

# NCACPA opposes taxing professional services

## Talking Points

The concept of taxing services is not new, but has gained favor in state legislatures over the years because of a state's eroding tax base and increased demand for spending. The shift in North Carolina's economy from manufacturing to services has prompted some policy development groups and state lawmakers to consider expansion of the state's sales tax to include services. As explained in the following talking points, taxing services may not be a wise alternative for raising state revenues.

The American Institute of Certified Public Accountants Tax Policy Statement #1 provides 10 guiding principles of good tax policy. We have outlined in these talking points, reasons why application of the state's sales taxes to services violates many of the principles.

**I. Equity and fairness:** *(Similarly situated taxpayers should be taxed similarly and encompasses horizontal equity (taxpayers with equal ability to pay should pay the same amount) and vertical equity (taxpayers with a greater ability to pay should pay more.)*

- Economist's studies have repeatedly noted that **sales taxes are regressive**. A sales tax on services ultimately falls heaviest on consumers who can least afford to pay.
- Some consumers will **forgo services** (i.e., health care) because the price will be higher.
- **Small and emerging businesses will suffer because the tax hits them disproportionately hard**. Small businesses outsource many of the services that large businesses internalize. Larger businesses have systems in place and have the necessary personnel, in most cases, to administer the new law, if it were to pass. It would be expensive for them to do so, but they could handle the additional burden.
- A tax on services is regressive because the **small businesses bear a disproportionately larger share of the expense of administration**. Small and emerging businesses may not have the resources to gear up to collect the sales tax to be remitted to the state of North Carolina. Administration of a tax on services typically requires software and consulting fees to implement it fully, which may be financially out of the reach of some businesses.
- Larger companies will **employ the service expertise** needed to comply rather than pay for services from an outside contractor to reduce the impact of the additional tax resulting in reduced realization of taxes for the state of North Carolina.
- **The law created significant business and voter backlash** in states where it has been legislated. Massachusetts and Florida are excellent examples. National advertising agencies refused to advertise in Florida,

- which prompted a reversal. Taxpayers in Massachusetts revolted over a tax on accounting services, which prompted its repeal.
- **CPA firms and other independent consultants will suffer** because the large businesses that can do so will bring the expertise in-house to escape the tax as well as the complexity of collecting it.

**II. Certainty:** *(Tax rules should clearly specify when and how a tax is to be paid and how the amount to be paid is determined.)*

- Taxpayers will **not easily determine** what is subject to the tax and how the calculation is determined. States enacting such laws invariably exempt some services making implementation difficult.
- This tax on services **creates a disincentive** to expand the service sector of the state's economy; the very sector responsible for the majority of highly desirable jobs. With expansion is uncertain, the state's revenue projections will be impacted

**III. Convenience of Payment:** *(A tax is due at a time or in a manner most likely to be convenient for the taxpayer.)*

- Service business will be **forced to remit the sales taxes billed** but not collected unlike point of sales transactions.
- **Interest free loans to the state** are created by tax payments from businesses and firms who operate on an accrual basis. The state will want their money, in some cases, well before the business would be paid for the service.

**IV. Economy of Collection:** *(The costs to collect a tax should be kept to a minimum for both the taxpayer and government.)*

- Compliance costs in the states that have implemented a sales tax on services have seen their **compliance costs soar** and the rate of compliance drop.
- Compliance **costs for consumers will increase** if they provide services to businesses rather than individuals.
- **Enforcement & compliance issues.** What will it take to equip the NC Department of Revenue to ensure compliance with the new tax? If it can't be enforced, will it end up like the NC Intangibles tax where there was spotty compliance until it was repealed?
- **Encourages cheating and creative pricing to avoid the tax.** Don't we have enough challenges to tax compliance in this state?

**V. Simplicity** *(The tax law should be simple so taxpayers can understand the rules and comply with them correctly and cost efficiently.)*

- A sales tax system with its many exemptions, multiple definitions and different rates is not simple.
- Expanding sales taxes to include services will probably include exemptions and complex definitions, which make it much more complex and difficult to understand and execute.

- The complexity of record keeping between NC and the other non-services tax states may prompt a reduction in doing business in the state of North Carolina. A business serving consumers in several states will now be faced with much more complicated record keeping to comply with the law in North Carolina.
- **Complicated administrative problems are created.** It has been demonstrated in states which have considered such a tax that it is difficult to define what gets taxed and when it gets taxed. How is the tax defined? How are services defined? Who makes a decision in a close call?
- **Very difficult to calculate.** How is a CPA firm expected to calculate the sales tax on a contingent fee/value added engagement versus an hourly engagement? How is the tax calculated on an asset management engagement? Filing an amended return? The list is substantial.

**VI. Neutrality:** *(The tax law's effect on a taxpayer's decision as to whether or how to carry out a particular transaction should be kept to a minimum.)*

- The additional costs imposed by expansion of a sales tax to include professional service might push **consumers to bypass needed services** such as health care, legal advice and accounting. These businesses may decline due to these consumer decisions.
- **This tax becomes discriminatory** when the General Assembly exempts one service and does not exempt another. States that have considered this tax have invariably exempted certain essential services from taxation. Is that a fair and equitable tax policy? Governor Easley's Commission has already indicated that it may be appropriate to exempt medical services. Of the states that tax services, less than 15 of the 34 business services identified are taxed in those states and they tax less than half of the personal services. Fair? Equitable? Sound Public Policy?

**VII. Economic Growth:** *(A tax system should not impede or reduce the economy's productive capacity, but be aligned with the taxing jurisdiction's economic goals (e.g., economic growth, capital formation and international competitiveness.)*

- A tax on services would place North Carolina at a **competitive disadvantage** with the surrounding states, which do not tax professional services. Multi-state businesses will have yet another incentive to locate just outside North Carolina's borders to operate their businesses and bill for their services to escape collection of this tax.
- **Chilling effect on persons seeking professional assistance.** A sales tax on services could discourage clients from seeking answers to important questions when they know that they will have to pay the state an additional tax.

**VIII. Transparency & Visibility:** *(Taxpayers should know that a tax exists and how and when it is imposed on them and others.)*

- When services are consumed by business, this principle is violated. The tax is **effectively hidden** from taxpayers and passed along to consumers and investors.

- **Pyramiding.** A tax on services may result in a pyramiding of taxes on services and the delivery of final goods. A tax on a tax can occur when suppliers are taxed at multiple levels before a service is delivered.
- **Taxing businesses for business services is a duplicate tax.**

**IX. Minimum Tax Gap:** *(A tax should be structured to minimize noncompliance.)*

- Compliance with the existing sales taxes on tangible property is relatively high, but one on services may not be. Service providers are typically small, less sophisticated and numerous.
- Enforcement of a tax on services will nearly impossible to enforce, creating inequities in compliance and effectiveness.

**X. Appropriate Government Revenues:** *(A tax system should enable the government to determine how much tax revenue will likely be collected and when.)*

- A sales tax on services does not offer this predictability or reliability because of the inequitable application, questionable compliance and difficulty with enforcement.

**XI. Exportability:** *(A state tax is exportable if the burden of the tax can be shifted to residents of other states. Exportability is also accomplished by deducting the state taxes on the federal return.)*

- Since 1986, the federal government has **not allowed taxpayers to deduct** state sales taxes in determining federal taxable income.
- **Companies currently operating in NC will relocate or shift operations** rather than be taxed (i.e., interstate trucking, general commerce, repairs to commercial vehicles, etc.) Multi-state companies will move their operations to neighboring states or stop doing business in NC all together because of the complexity of collecting an additional tax.

**XII. Additional reasons:**

- **Additional new tax or a replacement?** If the rationale for the new tax is due to the economy shifting from manufacturing to services, will any manufacturing based taxes will be repealed and if so, which ones?
- **Levies the tax on consumers at a potentially sensitive and inopportune time.** CPAs provide services to clients who are experiencing trauma such as an IRS tax audit, bankruptcy actions, estate administration, divorce actions, and other sensitive services. Would this be good tax policy for our citizens? Is it good tax policy to assess a sales tax on these events in the lives of any taxpayer?
- **Unpopular tax.** In 1990, Massachusetts repealed its tax on accounting services after only one day after it proved to be confusing to explain and difficult to administer. Florida likewise repealed their services tax in 1987.

- **Confidentiality problems.** Clients will be unhappy to know that the NC Department of Revenue will have **unfettered access to confidential client records**. For the state to be certain that they are receiving an accurate share of the sales tax revenues collected, confidential client records will have to be made available for **examination by sales tax auditors**.

The NC Association of Certified Public Accountants believes the concept is fatally flawed and should be avoided by the NC General Assembly for the following reasons:

### **Taxing services is bad public policy and is bad for North Carolina!**

*(Adapted in 2006, with appreciation, from a presentation by Roby D. Sawyers, Ph. D., CPA; Associate Professor of Accounting, NC State University before the Governor's Commission to Modernize State Finances, April 24, 2002)*