

SALES TAXATION OF SERVICES: 1996 UPDATE



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FOREWORD

The inexorable shift in consumer expenditures from the purchase of goods to the purchase of services continues to raise concerns about the long-term vitality of state retail sales taxes which traditionally are applied primarily to the sale of tangible personal property. While a stable and growing economy has improved states' fiscal conditions and slowed expansion to services, long-term fiscal pressures facing the states make it likely that a number of states will consider broadening their sales tax to include various services in the future.¹

To assist states in addressing this issue, the Federation of Tax Administrators (FTA) undertook an in-depth survey in 1990 to determine the breadth of states' sales taxes as applied to services. The results were published in FTA Research Report RR-137. An update of this survey, to include changes in state policy made through July 1, 1992, was published in FTA Research Report RR-143. This report updates the survey results to include changes made through July 1, 1996. It gives a general overview of how states treat services, summarizes the key legislative changes made since the 1992 survey, and examines the different service categories and the extent of taxation for each. The complete survey results are also contained in Appendix A to the report.

The data in this report were obtained through a 1996 survey of state tax agencies. The compilation of the survey is the result of extensive work by Fred Scharf, Research Assistant. The analysis was performed by Ronald Alt, FTA Senior Research Associate. The Federation of Tax Administrators expresses its appreciation to state tax agencies for their assistance in gathering the information for the report. Questions or comments should be directed to FTA.

Harley T. Duncan
Executive Director

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SALES TAXATION OF SERVICES: 1996 UPDATE

Overview

The long-term viability of state and local retail sales taxes continues to be threatened by a variety of economic and technological trends. One of the primary threats is the increasing proportion of economic activity related to the provision of services as opposed to goods. Many state sales taxes were enacted in the 1930s when services accounted for a small portion of overall economic activity. As a result, most state sales taxes have, as their primary base, the sale of tangible personal property. Since then, the U.S. economy has shifted away from the manufacture and sale of tangible property to activity based on service-related transactions. In some cases, service transactions today did not exist when the sales tax was originally conceived (e.g., computer and telecommunications services). As a result, state retail sales taxes are, in many cases, not well-suited for the economy of today.

To assist state tax policymakers in better understanding the issues associated with the imposition of sales taxes on service transactions, the Federation of Tax Administrators undertook an in-depth survey in 1990 to determine the breadth of state sales taxes as applied to services. The survey was later updated to include changes in state policy made through July 1, 1992.¹ This report discusses FTA's recent update of the sales taxation of services survey to include changes in law or interpretation made through July 1, 1996. The first section provides a general overview of the degree of service taxation in each state and summarizes the key changes made since the 1992 Update. The second section discusses how the data were compiled. This is followed by a section outlining the major legislative changes enacted during this period. The final section examines the taxation of certain key services among the states. A complete summary of the results is given in Appendix A. The issues surrounding the taxation of services have been discussed extensively by others and will not be elaborated here.²

The original 1990 survey was instrumental in demonstrating that most states taxed some types of services, but that the extent of service taxation varied considerably among the states. The 1992 Update reflected that states were taking a more incremental approach to broadening the sales tax base,

by opting to add selected, enumerated services during that period. The 1996 Update reveals that the rate of expansion of the sales tax base to include services has declined. As the improvement in the economy during the past several years has translated into more stable state budgets, state policymakers have been reluctant to impose tax increases or new types of taxes. Indeed, no state has undertaken a broad-based expansion of the sales tax to services since Massachusetts in 1990 and Florida in 1987 (both were subsequently repealed).³ Also, fewer states enacted legislation expanding the sales tax base to selected services than in earlier years.

As with the earlier surveys, the 1996 survey catalogs state practices in the taxation of over 160 service-related transactions under the general retail sales tax or another special excise/gross receipts tax. The survey results are summarized in Table 1 (see page 2).

The original 1990 survey demonstrated that most states tax a wide range of services including intangible items such as utility services, admissions, repair services, and lodging services. Beyond these general categories, however, the states exhibit great diversity in the extent to which they tax the full range of services covered in the survey. Hawaii, New Mexico, and South Dakota have general sales tax systems with broadly defined bases that tax the bulk of the enumerated services. Of the 164 services covered in the survey, Hawaii taxes 157, New Mexico taxes 152, and South Dakota taxes 141.

¹See Federation of Tax Administrators, *Sales Taxation of Services—An Update*, RR-143, April 1994.

²See Federation of Tax Administrators, *Sales Taxation of Services—Who Taxes What?* RR-137, April 1991, or *Financing State Government in the 1990s*, ed. Ronald Snell, National Conference of State Legislatures, December 1993, pp. 72-79.

³For a discussion on Florida's experiences, see James Francis, "The Florida Sales Tax on Services: What Really Went Wrong?" in *The Unfinished Agenda for State Tax Reform*, Steve Gold, ed., pp. 129-152. In the case of Massachusetts, see *Financing State Government in the 1990s*, pp. 72-79.

Table 1
Number of Services Taxed by Category and State

State	Utilities	Personal Services	Business Services	Computer Services	Admis./ Amus.	Prof. Services	Fabrication, Repair & Installation	Other Services	Total
Alabama	9	2	6	1	10	0	1	3	32
Alaska	0	0	0	0	0	0	0	1	1
Arizona	12	2	5	1	11	0	2	24	57
Arkansas	14	6	11	1	11	0	11	11	65
California	5	2	3	0	0	0	0	3	13
Colorado	4	0	2	1	2	0	3	2	14
Connecticut	10	11	20	6	13	0	14	13	87
Delaware*	9	20	33	6	10	8	19	37	142
District of Columbia**	10	7	11	6	6	0	13	10	63
Florida	7	4	8	2	13	0	16	14	64
Georgia	10	3	3	2	8	0	2	6	34
Hawaii	16	20	34	6	13	8	18	42	157
Idaho	0	3	4	0	11	0	6	5	29
Illinois	12	1	1	1	0	0	1	1	17
Indiana	8	4	2	2	2	0	0	4	22
Iowa	13	15	18	0	13	0	14	21	94
Kansas	10	10	9	2	13	0	16	16	76
Kentucky	10	2	4	0	6	0	3	1	26
Louisiana	12	9	5	3	8	0	13	8	58
Maine	9	1	6	3	2	0	4	2	27
Maryland	5	3	13	1	11	0	4	2	39
Massachusetts	9	1	4	0	1	0	2	3	20
Michigan	12	4	7	1	1	0	2	2	29
Minnesota	15	6	11	2	13	0	4	10	61
Mississippi	8	4	8	3	10	0	14	23	70
Missouri	8	1	2	1	11	0	0	5	28
Montana	12	0	0	0	3	0	0	4	19
Nebraska	14	6	6	3	11	0	5	4	49
Nevada	0	1	4	0	1	0	2	3	11
New Hampshire	8	1	0	0	0	0	0	2	11
New Jersey	6	2	10	0	6	0	14	12	50
New Mexico	16	20	32	6	13	8	18	39	152
New York	9	5	15	4	7	0	16	18	74
North Carolina	10	4	4	1	7	0	1	1	28
North Dakota	6	1	4	0	11	0	1	2	25
Ohio	8	7	14	3	2	0	12	6	52
Oklahoma	8	1	4	2	11	0	0	6	32
Oregon	0	0	0	0	0	0	0	0	0
Pennsylvania	8	6	17	6	1	0	15	8	61
Rhode Island	10	1	6	3	3	0	3	2	28
South Carolina	4	5	6	4	9	0	1	3	32
South Dakota	12	19	28	6	12	4	18	42	141
Tennessee	11	11	6	3	12	0	14	14	71
Texas	12	11	14	6	10	1	11	13	78
Utah	7	8	6	0	9	0	15	9	54
Vermont	3	2	4	1	10	0	2	1	23
Virginia	1	3	4	0	1	0	4	5	18
Washington*	16	20	34	6	10	8	15	43	152
West Virginia	10	17	26	4	13	1	13	26	110
Wisconsin	11	11	6	1	13	0	14	13	69
Wyoming	11	7	6	2	7	0	16	14	63
Number in Category	16	20	34	6	14	8	19	47	164

*Includes the business license tax in Delaware and the business occupation tax in Washington.

**1992 data.

Source: Federation of Tax Administrators, Sales Taxation of Services Survey, 1996.

In two other states exhibiting a high degree of service taxation in Table 1, the ranking is attributable in large part to broad-based, low-rate gross receipts or occupational taxes applied to most businesses. Delaware, which imposes no general sales tax, assesses a 0.4 percent gross receipts tax on most businesses. All but 25 of the services taxed in Delaware are at the 0.4 percent rate. Similarly, Washington State taxes many services through its occupation tax—93 services are taxed at a rate below the general sales tax rate. While these taxes are intended to be imposed on business activities, the economic incidence likely moves forward to the consumer in the form of higher prices as it does with a general sales tax. Since there is little difference in the economic effect of a business or occupational tax and a sales tax, both are included in the survey.⁴

Several other states tax a large number of selected services. These include Arkansas, Connecticut, Iowa, Kansas, Mississippi, New York, Tennessee, Texas, and Wisconsin. These states widely tax utilities, admissions/amusements, and labor and repair services but leave professional services largely untaxed. Within this group, three states—Connecticut, Iowa, and Texas—set themselves apart by taxing personal and business services more extensively, and in the case of Connecticut and Texas, more computer services than is the norm for most states.

At the other end of the spectrum, there are some states that include comparatively few services in their sales tax base, excluding even the more commonly taxed services of utilities and amusements. There are 16 states in which the general retail sales tax is imposed on 30 or fewer of the enumerated services. There are 24 sales tax states which tax fewer than 10 of the 19 enumerated labor and repair services.

Methodology

The data were collected from surveys mailed to each state revenue/tax department in early 1996. The questionnaires listed the state tax rates applicable to the 164 different services as summarized in the 1992 report, along with any comments summarized in the footnotes. States were asked to update the rates applicable to each service and make any comments in the designated section. See Appendix B for a sample of the survey questionnaire mailed to a state.

Because of the magnitude of the survey, FTA did not verify the accuracy of each individual response. We attempted to follow up with the states about any obvious mistakes or misunderstandings. However, most of the data is taken directly from the responses of the individual states. Thus, users should be cautious in directly comparing the 1996 responses with earlier responses since each survey

might have been completed by different people who might interpret the definition of the service differently. Also, many states did not note whether a change was a tax law change or a correction of an earlier mistake.

Changes 1992-1996

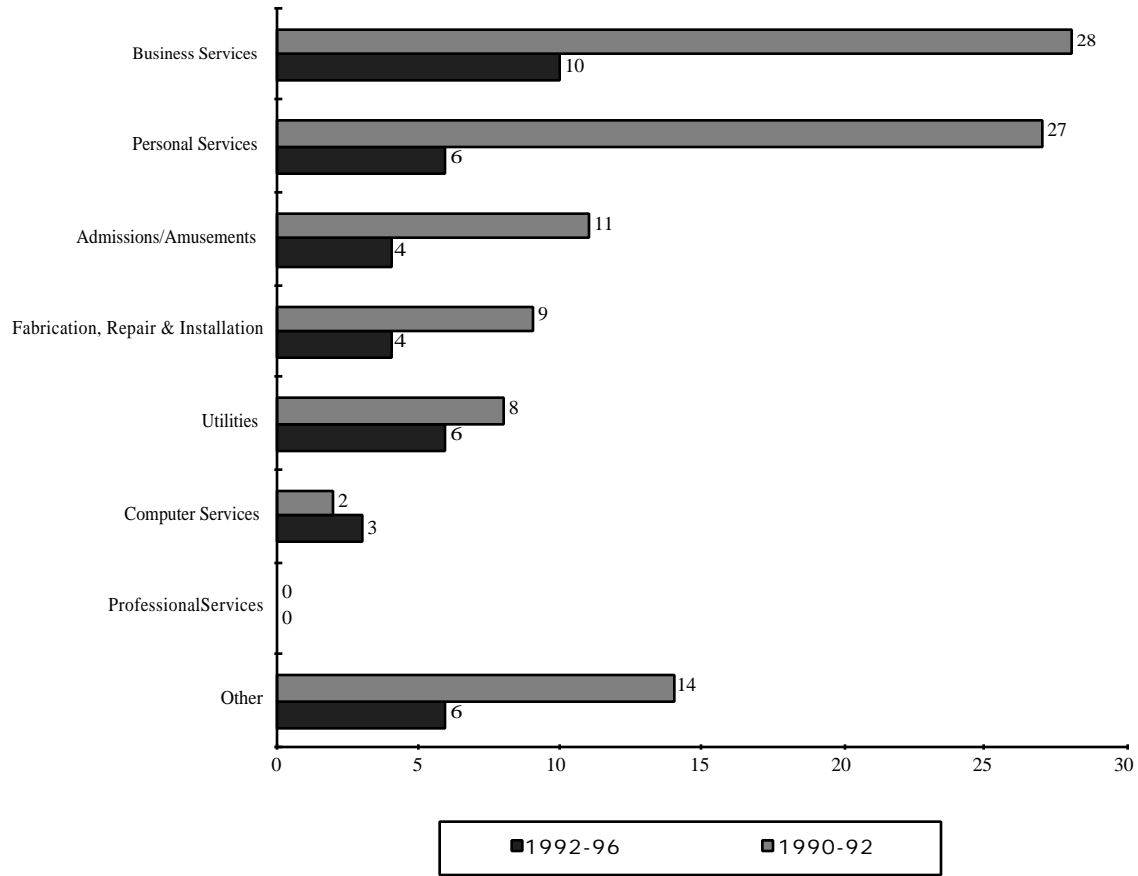
While the individual responses for each state cannot be compared directly with the earlier surveys, an examination of changes in aggregate data can be useful in identifying trends. In addition, a discussion of some of the major pieces of legislation in service taxation will also shed some light on this issue.

The Figure on page 4 summarizes the types of services added to the tax base between the 1990 and 1992 surveys and between the 1992 and 1996 surveys. In so doing, the figure illustrates the types of services most frequently added to the tax base over the time period; it also illustrates that states have added fewer services in the 1992-96 time period than during the 1990-92 period. Most of the activity during both periods is in the business services category, with 28 states adding new business services in 1990-92 and 10 in 1992-96. The next most common category was personal services. No state added any new professional services to their sales tax base during either period.

Several states made significant legislative changes in the degree to which they tax service transactions since 1992. Those actions are summarized in Table 2 (see page 5). In 1993, Arkansas policymakers approved legislation to add several services, increasing the number of services taxed (summarized in the FTA survey) from 52 to 65. They included various business services (debt collection, credit information, janitorial services, and telephone answering services), personal services (health clubs, swimming pool cleaning), and other services. Also in 1993, Ohio added selected services to the sales tax base, increasing from 42 to 52 the number of services taxed. They included janitorial services, exterminating services, selected personal services (including health clubs), and others. South Dakota added several services to its tax base in 1995, increasing from 130 to 141 services taxed. This legislation included services in nearly every category. While Connecticut enacted legislation to exempt several services from taxation (tax preparation, auctioneers, computer and data processing), these exemptions were delayed until Fiscal Year 1997.

⁴For a discussion of the economic incidence of general sales taxes and other gross receipts taxes, see Richard Musgrave and Peggy Musgrave, *Public Finance in Theory and Practice*, McGraw-Hill, New York, 1976, pp. 440-458.

Figure
Number of States Taxing Additional Services
by Category (1990-1992; 1992-1996)



Survey Results

This section discusses the results of the survey, examining each category in more detail. It lists the different services included in the categories and discusses the different treatments in the various states. The numbers refer to the item numbers in the table presented in Appendix A.

Repairs, Custom Fabrication and Installation

Beyond admissions and utilities, one of the more widely taxed categories is fabrication, repairs, and installation because of the close relationship to tangible personal property, the traditional focus of sales taxes. In fact, taxation of these sorts of labor services tends to be the demarcation point between states that tax services relatively extensively and those that make relatively little use of a tax on service transactions. Only eight states—Alabama, Arizona, Geor-

gia, Maryland, Minnesota, Nebraska, Oklahoma, and South Carolina—do not tax labor and repair services while taxing more than 30 of the services covered in the survey.

The survey asked states how they tax 19 different types of labor services dealing with the fabrication, installation or repair of tangible personal property (numbers 154 through 173). In addition to general repair labor, the survey included labor repair charges on aircraft, interstate vessels, intrastate vessels, commercial fishing vessels, railroad rolling stock, motor vehicles, electronic equipment, other tangible property, and goods repaired under warranty. The taxability of repairs or remodeling of real property and service contracts were also included. A breakdown of installation charges by the seller or third party is included. The list of services also includes custom fabrication, custom processing on the customer's property, custom meat slaughtering, taxidermy, and welding labor.

Table 2
Summary of Major Service Tax Legislation

Arkansas	In a special session, the legislature approved a bill to extend the gross receipts (sales) tax to armored car services, credit reporting, debt collection, cleaning and janitorial services, pool cleaning, pager services, lawn care and landscaping, answering services, auto parking and storage, fur storage and tanning salons. Effective March 1993.
Connecticut	In 1996, legislation was approved to <i>exempt</i> several services previously taxed. They include tax preparation, auctioneers, and computer and data processing services. However, these exemptions were delayed until July 1997.
Ohio	In a special session, the legislature approved a bill to extend the sales tax base to include janitorial services, exterminating services, personnel services (except employee leasing and health services like nursing), health club fees, and sports club fees.
South Dakota	Effective July 1995, legislation was approved to repeal several sales tax exemptions.
Washington	In 1993, legislation was approved which significantly revised the services taxed under the Business and Occupation tax and the state sales tax.

Only Delaware, through its occupational tax, taxes all 19 services examined in this category. Delaware taxes all these services at 0.4 percent except for repairs and remodeling of real property, which are taxed at 0.65 percent. Hawaii taxes all the services except labor repairs on interstate vessels, while New Mexico and South Dakota exempt only warranty services (unless reimbursed by a company other than the manufacturer in New Mexico). South Dakota also has a contractor's excise tax imposed at 2 percent in lieu of the sales tax for repairs or installations involving real property.

At the other end of the spectrum are states that tax few or no labor services. Four of the states without a retail sales

tax—Alaska, Montana, New Hampshire, and Oregon—apply no other taxes to repair, installation, and fabrication services or materials. Six states tax no labor services—Illinois, Indiana, Missouri, North Dakota, Oklahoma, and South Carolina—but do tax materials used in providing the service. Seventeen states exempt all labor services except most custom fabrications. They are: Alabama, Arizona, California, Georgia, Idaho, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Nebraska, Nevada, North Carolina, Rhode Island, Vermont, and Virginia. The remaining states tax a variety of labor services for repairs, installations, and fabrication.

Twenty-three states tax labor services for the repair of tangible personal property. They are summarized in Table 3. Most of the remaining states exempt the labor service if it is separately stated on the bill. Illinois is the only state to specifically exempt labor that is not separately itemized by permitting a 50 percent exemption. Some states tax labor repair services for specific types of personal property. Arkansas and Iowa responded with a list of goods for which repair services are taxable. Ohio and Wisconsin tax labor services if the tangible property being repaired is taxable.

Table 3
Taxation of Labor Services
for Repair of Tangible Personal Property
(By State)

Arkansas	New York
Connecticut	Ohio
Delaware	Pennsylvania
District of Columbia	South Dakota
Florida	Tennessee
Hawaii	Texas
Iowa	Utah
Kansas	Washington
Louisiana	West Virginia
Mississippi	Wisconsin
New Jersey	Wyoming
New Mexico	

Because of their traditional focus on personal property, most state sales taxes exempt labor services involved with real property and new construction of real property. While 23 states tax many consumer-oriented repairs, Table 4 lists only 13 states that tax labor services on real property. Nine states—Florida, Iowa, Mississippi, Ohio, Pennsylvania, Tennessee, Utah, Wisconsin, and Wyoming—exempt real property while taxing many other labor services, including installations. Connecticut and Texas tax repairs and remodeling on commercial property only.

Table 4
Taxation of Labor Repairs to Real Property
(By State)

Arizona	New Mexico
Connecticut*	New York
Delaware	South Dakota
Hawaii	Texas*
Iowa	Washington
Kansas	West Virginia
New Jersey	

*Commercial/Business property only.

Meanwhile, some states apply lower tax rates to repairs to real property to avoid taxing the labor involved. South Dakota applies a 2 percent contractor's excise tax, half the sales tax rate. Arizona allows contractors to deduct 35 percent of the final price to cover labor cost. Iowa exempts remodeling, while taxing repairs. In Mississippi, labor services on small remodeling jobs are exempt while any contract over \$10,000 is subject to the contractor's tax (3.5 percent which is one-half the sales tax rate).

Only 10 states tax construction contracts (Table 5), as some states treat new construction differently than repairs and remodeling (numbers 10 through 13). Iowa and New Jersey tax the latter while exempting new construction. Connecticut, New Jersey, New York, and West Virginia exempt labor services if the work constitutes a capital improvement in the property. Kansas and Texas exempt all new construction and all residential construction. Arizona, Mississippi, and South Dakota apply the same rules as described under labor repairs.

Table 5
Taxation of Income from Construction Contracts
(By State)

Arizona	Mississippi
Connecticut*	New Mexico
Delaware	South Dakota
Hawaii	Texas*
Kansas	Washington

*Commercial/Business property only.

Another area of differentiation among the states is the taxation of vehicles that move in interstate commerce versus

the repair of vehicles not in interstate commerce. For example, while 20 states tax repair services to shipping vessels, only 13 tax repairs to interstate vessels (shown in Table 6). The lower level of taxation of interstate vehicles exists for two reasons. First, the exemptions seem to be holdovers from now overturned legal principles that held states could not tax items moving in interstate commerce.⁵ Second, there is a concern among states about interstate tax competition and that interstate repairs may be moved to a state that does not tax such services.

Table 6
Taxation of Repairs to Interstate Vessels
(By State)

Arkansas	New Mexico
Connecticut	Pennsylvania
Delaware	South Dakota
District of Columbia	Tennessee
Florida	Utah
Iowa	Wyoming
Mississippi	

The second argument is demonstrated by the fact that certain states limit their exemption for interstate vessels to only large, commercial ships. Six states tax repairs on small vessels only, with Arkansas, Pennsylvania, Rhode Island, Tennessee, and Wisconsin exempting vessels over 50 tons and Michigan exempting vessels over 500 tons. Texas explicitly exempts commercial boats while taxing sport fishing or recreational boat repairs. Florida taxes a portion of the gross receipts from repairs to interstate vessels, apportioning the total sales according to the percentage of miles traveled in state waters.

Repairs of aircraft and railroad rolling stock show a lesser level of differentiation between vehicles used in interstate commerce and those that are not. Twenty states tax repair services on aircraft, while New Jersey, New York, Pennsylvania, and Wisconsin are the only states that exempt interstate aircraft. Labor charges on repairs to railroad rolling stock are taxed in 13 states, with five—Arkansas, Georgia, Maryland, New York, and Washington—providing exemptions for repairs to interstate railroad stock. Table 7 lists those states that tax repairs to railroad rolling stock. More states tax labor repair services to motor vehicles and electronics (22 and 23, respectively) than repairs to interstate vessels and railroad rolling stock (13 states).

⁵*Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

Table 7
Taxation of Repairs to Railroad Rolling Stock
(By State)

Arkansas	New Jersey
Connecticut	New Mexico
Delaware	New York
Florida	South Dakota
Hawaii	Tennessee
Iowa	Utah
Louisiana	

The distinction most states use to determine the taxability of labor services used in custom fabrication is whether it is part of the sale or creates a taxable good. This can be seen in the survey results as 39 states tax custom fabrication labor in general, while only 27 states tax fabrication labor on the customer premises when the customer supplies the materials. Tennessee taxes the transaction when the activity changes the character of the customer's property. Only Arkansas and South Carolina allow exemptions if labor is billed separately.

The survey requested information on differences in taxing installation services if performed by the seller or a third party. Few states make this distinction. In most states, installation is not taxed if it is a separately stated cost or if the product is not sold with installation included. Florida taxes installation labor if the installer supplies any parts. Ohio links taxation of installation services to the taxability of the product; if the product is exempt, then the installation services are exempt.

Utilities

As Table 1 illustrates, all states except Alaska, Idaho, Nevada, and Oregon tax some form of utility services either through the sales tax or a separate gross receipts levy. The types of utilities examined in the survey (numbers 29 through 44) include intrastate and interstate telephone, electricity, water, natural gas, other fuels, and sewer services. While 44 states tax intrastate telephone services, only 21 tax interstate telephone and telegraph. Electricity is taxed in 37 states, water in 19 states, and sewer services in 13 states. Fuels are taxed in 39 states.

The survey differentiates between commercial and residential uses of utilities. In 17 states, certain residential utility services are exempt while business purchases of the same services are taxable. They are Connecticut, Delaware, Florida, Kansas, Kentucky, Maine, Maryland, Massachu-

setts, Mississippi, Missouri, New York, Oklahoma, Pennsylvania, Rhode Island, Tennessee, Texas, and Vermont. Indiana and Utah, on the other hand, tax residential uses but exempt many industrial uses of utility services. Michigan taxes certain residential uses of utility services at a lower rate than industrial uses.

While many states tax commercial and industrial uses of certain utility services, some provide an exemption for services used directly in production or manufacturing. They include Colorado, Connecticut, Florida, Indiana, Iowa, Kansas, Kentucky, Maryland, Massachusetts, Michigan, Minnesota, Nebraska, Oklahoma, Pennsylvania, Rhode Island, Texas, Vermont, Virginia, and Wyoming. Several states tax sales for production uses at a lower rate to minimize any pyramiding effect. For example, Kansas taxes water, electricity and fuel consumed in production at 2.5 percent, while Mississippi and Tennessee both apply a 1.5 percent rate to industrial use of many utility services. Maine applies the sales tax to 95 percent of sales price. Wisconsin provides an income/franchise tax credit for sales taxes paid on electricity used in manufacturing.

While 44 states tax business telephone services (42 tax residential) within their state, only 21 states (20 residential) tax business interstate calls (see Table 8). In most of these states, interstate telephone service is taxable if the call originates or terminates in the state, providing it is also billed to an address in the state. However, Minnesota, Texas, and Wisconsin tax interstate calls originating in the state only.⁶ Meanwhile, cellular telephone services are taxed in 40 states.⁶

Table 8
Taxation of Interstate Telephone
(By State)

Arkansas	New Jersey
Connecticut	New Mexico
District of Columbia	Ohio
Florida*	Oklahoma
Hawaii	Pennsylvania
Illinois	Rhode Island
Kansas	Tennessee
Massachusetts	Texas
Michigan	Washington
Minnesota	Wisconsin
New Hampshire	

*Industrial Use Only

⁶For more information on how cellular telephone services are taxed in each state, see Washington State Department of Revenue, *Interim Report to the Legislature—Taxation of Cellular Communications in Washington State*, November 1992.

Business water services are taxed in 19 states while residential water services are taxed in only 13. Many states also treat water services provided through a public utility or water main differently than bottled water. Nine states — Colorado, Georgia, Nevada, New York, North Carolina, Ohio, Utah, Virginia, and Wyoming — exempt water services provided through water mains, but tax bottled water.

Personal/Business Services

The survey examined 59 different services covering a wide variety of business and personal activities. The results illustrate several different approaches to service taxation. The three major service-tax states—Hawaii, New Mexico, and South Dakota—along with Delaware, Washington, and West Virginia, widely tax both business and personal services. Other states tax a selected number of services. The sales tax bases in New York and Pennsylvania emphasize business services, taxing more than 15 of the 34 business services examined. However, they tax fewer than half of the personal services. Four other states—Kansas, Tennessee, Texas, and Wisconsin—have sales tax structures that tax personal services more heavily. Connecticut and Iowa, on the other hand, have a more balanced approach, applying a tax to about half of the business and personal services. The remaining states leave this area largely untaxed.

Personal Services. The survey examined the taxation of 20 different personal services including: barber services, dating services, and laundry service (numbers 53 through 72). The number of states taxing each service varied widely, with 39 states taxing tuxedo rentals while only 6 states tax barber/beauty services and tax return preparation services. Generally, while services involving tangible personal property—garment alteration, shoe repair, laundry—are taxed by a greater number of states, only tuxedo rental is taxed by more than half the states. Still, a number of states have added several personal services to the sales tax base since the original survey in 1990. The most common are health clubs (an increase from 12 to 20 states), 900 phone service (10 to 24 states), and gift wrapping (10 to 18 states).

Delaware, Hawaii, New Mexico, and Washington tax all 20 personal services surveyed. South Dakota and West Virginia tax 19 and 17 respectively, and six other states tax at least half the personal services—Connecticut, Iowa, Kansas, Tennessee, Texas, and Wisconsin. Meanwhile, 23 states tax three or fewer of the personal services.

The states' approach to the taxation of labor services or professional services not involving the transfer of tangible personal property influences how they treat some personal services. Some states try to separate labor services from

tangible goods when applying the sales tax, as illustrated in the taxation of funeral services. While 15 states apply sales taxes to funeral services, five states — Georgia, Indiana, Kansas, Utah, and Wyoming — apply only half the general sales tax rate or exempt half the total bill to account for nontaxable labor services involved. Iowa, Louisiana and Michigan give funeral parlors the option of exempting all separately stated labor services or exempting half of the total bill. Tennessee allows a \$500 exemption and North Carolina a \$1,500 exemption to cover the cost of the services. Eight states—Arizona, Arkansas, Connecticut. Colorado, Oklahoma, South Carolina, Virginia and West Virginia—explicitly exempt all funeral services but impose the sales tax on all tangible sales. In these states, the bill must separately list the cost of tangible property.

As should be expected, services involving tangible personal property such as garment alteration, shoe repair, and laundry are taxed by a greater number of states. Nineteen states tax general garment repairs and alterations. California, Maryland, Nebraska, New York, and South Carolina tax alteration of new clothing only, while Connecticut and Tennessee only tax repairs to clothing. Shoe repair services are taxed by 21 states. Some of the remaining states still tax the materials used in the repair, with California and Michigan taxing 25 percent and 35 percent of the total bill, respectively.

While 21 states tax laundry and dry cleaning services, only 8 states tax coin-operated laundries (Table 9). Meanwhile, South Dakota imposes an annual license fee in lieu of the sales tax. This treatment reflects the difficulty in collecting the sales tax on vending machine operations as well as a concern for the income level of the clientele generally presumed to make greater use of coin-operated laundries.

Table 9
Taxation of Laundry/Dry Cleaning Services
(By State)

Delaware*	Pennsylvania
District of Columbia	South Carolina
Hawaii*	South Dakota
Iowa*	Tennessee
Kansas	Texas
Louisiana*	Utah
Maryland	Washington*
Minnesota	West Virginia*
Mississippi	Wisconsin
New Mexico*	Wyoming*
North Carolina	

*Also taxes coin-operated laundries.

As states have examined expansion of the sales tax base, a number of them have begun to impose the tax on such personal services as health clubs, instructional services, and certain cleaning and maintenance services. However, these services are still largely untaxed in most states, with no fewer than 20 states applying sales tax to these services.

Table 10
Taxation of Health Club Services
(By State)

Arkansas	New Mexico
Connecticut	Ohio
Delaware	South Carolina
Hawaii	South Dakota
Idaho	Tennessee
Iowa	Texas
Kansas	Vermont
Minnesota	Washington
Missouri	West Virginia
Nebraska	Wisconsin

Business Services. Thirty-nine business services were examined in the survey including various forms of advertising, commercial linen, employment agencies, security, janitorial, investigative, secretarial, and court reporting (numbers 73 through 106). The most widely taxed business services are printing, taxed in 45 states, followed by photo-finishing and photocopying services, taxed in 44 and 42 states, respectively. Meanwhile, advertising services are largely untaxed, only being taxed in the states with broad-based sales taxes. Most of the expansion in business services has been in maintenance and janitorial services (an increase from 13 to 18 states since the 1990 survey), telephone answering services (10 to 18), and commercial art and graphic design (13 to 20).

While all the services examined in this category are not direct inputs into production, concern over raising business costs as well as the relative novelty of taxing services not associated with tangible personal property is evident in this category. Despite the revenue potential, many states still leave business services largely untaxed.⁷ However, as pointed out in the previous section, the business services area is one which states, looking to broaden their sales tax base, will examine.

With the exception of those services linked to the production of tangible goods (e.g., printing and photo finishing), the other services examined in the survey are taxed in few states. The survey points out that 19 states tax no more

than four of the services. Several states do tax a substantial number of services in the list. Three states—Delaware, Hawaii, and Washington—tax all 34 business services. New Mexico taxes 32, while South Dakota and West Virginia tax 28 and 26, respectively. Some states have imposed the sales tax on selected lists of business services. Connecticut has a long list of business services, taxing 20 of the 34 services. Iowa and Pennsylvania also tax respectively, 18 and 17 of the total number of business services.

Computer Services

Computer software, programming, and related data processing services have presented a problem for traditional sales taxes. The problems stem from the intangible nature of programming instructions, the lack of need for a tangible medium for providing information, and the nature of the data and information processing services performed with computers, as well as the professional nature of the programming design and development services. States have, however, begun to tax certain services associated with computers. The survey asked states how they tax canned (i.e., pre-packaged) software, customized software, and programming services. Also examined in the survey were information, data processing, and mainframe access services (numbers 107 through 113).⁸

All sales tax states, except Alabama,⁹ tax canned or packaged software. Nine states—Idaho, Iowa, Kentucky, Massachusetts, Nevada, New Jersey, North Dakota, Utah, and Virginia—tax only canned software. Nine other states—Connecticut, Delaware, D.C., Hawaii, New Mexico, Pennsylvania, South Dakota, Texas, and Washington—tax all forms of computer services including information services. The remaining states tax a mixture of computer services.

There is great variability in how professional services related to computer software sales are defined. While South Carolina defines any service associated with software sales

⁷In William F. Fox and Matthew Murray, "Economic Aspects of Taxing Services," *National Tax Journal*, March 1988, pp. 19-36, business services is second only to the construction sector in potential revenue-generating ability.

⁸For a more detailed discussion on taxation of computer software, see L.J. Kuttan, "Software Taxation—The Current Picture," in *State Tax Notes*, July 1, 1996, pp. 45-48.

⁹Alabama Department of Revenue released regulation C28-001 which defines canned computer software as tangible personal property and subject to the sales and use tax effective March 1, 1997.

as a taxable service, Nebraska taxes any service that results in the production of software. Tennessee taxes custom programming services but not consulting services performed by the vendor. Michigan, Minnesota, New York, Utah, and Virginia exempt all professional services only if separately stated when modifying canned software. Ohio exempts sales of any software package if the charge for revision is greater than 51 percent of the total cost. Colorado exempts the modification of canned software only if consultation or an analysis of customer needs is part of the service.

Similarly, two states subject certain computer services to different tax rates. Washington defines canned or custom software as a tangible good subject to the 6.5 percent sales tax plus 0.471 percent Retail Business and Occupation Tax. All other services are defined as professional services subject to a 2.0 percent Business Services Tax. Delaware treats canned software as a sale of goods and imposes an occupational tax of 0.75 percent on retailers (lower rates apply to manufacturers and wholesalers), while all other computer services are taxed at 0.4 percent.

While Alabama stands out as the only sales tax state not to tax canned software, relatively few states tax custom software. This is not surprising since custom programming consists mostly of labor services producing an intangible good. Still, 16 states tax customized software as pointed out in Table 11. Fifteen states tax other types of computer services. Table 12 summarizes which states tax information services, data processing, and mainframe computer access services.

Table 11
Taxation of Custom Software
(By State)

Connecticut	New Mexico
Delaware	Pennsylvania
District of Columbia	South Carolina
Hawaii	South Dakota
Louisiana	Tennessee
Maine	Texas
Mississippi	Washington
Nebraska	West Virginia

Admissions and Amusements

Admissions and amusements is the most widely taxed service category in the survey, with over half the states taxing 10 or more services (out of 14). Some states tax these services under special taxes or allow local governments to

Table 12
Taxation of Computer Services

State	Info. Services	Data Processing	Mainframe Access
Connecticut	Yes	Yes	Yes
Delaware	Yes	Yes	Yes
Distr. of Columbia	Yes	Yes	Yes
Florida	Yes	No	Yes
Hawaii	Yes	Yes	Yes
New Mexico	Yes	Yes	Yes
New York	Yes	Yes	No
Ohio	Yes	Yes	No
Pennsylvania	Yes	Yes	Yes
Rhode Island	No	No	Yes
South Carolina	Yes	No	No
South Dakota	Yes	Yes	Yes
Texas	Yes	Yes	Yes
Washington	Yes	Yes	Yes
West Virginia	Yes	No	No

tax these activities. Maryland and Washington allow local governments to impose an admissions tax in addition to the state tax, while Ohio and Pennsylvania have only local taxes. However, some states still tax very few services in this category. Seven states — California, Colorado, Massachusetts, Michigan, Nevada, Pennsylvania, and Virginia — do not tax any other service except film and videotape rentals. Another three—Indiana, Maine, and Rhode Island—tax only videotape rentals and cable TV. Illinois is the only sales tax state that does not tax any service in this category.

The survey examined a wide variety of amusement services (numbers 119 through 132) including admissions to amusement parks, school and professional sporting events, and cultural events. The survey asked how states tax rentals of videotapes and films by theaters as well as cable TV services. Other amusement services covered include parimutuel betting, billiard parlors, bowling alleys, circuses, video and pinball machines, and membership fees for private clubs.

Videotape rentals are the most widely taxed service in the category, taxed in 45 states. Of the sales tax states, only Illinois does not tax video rentals. Michigan, Missouri, and Rhode Island give the vendor the option of paying the sales tax on their purchase of the tape or charging a sales tax on rentals. This contrasts with film rentals to theaters, which are taxed in only eight states. Indeed, most states treat film rentals as an input to production, charging sales taxes on the final product (the viewer). This is illustrated by nine states

— Florida, Idaho, Indiana, Kentucky, New Mexico, Oklahoma, Utah, Virginia, and Wyoming — which exempt all film rentals from sales taxes if a taxable admission is charged. Meanwhile, cable TV services are taxable in only 24 states. Arizona, Maryland, Maine, Pennsylvania, and Tennessee tax extended or premium channels only.

Some states exempt admissions to college or school sporting events while taxing professional events. Admissions to professional sporting events are taxed in 35 states, while college events are taxed in only 25 states. Arizona, Arkansas, Delaware, Georgia, Kentucky, Louisiana, Montana, North Dakota, South Dakota, and Vermont provide exemptions. Ten other states—Georgia, Iowa, Mississippi, New Jersey, New York, Oklahoma, South Carolina, Tennessee, West Virginia, and Wisconsin—tax admission to college events but exempt elementary and secondary school events.

Professional Services

Most discussions of taxing services end up focusing on certain professionals such as lawyers, accountants, engineers, and doctors. For various reasons, most states have avoided this area. Only eight states tax any of these services listed. The list includes: accountants, attorneys, dentists, engineers, land surveyors, medical laboratories, nursing (out-of-hospital), and physicians (numbers 133 through 140). Only four states tax all the services surveyed. Hawaii and New Mexico apply their general sales taxes to these services while Delaware and Washington tax professional services under their business gross receipts taxes. To offset the impact on low-income households of taxing medical-related services, Hawaii has a sales/excise tax credit on the personal income tax. South Dakota taxes accountants, attorneys, engineers, and land surveyors. Connecticut, Texas, and West Virginia tax land surveyors only.

Other Services

The survey examined several other categories that are not discussed in the text. Listed in Appendix A, they include such items as agriculture (numbers 1 through 5), industrial mining (numbers 6 through 9), construction (numbers 10 through 13), transportation and storage (numbers 14 through 28), finance, insurance, and real estate (numbers 45 through 52), automotive (numbers 114 through 118), and leasing and rental services (numbers 141 through 153). These areas tend to be relatively untaxed (except for the leasing and rental area) except in states that tax a large number of other services or those that impose a gross receipts tax on most enterprises.

Many of the services listed in the leasing and rental category are not included in the survey totals since there is considerable difference in how these goods are taxed. Some states tax rental goods when they are purchased and exempt the rental services. Others tax all rental services, exempting the original purchase. Some states give the lessor the option of either method.

Conclusion

Imposing the sales tax on services will undoubtedly continue to be one of the most discussed topics in state tax policy in the coming years. As states try to arrest the erosion of the traditional sales tax base and meet increased service demands, they will, by necessity, examine the taxation of the service sector. The diversity among the states will provide an ample set of experiences upon which to draw.

The FTA work on the taxation of services is intended to assist state tax administrators and others in assessing the potential for, and the implications of, taxing services. We expect to continue working in this area with updates of this survey.