The sales tax is not what it used to be. Although it’s still one of the most important and longest-standing sources of revenue for the 45 state governments that levy it, the tax has steadily lost ground for the last several decades as consumers increasingly spend more on services than on retail goods.

Services can be grouped in broad categories, such as professional (accounting, legal), personal (tanning, salons, barbers) and business (advertising, magazines). Many of these are exempt from sales taxes.

Most state legislatures adopted their sales taxes between 1930 and 1960 and chose to apply the tax to the sales of tangible personal property, which represented 60% or more of the average consumer’s total personal expenditures during that time. Since then, however, the amounts consumers spend on tangible property and services have basically reversed. Services now make up about two-thirds of personal consumption.

This narrowing of state sales tax bases has resulted in dwindling revenue. To compensate, lawmakers have gradually raised sales tax rates, which averaged 3.25% in 1970, 5% from 1990 through 2000, and 6% today.

Tax policy experts on both ends of the political spectrum generally agree that good tax policy follows the widely accepted principle of “broad bases, lower rates” and should fall to a greater degree on the things people buy the most.

The number of services taxed by each state varies fairly widely, according to a recently updated survey by the Federation of Tax Administrators. Only six states—Delaware, Hawaii, New Mexico, South Dakota, Washington and West Virginia—tax services broadly and few have expanded their
tax bases. Perhaps most notable in the updated survey was how little things had changed from when it was last conducted, in 2007. Iowa and Kentucky both expanded their tax bases in 2018 to include a handful of services (tanning, landscaping, subscription services), and Connecticut added dry cleaning and interior design work in 2019. (Connecticut has added 20 services over the last decade, the most in the country.)

A significant majority of states, however, added fewer than 10, if any. But that may be changing.

In a December special session, Utah lawmakers passed an extensive tax reform package. Along with lowering income taxes, restoring the full grocery tax and repealing exemptions on motor fuel taxes, the legislation also eliminates certain sales tax exemptions (college sporting events, newspaper subscriptions, external car washes) and expands the sales tax to certain services (pet grooming and care, streaming media, parking lots and dating referral sites, to name a few). The loud buzz the overhaul generated in the Beehive State will likely pique interest elsewhere. A revenue working group in

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**IT’S NOT ONLY BUSINESSES THAT OPPOSE TAXING SERVICES.**

**ADDING TAXES TO THE COST OF POPULAR DIGITAL GOODS, ENTERTAINMENT AND OTHER CONSUMER SERVICES CAN ALSO DRAW CRITICISM FROM THE PUBLIC.**

Massachusetts is considering ways to tax services.

The limited action on this front is due partly to the challenges in administering and defining taxation of services. Many services are complex and industry-specific, making them more difficult than tangible goods for states to value, define and determine how to audit.

It can be a very politically challenging task as well. No industry wants to see new tax burdens, and service taxation debates are prone to hyperbole. A proposed tax on legal services in Wisconsin in 2009 resulted in the state bar claiming it was nothing less than an attempt to tax “justice itself.” And in Washington, D.C., a tax on health club services was derided by the industry as a penalty for being healthy.

It’s not only businesses that oppose taxing services. Adding taxes to the cost of popular digital goods, entertainment and other consumer services can also draw criticism from the public. In fact, voters in Arizona and Missouri recently passed constitutional measures that ban the taxation of services. And at least two groups in Utah have already begun gathering signatures to force a referendum on the ballot to give voters the opportunity to repeal the state’s new law.

Although concerns about shrinking sales taxes have been building for decades, state legislatures have largely resorted to passing piecemeal efforts rather than adopting measures to tax services broadly. This year may very likely feature renewed state efforts.

Jackson Brainerd is a senior policy specialist in NCSL’s Fiscal Affairs Program.