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EXPANDING DISTRICT'S SALES TAX BASE CAN RAISE REVENUE, WHILE INCREASING TAX FAIRNESS

In response to the most recent revenue shortfall, the DC Council voted in July 2009 to raise the District's sales tax rate from 5.75 percent to 6 percent. Raising revenue is important to ensure that DC can continue to provide education, transportation, and other critical services during this economic downturn. As policymakers approach future revenue shortfalls, they should consider building on prior efforts to expand the sales tax base by including more services in DC's sales tax. This approach can improve both the fairness and the adequacy of the District's sales tax, and it can prevent the need for future rate increases. Expanding DC's sales tax could generate \$14 million or more in additional revenue each year.

Including More Services in the Sales Tax Makes Sense

In the District, as in many states, the sales tax applies primarily to goods but not to most services. For example, if you buy a piece of exercise equipment, you will be charged the DC sales tax. If your neighbor buys a health club membership, she will not pay sales tax.

Why is this the case? States' sales taxes were created decades ago, at a time when the sale of goods dominated the economy. However, a larger share of households' purchases now comes in the form of services, rather than goods. In 2007, services accounted for 45 percent of household consumption expenditures, compared to 32 percent for goods.¹

In response, the District and most states have expanded their sales taxes to cover selected services. The District does a better job than many states, but it still excludes a large number of services from its sales tax. For example, DC currently does not tax pet grooming, health clubs, diaper services, security services, and live theater performances. These and other services that are not included in DC's sales tax are listed in the sidebar.

Selected Services Not Currently Taxed in DC

- Auto Road Service and Towing
- Auto Washing
- Bowling Alleys
- Carpet and Upholstery Cleaning
- Dating Services
- Diaper Service
- Health Clubs
- Investment Counseling
- Packing and Crating
- Performing Arts
- Pet Grooming
- Private Club Memberships
- Private Investigation Services
- Security Services
- Self Storage
- Veterinary Services

¹ Michael Mazerov, "Expanding Sales Taxation of Services: Options and Issues," Center on Budget and Policy Priorities, July 2009, <http://www.cbpp.org/files/8-10-09sfp.pdf>.

Expanding the Sales Tax to Services Improves the Fairness and Adequacy of the Sales Tax

In addition to raising revenue, expanding the sales tax base can help to improve the District's sales tax in two key areas: adequacy of the revenues generated by the sales tax and tax fairness.

- **Improving Tax Fairness:** Under the District's current sales tax, a person who buys supplies to groom their pet pays the sales tax, while a person who takes their pet to a business to be groomed does not. The same is true for someone who buys diapers versus someone who pays for a diaper service. If a sales tax is intended to tax what households consume, it does not make sense to differentiate between goods and services — especially when they perform the same function.
- **Increasing Revenue Adequacy:** DC's sales tax cannot remain healthy if it is tied mainly to goods while consumption continues to shift toward services. As the percentage of household consumption of goods continues to fall, so does the amount of households' purchases that are subject to the sales tax. Expanding the sales tax base can help ensure that sales tax collections will grow at a stable rate and keep up with the DC economy.
- **Preventing the Need for Sales Tax Rate Increases:** If the sales tax applies to a broader share of consumer purchases, sales tax collections will grow at a healthier rate. This will make it less likely that the city will have to resort to increasing the sales tax rate

How Much Revenue Would Be Generated by Expanding the Sales Tax Base?

Including more services under DC's sales tax would increase sales tax collections, and the amount would vary depending on how many services are taxed.

- **Expanding the Sales Tax to Selected Services Would Raise \$14 Million:** If the District taxed seven services — pet grooming; health clubs; packing and crating, armored car, private investigation, and security services; and performing arts — at its general sales tax rate (6 percent, beginning in FY 2010), it could raise \$14 million in FY 2010 (Table 1).

Service	Potential taxable sales* (in thousands)	Rate	Estimated Revenue (in thousands)
Pet grooming	\$3,370	6%	\$202
Health clubs	\$1,410	6%	\$85
Packing and crating	\$1,589	6%	\$95
Armored Car, Private Investigation and Security Services	\$146,771	6%	\$8,806
Performing arts (excluding Opera)	\$87,135	6%	\$5,228
Total	\$240,275		\$14,417

Source: DC Office of the Chief Financial Officer, 2009; updated to reflect the new sales tax rate for FY 2010.
*2002 Economic Census, U.S. Census Bureau; The 2002 figures have been adjusted for inflation.

- **Expanding the Sales Tax Broadly Could Raise Hundreds of Millions:** By extending its sales tax to all “feasibly taxable services” (all services consumed by households except for health care, housing, education, legal, banking, public transit, insurance, and funeral services), the District could raise more than \$300 million annually.² It is unlikely that the District would choose to tax all services, but this figure offers a sense of the revenue potential from expanding the sales tax base.

In response to the most recent revenue shortfall, the Council voted to raise the sales tax rate from 5.75 percent to 6 percent. To address future revenue shortfalls, the Mayor and Council should consider expanding DC’s sales tax to more services, before increasing the rate further.

² Mazerov, p. 5. Maximum revenue from taxing services amount for DC has been updated to reflect increase in sales tax to 6 percent, beginning FY 2010.