

[11] Mazerov, "Expanding Sales Taxation of Services: Options and Issues, *State Tax Notes*, 7/21/03; also available at http://www.cbpp.org/3-24-03sfp.htm.

[12] Bureau of Economic Analysis, Table 116. Final Consumption Expenditure of Households by Purpose; available at http://www.bea.gov/national/xls/tab116.xls.

[13] Horrigan, Pew Internet and American Life Project, *Consumption of Information Goods and Services in the United States*, (Nov. 2004), page 1; available at http://www.pewinternet.org/pdfs/PIP_Info_Consumption.pdf.

[14] U.S. Census Bureau, *Computer and Internet Use in the United States: 2003* (10/05); available at http://www.census.gov/prod/2005pubs/p23-208.pdf.

[15] Horrigan, Pew Internet and American Life Project, *Home Broadband Adoption 2006*, (May 2006), page 1; available at http://www.pewinternet.org/pdfs/PIP_Broadband_trends2006.pdf.

[16] Horrigan, Pew Internet and American Life Project, *Home Broadband Adoption 2006*, (May 2006), page 3; available at http://www.pewinternet.org/pdfs/PIP_Broadband_trends2006.pdf.

[17] Nielsen//NetRatings, "Affluent Americans Power Internet Growth," 4/19/04; available at http://www.nielsen-netratings.com/pr/pr_040419.pdf.

[18] US Census Bureau, E-Stats Division, Table 6/Historical U.S. Electronic Shopping and Mail-Order Houses (NAICS 45411) – Total E-commerce Sales by Merchandise Line: 2001-2006; available at http://www.census.gov/eos/www/2006/historical/2006ht.pdf.

[19] For example, in 2007, Intuit announced a 400% increase since 2004 in the number of customers using QuickBooks®: Online Edition; press release of 5/29/07; available at http://web.intuit.com/about_intuit/press_releases/2007/05-29.html.

[20] David Card, Jupiter Research US Digital Music Forecast, 1/8/07; available at http://weblogs.jupiterresearch.com/analysts/card/archives/2007/01/jupiterresearch.html.

[21] Apple, "100 million iPods sold," 4/9/07; available at http://www.apple.com/pr/library/2007/04/09ipod.html.

[22] Reuters, "Apple's iTunes grows to No. 2 U.S. music retailer," 2/26/08; http://www.reuters.com/article/idUSWNAS243320080226.

[23] Reuters, "Apple now third largest music retailer: survey," 6/22/07; available at http://www.reuters.com/article/companyNewsAndPR/idUSWEN893120070622.

[24] Apple press release of 4/3/08, "iTunes Store Top Music Retailer in the US;" available at http://www.apple.com/pr/library/2008/04/03itunes.html.

[25] Emma Ritch, "Mobile music is shooting up the charts," Silicon Valley/San Jose Business Journal, 3/28/08; available at http://sanjose.bizjournals.com/sanjose/stories/2008/03/31/story4.html.
[26] CNET, "Study: On-line game revenue to skyrocket," 7/12/04, based on a report from the Yankee Group; available at http://news.com.com/Study+Online-game+revenue+to+skyrocket/2100-1043_3-5266062.html.
[27] Information is from the Federation of Tax Administrators at http://www.taxadmin.org/fta/rate/sale_vdr.html.
[28] US Bureau of Labor Statistics, "Consumer Expenditures in 2006, Table 3 – Higher income before taxes: Average annual expenditures and characteristics, Consumer Expenditure Survey, 10/08' available at http://www.bls.gov/cex/csxann06.pdf.
[29] FTA data available at http://www.taxadmin.org/fta/pub/services/services.html.
[30] FTA, "FTA Survey of Services Taxation – Update," 7/08 at http://www.taxadmin.org/fta/pub/services/btn/0708.html.
[31] Wisconsin SB 62 (2/19/09); available at http://www.legis.wi.gov/2009/data/acts/09Act2.pdf.
[32] Mississippi HB 1461 (3/12/09); available at http://billstatus.ls.state.ms.us/2009/pdf/history/HB/HB1461.xml.
[33] North Dakota SB 2347 (3/19/09); available at http://www.legis.nd.gov/assembly/61-2009/bill-actions/ba2347.html and http://www.legis.nd.gov/assembly/61-2009/bill-text/JRDU0100.pdf.
[34] North Carolina proposal S 487 (2009); available at http://www.ncga.state.nc.us/sessions/2009/bills/senate/pdf/s487v1.pdf.
[35] For example, see written testimony presented to the Commission on the 21st Century Economy by the California Foundation for Commerce & Education, affiliated with the California Chamber of Commerce, "A Tax System for the 21st Century: Protecting California Jobs and the Economy," (3/09); available at http://www.cfcepolicy.org/NR/rdonlyres/92176667-50FF-4C2F-A47B-B66CE79D4998/59/TaxCommissionWhitePaper1.pdf.
[36] Executive Order S-12-08 (10/30/08); at http://gov.ca.gov/executive-order/10928/.
[37] *1964 Report*, *supra*, p. 13.
[38] For an overview of Florida's prior tax on services and the issues that led to its demise, see Hellerstein, "Florida's Sales Tax on Services," *National Tax Journal*, Vo. 41, No. 1, March, 1988, pp. 1 – 18.
[39] For more information on problems with pyramiding and how to eliminate pyramiding, see Nellen, The Pyramiding Nature of the Tax; at http://www.cob.sjsu.edu/nellen_a/TaxReform/Report2c_21stCenturyTaxation_Pyramiding.htm.
[40] The author has a paper on the use tax collection problem and possible remedies at http://www.cob.sjsu.edu/nellen_a/TaxReform/Report2b_21stCenturyTaxation_UseTax.htm.
[41] See IRS Schedule H (Form 1040) Household Employment Taxes and IRS Publication 926, *Household Employer's Tax Guide*.
[42] CaliforniaCityFinance.com, "Utility User Tax Facts," 9/08; available at http://www.californiacityfinance.com/UUTfacts08.pdf.
[43] See http://www.state.nj.us/treasury/taxation/salestaxbase.htm. Legislative text and revenue estimates can be found at http://www.njleg.state.nj.us/Default.asp, by searching in the 2006-2007 legislative session for either A4901 or S1996. The enacted law is L. 2006, c. 44, enacted on July 8, 2006. Due to revenue needs, New Jersey also raised the sales tax rate from 6% to 7%, which was estimated to increase annual revenues by $1.2 billion. Such a change is contrary to broadening the base which should call for a rate decrease.
[44] For example, the BOE could give online vendors the option of including a payment link on their website that would enable the credit card of California buyers to be charged by the seller for the cost of the item and by the BOE for the associated sales tax. This would eliminate the vendor's compliance obligations and reduce costs for vendors because they would not bear the costs incurred through additional credit card fees for the assessed sales tax. Such a system might only be appropriate for small online vendors.
45 For example, AB 9 (2005-2006) proposed to broaden the sales tax to include "specialized services" that included marina services, custom computer software, charter of a plane or limousine, accounting and bookkeeping services, legal services, security and detective services, and various consulting services. Challenges with this bill included that it primarily covered services used by businesses as well as individuals so it expanded the pyramiding problem. In addition, revenues were earmarked for a specific purpose exacerbating another weakness in California's tax and budget system. The assembly analysis (4/22/05) to AB 9 and noted: "This bill does not require service providers with a business presence in California to collect sales or use tax on any sales made to California, as retailers of goods are required to under the current SUTL. This may compel service providers to divert their service transactions with California clients through out-of-state offices in order to avoid the tax."
[46] This analysis uses a document prepared by the American Institute of Certified Public Accountants (AICPA) Tax Division and altered to the above format by Joint Venture: Silicon Valley Network. The AICPA document, *Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals* (2001) is available at

http://ftp.aicpa.org/public/download/members/div/tax/3-01.pdf. The Joint Venture workbook is available at http://www.jointventure.org/PDF/taxworkbook.pdf. The principles laid out in these documents are frequently used tax policy analyses ones. For more information see Nellen, Policy Approach to Analyzing Tax Systems; available at http://www.cob.sjsu.edu/nellen_a/TaxReform/PolicyApproachToAnalyzingTaxSystems.pdf.

[47] *1964 Report*, *supra*, p. 13.

[48] Note: Author of this report (Annette Nellen) was the lead author of the Commission's report at pages 115 – 119 and 132 – 136.

[49] CaliforniaCityFinance.com, "Utility User Tax Facts," 9/08; available at http://www.californiacityfinance.com/UUTfacts08.pdf.

[50] California Dept. of Finance, Governor's Budget 2009-10, "Revenue Estimates," available at http://www.ebudget.ca.gov/BudgetSummary/REV/1249563.html. Following is the excerpt describing the sales tax base broadening. The estimates include a proposed temporary rate increase of 1.5 cents (from 5% to 6.5% state rate).

> "Broaden the Sales and Use Tax to Include Certain Services: Effective March 1, 2009, the sales and use tax would be extended to appliance and furniture repair, vehicle repair, and veterinarian services. Effective April 1, 2009, the sales and use tax rate would be applied to amusement parks, sporting events, and golf. Selection of these services was based on ease of implementation as these services are generally provided by entities that already have a relationship with the Board of Equalization. Assuming a 6.5-percent General Fund tax rate, this proposal is expected to generate additional General Fund sales tax revenue of $272 million in 2008-09 and $1.154 billion in 2009-10. These estimates assume initially low collections but significant improvements in collections over time. This proposal will also generate revenues for local government agencies of $113 million in 2008-09 and $479 million in 2009-10, including $21 million for local public safety funds in 2008-09 and $89 million in 2009-10."

[51] Letter dated 3/16/09 from Mark Ibele, Staff Director for the Commission and Phil Spilberg, Chief, Financial Research, Department of Finance, to the members of the Commission on the 21st Century Economy; available at http://www.cotce.ca.gov/documents/correspondence/.