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Memorandum

To: Steve Klein, Chief Fiscal Officer, Joint Fiscal Office
From: Tom Kavet, Nic Rockler and Jeff Carr, State Economist for the Administration
CC: Sara Teachout, JFO, Jake Feldman, Tax Department
Date: January 15, 2016
Re: Economic and Revenue Impacts of Sales Taxes on Selected Services, per H489

As directed in H489, we have explored the economic and revenue impacts of extending the sales and use tax to selected services not currently subject to this tax in Vermont. Because there are hundreds of possible services that could be taxed, and the cost of analyzing all in depth would be prohibitive, we have focused on five sample services so as to illustrate some of the issues attendant to extension of this tax and their impacts on revenue projections and the broader economy. As requested in H489, the expected revenue derived from taxation of these five services would exceed \$30 million per year, in 2015 dollars, throughout the forecast horizon, and could be reassembled in part to generate \$15 million per year, if desired.

The five consumer services analyzed herein are: Legal, Personal Care (hairdressers, barbers, nail and skin care, etc.), Landscaping (including snowplowing, etc.), Motor Vehicle Maintenance and Repair and Dental services. The relevant tax changes would apply only to consumer purchases, and exclude all business to business purchases.

The primary findings of our analysis are as follows:

- The revenue yield will be slightly lower than some of the preliminary Tax and JFO estimates, primarily due to losses from elasticity responses, cross-border competition and avoidance. Only one border state (New York) has a tax on any of the five services analyzed (only landscaping and motor vehicle repair @ 7%-8% for the relevant border counties). The most important border states, MA and NH, have no consumer taxes on any services.
- We have analyzed five possible taxes as a way to demonstrate these effects and show the kinds of issues that will be in play, depending upon the exact taxes chosen by the legislature. As noted, these five tax sources sum to about \$40 million in revenue, so could be combined in various ways to get to either the \$30M or \$15M goals mentioned in H.489.

- The larger net economic effects of imposing any of these taxes depends heavily upon what the money raised by these new taxes is spent on by the State. In isolation, a tax increase creates a negative economic impact, however, if it is spent on something that is likely to generate a favorable return on investment, it can have net positive economic impacts. If the tax dollars are assumed to be spent as nondescript “general state government spending,” the net effects are close to neutral, with taxes on legal and dental being slightly positive, personal care and motor vehicle repair being slightly negative and landscaping, very close to zero.
- No matter what, the cross-border effects are negative to the economy, but likely to be relatively small for the five taxes considered – and probably smaller than for goods in general.
- Taxing selected services will expand the tax base, but in the case of the five taxes we evaluated, not appreciably change its growth trajectory. Many of the services that could be taxed are not growing much, if any, faster than taxable goods. So, there will be more revenue, but only slightly higher growth rates, based on the taxes included in our analysis.

Estimated net revenues from these five taxes and their impact on total expected Sales and use tax revenues are outlined in the below table.

SELECTED CONSUMER SERVICES					
Expected Revenue After Deducting Both Compliance and Adaptive Losses					
Service Industry	Calendar Year Basis				
	2017	2018	2019	2020	2021
1. Legal Services	7.5	7.7	7.9	8.0	8.2
2. Personal Care	2.7	2.7	2.7	2.7	2.7
3. Landscaping Services	3.5	3.5	3.6	3.6	3.7
4. Motor Vehicle Repair	10.4	10.3	10.2	10.2	10.1
5. Dental Services	16.3	16.6	16.9	17.3	17.6
TOTAL (Constant 2015 Dollars)	\$40.4	\$40.9	\$41.3	\$41.8	\$42.3
Current Dollar Revenue	\$41.8	\$43.3	\$44.8	\$46.3	\$47.8
%change vs. year-ago		3.5%	3.5%	3.4%	3.2%
S&U (Cal Basis) - Without any New Taxes	\$385.2	\$398.0	\$409.7	\$421.0	\$431.7
%change vs. year-ago		3.3%	2.9%	2.7%	2.6%
S&U (Cal Basis) - With Selected Service Taxes	\$427.0	\$441.3	\$454.5	\$467.2	\$479.5
%change vs. year-ago		3.3%	3.0%	2.8%	2.6%

APPENDIX A

Background Information for Discussion Purposes and Assumptions Associated With Analysis of Selected Sales Taxes on Services

Table 1

Tax Base and Consumer Share Data Sources

Tax Base Description	Taxable Base Source Data	Base Value 2014 (\$2014, mil.)	Consumer Share (Proportion) From 2007 Benchmark I/O	Value-Added Share, where Relevant
1. Legal Services	2007 Economic Census (US Census, BLS)	381.0	0.313	Not Applic.
2. Personal Care	2012 Economic Census (US Census, BLS)	52.5	0.994	Not Applic.
3. Landscaping Services	2012 Economic Census (US Census, BLS)	153.6	0.440	Not Applic.
4. Motor Vehicle Repair	2012 Economic Census (US Census, BLS)	395.8	0.845	0.557
5. Dental Services	2012 Economic Census (US Census, BLS)	264.3	0.999	Not Applic.

Table 2

Hypothetical Revenue Losses Due to Compliance and Cross-Border Losses

	Annual Compliance, Misclassification, Avoidance Losses¹ (Percent each year)	Loss to Neighboring States (Percent after 10 years)²
1. Legal Services	low	low
2. Personal Care	high	moderate
3. Landscaping Services	very high	low
4. Motor Vehicle Repair	moderate	moderate
5. Dental Services	low	low

¹ Losses that occur with non-reporting or underreporting of transaction values, e.g., some cash transactions, arbitrary classification as business-to-business rather than business-to-consumer transaction, or misunderstanding as to taxability of services

² Loss rate increases annually starting at zero for the year of tax implementation and interpolated linearly over 10 years. After 10 years, "low" losses are assumed to be circa 5%, "moderate" losses are circa 10%, "high" losses are circa 15%, and "very high" losses are circa 20%.

Table 3

Price Elasticity to Demand Assumptions and Net Revenue Losses from All Sources

	Price Elasticity to Demand Estimate	Average Annual Net Revenue Loss Rate - All Sources
1. Legal Services	-0.4	7.2%
2. Personal Care	-1.2	12.0%
3. Landscaping Services	-0.6	12.1%
4. Motor Vehicle Repair	-0.9	14.4%
5. Dental Services	-0.6	9.7%

Table 4

Competitive Border State Tax Rates

TAX BASE	NY Tax?	MA Tax? ¹	NH Tax?
1. Consumer Legal Services	No ³	No	No
2. Personal Care	No - except in NYC ⁴	No	No
3. Household Landscaping Services	Yes ⁵	No ⁵	No
4. Consumer Motor Vehicle Repair	Yes	No	No
5. Dental Services	No	No	No

NY Counties that Border VT ⁶	State Sales Tax	County Sales Tax	Total Sales Tax
Clinton	4.0%	4.0%	8.00%
Essex	4.0%	3.8%	7.75%
Warren	4.0%	3.0%	7.00%
Washington	4.0%	3.0%	7.00%
Rensselaer	4.0%	4.0%	8.00%

³ Sales of professional services are not subject to the sales tax in NY.

⁴ Personal care services are not subject to the sales tax in NY except in NYC where they are subject to the total sales and use tax rate of 8.875%.

⁵ Maintaining, installing, services, and repairing of tangible personal property and maintaining, servicing, and repairing real property are subject to the sales tax in NY. But capital improvements to real property are not subject to sales tax.

⁶ Note: Vermont Local Option Taxes could raise the effective sales tax rate for these services, pending local decisions in affected tax jurisdictions. This analysis did not assume any Local Option Tax levies, above the statewide tax rate.