



ESTIMATE OF POTENTIAL REVENUE TO BE DERIVED FROM TAXATION OF CURRENTLY NON-TAXABLE SERVICES April 14, 2015

Proposal

The Senate Committee on Governance and Finance asked the Board of Equalization to prepare a revenue estimate on all currently non-taxable services.

Background, Methodology, and Assumptions

Highlights

- 15 service industries
- 293 sub-industries
- Over 30,000 Product and Service codes reviewed
- 3 million plus employer and non-employer California establishments
- Possibly more than 2.5 million new permits to administer
- Estimated total receipts of \$1.456 trillion
- Potentially \$57.3 billion in General Fund revenue

Executive Summary

The Board of Equalization, Research and Statistics Section, was asked to produce a comprehensive listing of all services within California that are not currently subject to tax and to calculate an estimated amount of revenue that would be derived from extending the sales and use tax to these services. This revenue estimate provides information on high-level statistics, data sources and the methodology used to compile the detailed services revenue estimate. The estimate breaks out California services by employer and non-employer. These two main reports are titled: Estimated Revenues Generated from Extending the Sales and Use Tax to Services: Employers; and Estimated Revenues Generated from Extending the Sales and Use Tax to Services: Non-employers. They detail each service industry and provide estimated 2015-16 receipts for each component of the current statewide average sales tax rate. There are also nine additional reports that provide high-level data sorts, including a further breakdown of non-employers by corporations, partnerships, and sole proprietorships and listings of insurance establishments. A list of these reports can be found in the table guide at the end of this revenue estimate.

The data shows that employers comprise approximately 17.5 percent of the service industry establishments, yet generate 91 percent (\$1.325 trillion) of estimated receipts. Application of the

sales and use tax to these receipts could generate an estimated \$52.2 billion for the State General Fund.

Non-employer establishments represent 82.5 percent of the services in California, accounting for 9 percent (\$131.7 billion) of receipts. This amount would translate into \$5.2 billion in sales and use tax revenues for the State General Fund. This 82.5 percent further breaks down into three sectors: corporations, partnerships, and sole proprietors. Corporations represent the smallest portion at 3.74 percent (\$15.4 billion) of receipts, partnerships represent 5.24 percent (\$31.9 billion) receipts, and sole proprietors are the largest portion at 73.52 percent (\$84.4 billion) in receipts.

The largest service industry is professional, scientific, and technical services (NAICS 54) with total estimated receipts of \$300.6 billion, and a potential of \$11.8 billion for the State General Fund. This industry also represents the largest number of establishments (see Table 1).

High-level Statistics

Employer

Establishments: 531,212

Total receipts: \$1.325 trillion

Total potential taxable revenue (8.42% statewide average): \$111.5 billion

Total potential general fund revenue (3.9375%): \$52.2 billion

Total industries five-digit NAICS codes: 293

Non-employer

Establishments: 2,503,906

Total receipts: \$131.7 billion

Total potential taxable revenue (8.42% statewide average): \$11.1 billion

Total potential general fund revenue (3.9375%): \$5.2 billion

Total industries three, four and five-digit NAICS codes: 143

Total Employer and Non-employer

Establishments: 3,035,118

Total receipts: \$1.456 trillion

Total potential taxable revenue (8.42% statewide average): \$122.6 billion

Total potential general fund revenue (3.9375%): \$57.3 billion

Data Sources

Services industry revenue estimates were determined for the five-digit level of detail for North American Industry Classification System (NAICS) codes to the extent the data was available. Staff developed revenue estimates for 293 NAICS industries for employers and 143 industries for non-employers. Staff used two major U.S. Census Bureau surveys for this effort – Economic Census and County Business Patterns.

US Economic Census

The US Economic Census is completed every five years (most recently for 2012), and it collects data for the states and nation as a whole. National industry data is more detailed than the individual state data, and the Census Bureau has not yet released much of the 2012 data for individual states.

The last complete Census with detailed national and state data is 2007. The Census data are collected in two separate surveys, one for employer firms and one for non-employer firms.

County Business Patterns

This Census survey provides 2012 California data related to the numbers of business establishments for employer firms.

IHS Global Insight

IHS Global Insight was used to forecast economic growth.

Methodology

The Census Bureau uses the North American Industry Classification System (NAICS), and information regarding this coding system can be found in the NAICS manual published by the Executive Office of the President – Office of Management and Budget.

Definitions

- Tangible personal property - Any personal property that may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses.
- Establishment - A single physical location where business is conducted or services are performed.
- Firm - A business organization or entity consisting of one or more domestic establishments under common ownership or control.
- Employer – A business that has paid employees.
- Non-employer – A business that has no paid employees, has annual business receipts of \$1,000 or more (\$1 or more in the construction industries), and is subject to federal income taxes. Most non-employers are self-employed individuals operating very small unincorporated businesses, which may or may not be the owner’s principal source of income.
- Corporation - An incorporated business that is granted a charter recognizing it as a separate legal entity having its own privileges, and liabilities distinct from those of its members.
- Partnership - An unincorporated business where two or more persons join to carry on a trade or business with each having a shared financial interest in the business.
- Sole Proprietorships - An unincorporated business with a sole owner.
- Service Annual Survey (SAS) - A mandatory annual survey that collects estimates of operating revenue, operating expense, and inventory from firms in service industries. This supplements the Economic Census.

2012 Services Receipts

Staff used 2012 Census services receipts for California if available; however the 2012 data for California was not available for many industries. In these instances, staff used the 2007 US Economic Census services receipt data and calculated the state-to-national ratio for each service industry. They then applied that percentage to the national receipts to determine California’s 2012 receipts per industry.

Estimate Limited to Current Non-taxable Sales

Some revenues received by service industries are already subject to sales and use taxes under current law. For example, food, drinks, and souvenirs sold at sporting events are already subject to sales and use taxes. These revenues are excluded to prevent double counting. Staff used Product Lines reports from the 2007 Economic Census to determine taxable portions of service industries' revenues. The Product Lines report details sources of revenue for each industry. In some cases staff also used these product lines to subtract income sources that were determined not to be subject to sales and use tax. For example, investment earnings from endowments to museums were subtracted from museum receipts. Whether a product line was found to be subject to sales and use tax required some exercise of judgment.

Taxable portions varied significantly, depending on the specific services industry. In most cases the taxable portions were close to one hundred percent. However, many service industries provide tangible products that are already taxed. For example, publishers are considered to be an information service, but sales of printed publications are subject to the sales and use tax. Only the digital publication revenues will be taxed as services. Similarly, car rentals are considered to be a service but most car rental revenues are already taxed as leases.

Utilities

Gas, electricity, and water are exempted from sales and use taxes when delivered to consumers through mains, lines, or pipes (Reference Sales and Use Tax Law, Chapter 4. Exemptions, Article 1. General Exemptions, Section 6353). This sector was not included in the overall grand total; however, staff calculated an estimate separately for both employers and non-employers.

Insurance Industry Exemption

The insurance industry is generally exempt from most forms of taxation by the California Constitution Article 13 Taxation. Therefore, it was not included in the overall grand total. However, staff calculated an estimate separately for both employers and non-employers. This included all types of insurance, such as, home, auto, life, etc.

Growth Rates

Staff used the March 2015 economic forecast from IHS Global Insight to estimate growth rates in each services industry from calendar year 2012 to fiscal year 2015-16. Service consumption forecasts for the industry most closely related to each NAICS code were used. For instance, transportation and warehousing (NAICS 48 and 49) were grown from 2012 to FY 2015-16 using public transportation spending information.

Tax Rates

The most current January 2015 data were used to calculate the average statewide tax rate, including local district taxes. The total average statewide tax rate is 8.42 percent (see below).

Establishments and Firms

A firm may have more than one physical establishment as a place of doing business. Most Census data are tabulated by establishments, not by firms. However, in the 2007 Economic Census, national data are tabulated for both. Staff calculated the 2007 national ratio of firms to establishments and

assumed this ratio held for California. For non-employers, staff assumed a one-to-one ratio for firms to establishments.

Non-employer Firms

California non-employer data from the 2012 Economic Census were released last year. Many industries were released for California at the five-digit NAICS code level of detail. However, more detailed industries are available for employers than for non-employers. Staff obtained 143 industries for non-employers, with 99 at the five-digit level, and 44 industries at the three or four-digit level. The California non-employer data provided a breakdown by type of legal organization: corporations, partnerships and sole proprietorships, which was lacking in the employer data.

Staff followed the same methodology regarding taxable portions and growth rates for both non-employer and employer firms. In doing so, staff assumed that the Product Lines percentage relationships applied to non-employer firms.

Total Revenue Impact

Total receipts for all currently non-taxable services are \$1.456 trillion.

Revenue Summary

The \$122.63 billion revenue impact from taxing all currently non-taxable services would be as follows (billions):

State General Fund	3.9375%	\$57.35
Prop 30	0.25%	\$3.64
Local Revenue 2011	1.0625%	\$15.47
Local Revenue 1991	0.50%	\$7.28
Public Safety Fund	0.50%	\$7.28
Local Sales and Use Tax	1.25%	\$18.21
Special District	0.92%	\$13.40
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Statewide Average Rate	8.42%	\$122.63

Qualifying Remarks

- Some of the services identified are specifically exempted or excluded from tax under current law. Any legislation to impose tax on services would require corresponding amendments to the sales and use tax law to address the current statutory exemption or exclusion.
- This estimate does not include out-of-state establishments.
- The permit counts do not correspond directly with the number of firms due to changes in the NAICS codes. The permit counts are rolled up to the two-digit NAICS code.
- Every effort was made to avoid duplication using US Economic Census data.
- Staff assumes 100 percent compliance; however, due to differences in the nature of services compared to goods, compliance may be lower. It may be more difficult to track a service provided than goods sold.

- This estimate does not account for any currently taxed fabrication labor charges, such as assembly charges by contractors to affix fixtures to real property; however, these charges do not significantly impact this estimate.
- This estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

Joe Fitz, Chief Economist
April 14, 2015

Table 1

Two-Digit NAICS	Service	Estimated 2015-16 Receipts	State General Fund 3.9375%	Total Average Statewide 8.4200%	Estimated California Establishments in 2012*
11	Support activities for agriculture and forestry	1,933,701,425	76,139,494	162,817,660	10,025
21	Support activities for mining	2,814,696,781	110,828,686	236,997,469	744
23	Construction**	87,885,487,963	3,460,491,089	7,399,958,086	271,798
44	Automobile dealers	5,710,000,000	224,831,250	480,782,000	3,220
48-49	Transportation and warehousing	103,236,614,471	4,066,407,528	8,695,657,495	149,530
51	Information	153,707,493,504	6,052,232,557	12,942,170,953	73,860
52	Finance & insurance	225,083,591,772	8,862,666,426	18,952,038,427	70,538
53	Real estate & leasing	102,408,762,385	4,032,345,019	8,622,817,793	352,490
54	Professional, scientific, & technical services	300,583,558,665	11,835,477,622	25,309,135,640	625,618
56	Administrative and Support and Waste Management and Remediation Services	96,041,878,530	3,781,648,967	8,086,726,172	288,414
61	Educational services	8,384,588,695	330,143,180	705,982,368	83,614
62	Health care & social assistance	255,270,247,799	10,051,266,007	21,493,754,865	371,430
71	Arts, entertainment & recreation	42,935,439,492	1,690,582,930	3,615,164,005	210,211
72	Accommodations	26,793,441,971	1,054,991,778	2,256,007,814	13,241
81	Other Services Except Public Administration	43,573,908,655	1,715,722,653	3,668,923,109	510,385
Grand Totals, All Services		1,456,363,412,108	57,345,775,185	122,628,933,856	3,035,118

*Estimated California Firms combines employer firms and non-employer establishments. For non-employers, staff assumed a one-to-one ratio for establishments to firms.

**For construction, the estimate does not account for any currently taxed fabrication labor charges, such as assembly charges by contractors to affix fixtures to real property. However, staff does not anticipate such charges to significantly impact this estimate.

Table Guide

Report Title	Excel Sheet Title	Brief Description
Estimated Revenues Generated from Extending the Sales & Use Tax to Services: Employer and Non-employer Establishments	Grand Total	Grand total of all services for both employer and non-employer establishments. Sorted by NAICS code.
Estimated Revenues Generated from Extending the Sales & Use Tax to Services: BOE Permit Counts for Firms (Employer and Non-employer)	Two-Digit Sums	All services NAICS codes at the two-digit level with current BOE permit count.
Estimated Revenues Generated from Extending the Sales & Use Tax to Services: Firms	Firm Sort	Sorted by firms.
Estimated Revenues Generated from Extending the Sales & Use Tax to Services: Firms	Revenue Sort	Sorted by estimated revenue.
Estimated Revenues Generated from Extending the Sales & Use Tax to Services: Employers	Employer Revenues	Listing of all employer firms and establishments by NAICS codes.
Estimated Revenues Generated from Extending the Sales & Use Tax to Services: Non-employers	Non-employer Revenues	Listing of all non-employer establishments by NAICS codes.
Estimated Revenues Generated from Extending the Sales & Use Tax to Services: Non-employer Partnerships	Non-employer: Partnerships	Listing of all non-employer partnerships by NAICS codes.
Estimated Revenues Generated from Extending the Sales & Use Tax to Services: Non-employer Sole Proprietorships	Non-employer: Sole Proprietorships	Listing of all non-employer sole proprietorships by NAICS codes.
Estimated Revenues Generated from Extending the Sales & Use Tax to Services: Non-employer Corporations	Non-employer: Corporations	Listing of all non-employer corporations by NAICS codes.
Estimated Revenues Generated from Extending the Sales & Use Tax to Services: Employers - Insurance	Employer Ins.	Listing of all employer insurance establishments.
Estimated Revenues Generated from Extending the Sales & Use Tax to Services: Non-employers - Insurance	Non-employer Ins.	Listing of all non-employer insurance establishments. Includes breakdown of partnerships, sole proprietors, and corporations.
Estimated Revenues Generated from Extending the Sales & Use Tax to Services: Employers - Utilities	Employer Utilities	Listing of all employer utility establishments.
Estimated Revenues Generated from Extending the Sales & Use Tax to Services: Non-employers - Utilities	Non-employer Utilities	Listing of all non-employer utility establishments. Includes breakdown of partnerships, sole proprietors, and corporations.