

SB 640 (HERTZBERG): SERVICES TAX

POSITION: The Chamber's Small Business Roundtable opposed SB 640 on April 4, 2017. The Chamber's Public Policy Committee is scheduled to consider the bill on April 11, 2017.

STATUS: SB 640 was introduced by Senator Robert Hertzberg on February 17, 2017 and referred to the Committee of Governance and Finance on March 2, 2017.

AT-A-GLANCE

Current law imposes a tax on the purchase or use of products at the point of sale. This bill would impose a sales tax on services, establish a Retail Sales Tax on Services Fund to accept the tax revenues, and would state the intent of the Legislature that those funds are to be "appropriated to, among other purposes, provide tax relief to middle- and low-income Californians to offset the effect of a sales tax on services."

SUMMARY

SB 640, as currently drafted, would:

- 1 – Impose "a modest sales tax on services."
- 2 - Establish the "Retail Sales Tax on Services Fund" in the Treasury in which the newly created tax revenue would be deposited.
- 3 – Declare the intent of these funds to:
 - (1) Provide tax relief to middle- and low-income Californians to offset the effect of the sales tax on services.
 - (2) Assist in securing greater stability for California's infrastructure, its workforce, and its health care and education systems, including higher education.
 - (3) Enhance California's business climate and incentivize and protect small businesses.

The legislation exempts very small businesses from the sales tax on services. In the previous legislative session, similar Hertzberg legislation (SB 8) defined "very small businesses" as those with under \$100,000 gross sales.

Unlike the existing sales tax on goods, local jurisdictions would not have the ability to increase the sales tax on services.

In less detail, the legislation states its intent to go far beyond merely instituting a services tax by realigning "the state's outdated tax code" with references to revenue-neutral reforms to the income tax structure, ensuring that "out-of-state corporations that do business in California contribute their fair share," lowering the corporate income tax on small businesses, and significantly reducing the minimum franchise tax.

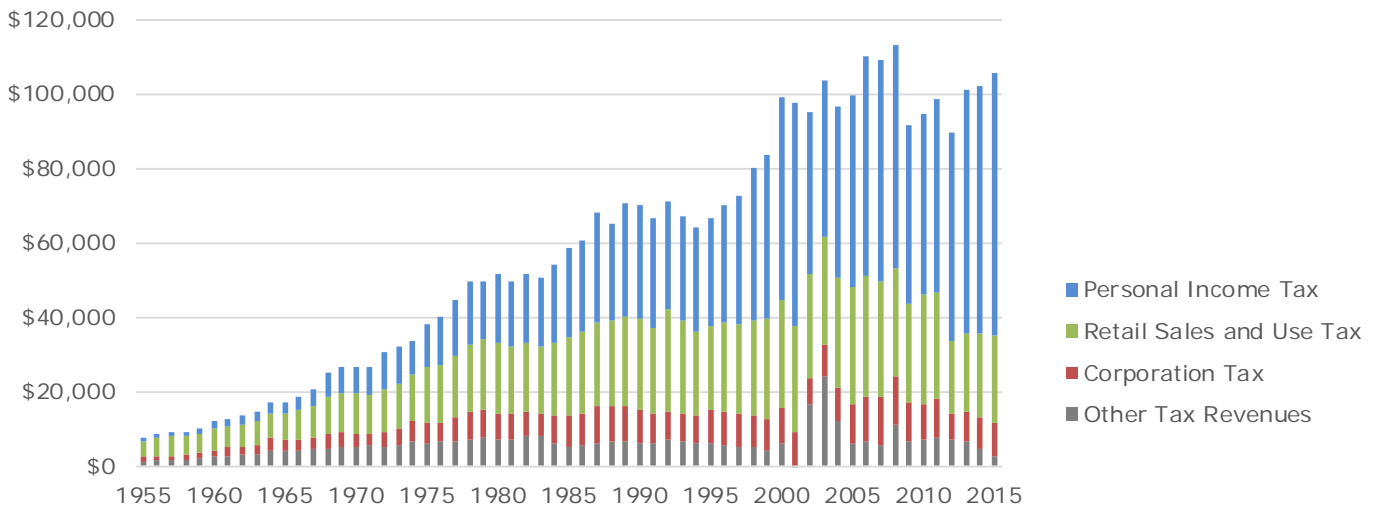
ANALYSIS

The intent of the legislation appears to be to increase the stability of tax revenues and to address income inequality by creating a tax structure that the author believes is fairer for middle- and low- income populations, and to increase tax revenues to be used for investing in infrastructure, workforce development, healthcare and education systems, including higher education. Specific tax rates and details regarding implementation are limited past the creation of a services tax.

The author cites the dependence of the State on top earners and the resulting “dramatic revenue swings” as the economy moves through cycles and phenomenon. As further evidence for the need for reform, the author cites the shift from an agriculture- and manufacturing-based economy to a services-based economy over several decades with no substantial structural change to the tax system.

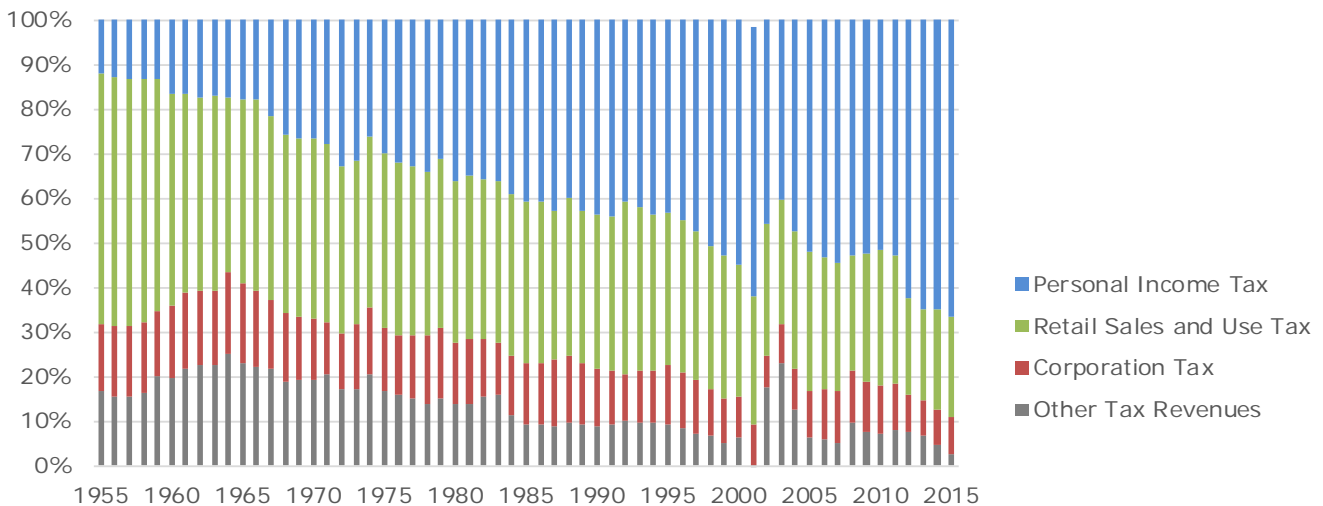
Presented below, is historical data on “State of California Revenues” available from the California Legislative Analyst’s Office. Revenue growth has been strong in the long term while not particularly stable in the short term. The sources of revenue has shifted towards Personal Income Tax from Sales Tax over time only when seen as a percentage of all State tax revenues. In real terms (adjusted for inflation), the revenue from Corporate sales taxes have stayed relatively flat over the past two decades, while personal income tax revenue has increased over 140 percent.

Historical California State Revenues (in millions of 2015 dollars)



Source: SDRCC, Bureau of Labor Statistics, [California State Legislative Analyst's Office](#)

Historical California State Revenue Source Share



Source: SDRCC, Bureau of Labor Statistics, [California State Legislative Analyst's Office](#)