

## State Tax Policy in the New Economy

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## Three Economic Trends All Related to Technology

- Growth in Services
- Increased Mobility and Flexibility of Individuals and Business
- "Fractal" Inequality--The Rich Are Different
  - Not Just Concentrated in the Top 1% But Within the Top 1%

## What Do These Trends Imply for State Tax Policy?

- Growth in Services
  - Reduction in base for sales tax from sales of tangible personal property
  - Increased importance in determining situs of sales for taxation (market vs. cost of performance)
- Increasing Mobility and Flexibility
  - Individuals and business can flee taxation more easily reducing taxing options.
  - Organizational structures can change as well
- Fractal Inequality
  - Potentially large super-rich income targets
  - Volatile income tax receipts
  - These are the most savvy taxpayers

## Preliminary Lessons

- Clear need to reach a broader consumption base for sales taxation
- Natural limits to increasing rates for state income taxation as mobility increases
- Upper-middle class are different than "rich"
- Ideally, like to reach less mobile tax bases, such as property

## What Have States Tried?

- Broad-based (unsuccessful) and more narrow attempts to impose sales taxes on services
  - Florida and Massachusetts had dramatic failures, but Texas and other states added many selective services
- Recent Introduction of gross receipts taxes
  - Ohio and Texas
  - Designed to replace ailing corporate tax, not as an alternative to low-rate sales tax (Hawaii, New Mexico)
- Streamlined Sales Tax Project
  - Designed to convince Congress to change use tax collection rules—will require a new Congress
- Revision for UDITPA underway
  - Impetus was to deal with the situs of services in apportionment

## California History

- Riley-Stewart Initiative 1933
  - Abolished gross receipts tax on utilities (52% of state budget)
  - Provided State aid for education allowing property taxes to be cut
  - Authorized Legislature to raise additional revenue (unspecified) for state aid to schools
- Introduction of Sales Tax 1933
- Introduction of Personal Income Tax 1935
- These taxes provided a very elastic revenue base for postwar California growth

### The California Context Today

- Low reliance on property taxation
- Narrow base for sales tax
- Progressive personal income tax and increasing reliance on personal income tax for financing state budget
- Reasonably robust corporate tax framework (combined reporting)

### What Can California Do In This New Economy?

- Low-Hanging Fruit
  - Impose sales taxes on selected services (e.g. repair and other consumer services)
  - Tackle selected tax expenditures on both sales tax and personal income tax
- Politically Higher Hanging Fruit
  - Expand the selected services to include medical and educational services
  - Market value taxation for non-homeowner property

### More Controversial Ideas

- Energy Taxation
  - The Pigovian Approach
- Adopt a Broad-Based Sales Tax on Services
  - Some exemptions (e.g. sale for re-sale) will be needed
  - It would inevitably tax business inputs—like existing sales taxes
  - Would require a use tax (like Florida had) and need to carefully apportion multistate taxpayers
  - Have we learned from political failures?
- Add A New Low Level Gross Receipt Tax
  - 1-2% for all transactions not subject to sales and use taxation
  - Allow business to deduct it as an expense
  - Meant to capture gaps in existing tax structure and raise revenue
  - Has disadvantages of all gross receipts taxes (pyramiding, incentives to integrate functions within businesses)