TAX ON PROFESSIONAL SERVICES

Position

The [State Society] opposes any effort to enact a state service or use tax on accounting, tax or other professional services. Application of such a tax penalizes individuals and businesses seeking to comply with state law, generates an administrative burden for the business community and creates an economic disadvantage for businesses to move to the state or supply services within.

Background

States typically impose sales and use taxes on the sale of tangible personal property and selected services, with a few states – Hawaii, New Mexico and South Dakota - broadly taxing all types of services, including accounting services. In addition to the traditional accounting and tax services, accounting firms may also provide services that could be construed as “data processing services,” “information services,” and “management services,” which are taxable in several states.

As states explore a variety of solutions to budget constraints, some policy makers have explored combining a tax on accounting and other professional services with a reduction in a state’s personal income tax as a means to make the state more attractive for businesses; current research and past precedence do not support this position. In the past quarter-century, numerous states have considered expanding the services exposed to a sales and use tax (expanding the base), but only five – Florida, Iowa, Maryland, Massachusetts and Michigan – have actually passed such legislation. Each of those states quickly repealed the offending provision either before or shortly after implementation.

Explanation of Opposition

Because of negative economic implications and difficulty surrounding the taxation of professional services, the imposition of such a sales and use taxes should not be considered by state legislatures; specifically:

- **Is complicated to administer** for states and taxpayers, as the multi-state nature of customers and service providers often makes it difficult to determine where, when and how the services take place and what services are actually covered. In fact, four states (Florida, Massachusetts, Michigan and Iowa) enacted and then swiftly repealed sales taxes on services, in part because of the complexity in administering the taxes.
- **Creates a competitive disadvantage** for the state compared to those without a services tax by discouraging relocation and expansion, which negatively affects economic growth and development. Service providers are likely to remain in the tax-free state and restrict services supplied in taxing states.
- **Discriminates against small businesses** because small and emerging firms often have a need to use outside services that would be taxed, while larger companies with in-house expertise could avoid taxation for such services.
- **Is regressive,** as sales taxes affect everyone at the same tax rate, regardless of the individual’s income level.
- **Penalizes those seeking to comply with state and federal law** by forcing individuals and businesses to pay for services necessary to accurately comply with complicated tax and financial laws.

Contact

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