

[Hide photos](#)

The Journal Gazette

Published: November 3, 2009 3:00 a.m.

Expanding tax base?

When angry Indianapolis homeowners launched a property tax revolt two years ago, some cooler heads warned that a shift to sales taxes placed a burden on an unreliable revenue source. But the scenes of picketing taxpayers outside the governor's residence were enough to frighten the Indiana General Assembly into increasing the sales tax rate by almost 17 percent. Then recession hit, and the predictions of plummeting sales tax revenues became reality.

From July 1 to Sept. 30 alone, sales tax revenue was 10.9 percent lower than in 2008. Combined with declining individual income tax revenue, the state is starving for revenue. The dismal numbers had Gov. Mitch Daniels and Sen. Luke Kenley, chairman of the State Budget Committee, suggesting the possibility last month of cuts to schools.

Which makes a recently released study by the non-partisan Indiana Fiscal Policy Institute all the more timely. "Sales Taxation of Services in Indiana" looks at the issues involved in expanding the state's sales tax base, which currently includes only two dozen services.

Indiana's sales tax rate is 7 percent – tied with four other states for the second-highest rate in the nation. Some states permit local governments to levy additional sales taxes, however. The city of Chicago has the highest rate in the nation at 10.25 percent.

Indiana raised \$5.7 billion in sales taxes in the last fiscal year. According to the policy institute study, the state could raise an additional \$6.76 billion if it taxed all services. If it were to exempt medical and legal services, Indiana could still raise an additional \$4.5 billion.

The state ranks 39th among the states for the number of services it currently taxes, according to the Federation of Tax Administrators. Indiana taxes utility services, hotel and motel accommodations and intrastate cable TV and telecommunications.

According to the study, services are an attractive source of sales tax revenue because the service base is large and growing faster than the personal property tax base.

The study notes that sales taxes on tangible property covers items that aren't optional – clothing, for example – but some services considered luxuries, including cosmetic surgery and greens fees, are tax-exempt.

But expanding the sales tax base is not a clear-cut solution, as the study notes. Simply defining a service and deciding which services should be taxed is a challenge, and states that have attempted to do so have run into tremendous opposition. Florida repealed a broad tax on services passed in 1987. Massachusetts passed a tax on business-to-business services in 1990, which also was repealed. Both Maryland and Michigan passed taxes on services that were later repealed.

The study also cites the additional administrative costs involved in



Daniels



Kenley

Tax on services

Number of services taxed:

Indiana

: 24

Ohio

: 68

Michigan

expanding the tax base, as well as the likelihood that Hoosiers would seek out services in neighboring states to avoid the 7 percent surcharge on services.

"Of the major sources of revenue available to the state, broad-based taxation of services is the only one yet to be tapped by the state of Indiana," writes Earl Ryan, the study's author. "The revenue possibilities are great, and it would bring a degree of equity to the tax system. At the same time, defining the base would be difficult, both conceptually and politically, and the cost of collecting the tax on the part of both the state and the taxpayers would be significant."

The study makes no recommendation on what course Indiana should follow, but it offers a helpful guide for the General Assembly as it confronts Indiana's serious financial challenge. Lawmakers should acquaint themselves with the report to be better prepared for that challenge.

Copyright © 2009 The Journal Gazette. All rights reserved. News service copy is used with permission. The information contained in the report may not be published, broadcast, rewritten or redistributed without the prior written authority of The Journal Gazette or granting news service.

: 26

Illinois: 17

Kentucky

: 28

Source: Federation of Tax Administrators