

## Proposition 126: Taxes on Services

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Proposition 126 represents an effort by the Arizona Association of Realtors, acting through an organization called “Citizens for Fair Tax Policy, to prevent the state government or any local government in the state from taxing any service-based business or increasing taxes on any service-based business already subject to taxation. The proposition, coming through the initiative process, would prohibit such action through a constitutional amendment.

Proponents contend there is a real danger that Arizona politicians will try to raise more revenue by imposing taxes on services ranging from haircuts, manicures and car repairs, to child care and medical care and real estate transactions. They warn that these taxes could greatly add to the existing tax burden of many businesses, which in turn would be passed along to consumers in the form of additional sales taxes (presently a 5.6 percent state levy plus additional local sales taxes). The overall effect, they say, would be especially burdensome to small businesses, people with limited incomes and, in the long run, would hurt the economy by prompting businesses to leave the state. Among the groups backing the proposition are the Arizona Retailers Association and the Arizona branch of the National Federation of Independent Business (NFIB).

“Imagine paying more for childcare services, rent, installations or repairs in your home, or automotive service for your car. These are just a few services provided by small businesses that could someday be taxed if we don’t act to prevent it. Most concerning is that increasing the costs on these types of services would negatively affect low- to moderate-income Arizonans the most,” Chad Heinrich, state director of NFIB, wrote in a paid entry for the state’s election publicity pamphlet.

Taxing services could put Arizona at a competitive disadvantage with neighboring states, proponents argue.<sup>1</sup> Lori Doerfler, president of Arizona Association of Realtors, noted: “A service

### ***Understanding Arizona’s Propositions***

*Arizona voters will be asked to pass judgment on five measures on the ballot in the November 2018 general election. Four propositions call for amendments to the Arizona Constitution.*

*Two propositions were placed on the ballot by the Legislature, two others through the initiative process and the remaining one via a signature-gathering campaign challenging legislation passed by the Legislature and signed into law by the governor.*

*As in past years, ASU Morrison Institute for Public Policy examined Arizona’s propositions to offer voters independent and nonpartisan assessments based on relevant documents and views expressed by subject-matter specialists and those who support and oppose particular measures.*

*“Understanding Arizona’s Propositions” will provide information on each ballot proposal, how each came about, what it would do if passed, and its likely impact.*

tax makes Arizona less appealing for commercial recruitment by big companies because of the higher costs associated with this sort of tax. As an example, the state of Washington recently passed a new service sales tax and big companies are already leaving. Amazon stopped construction of a new headquarters and has instead opted for Arizona because we do not currently have service taxes.”

Opposition to the proposal has been expressed by groups, such as the Americans for Prosperity and the Arizona League of Cities and Towns.

Opponents make several objections. One is that the law is not really needed because it is already very difficult for Arizona governments to adopt or raise taxes on services. Among the serious legal obstacles to raising taxes on the state level is Proposition 108, adopted by the voters as a constitutional amendment in 1992. This requires a two-thirds majority of the total membership in the House and Senate to increase any tax or revenue source or to make any “net increase in the state’s revenue collection.” Under existing political conditions, this requirement makes the adoption of any tax increase in an existing tax highly unlikely unless there is a clear and compelling reason to do so. State law also currently denies localities the ability to impose a sales tax on services.

Opponents also argue that it is wrong to further tie the hands of lawmakers, especially with the rigidity imposed by a constitutional amendment, because taking the taxation of services off the table will make it difficult for lawmakers to respond to emergency financial situations in order to maintain essential services. Arizona House Speaker J.D. Mesnard said that while he opposes higher taxes, he does not believe it’s a good idea to hobble future lawmakers who may want to revamp the tax system.<sup>2</sup>

Going further is the argument that there is really little reason to give businesses offering services special protection or to think there are any differences between goods and services when it comes to taxation. Opponents such as the state director of the Americans for Prosperity ask: Why should we treat businesses differently, requiring some to pay taxes while exempting others? Tax policy experts tell us one cannot fairly distinguish goods from services when it comes to taxation, “there is no economic or tax policy reason to tax the purchase of a toaster oven but exempt the purchase of a haircut or accounting service. They’re both consumption.”<sup>3</sup> Exempting services from taxation narrows the tax base, raising taxes for everything else that is sold, they contend.

Opponents further note that the on-going pronounced shift in the economy from a goods-based one to a service-based one not only escalates the tax problems of those who are not exempt, but means that states and localities are losing out on an ever-increasing amount of revenue that could be used to finance essential services or revamp the tax system, making it more equitable and reducing the load on other taxes.

Some opponents also point out that the ultimate effect of taxing services should not be regressive. Much would depend on which personal or professional services are taxed – lawyers, financial advisers, accountants and psychotherapist, for example, are used more by the relatively wealthy.

It should be noted, however, that the effect of increasing adding or increasing taxes on services could be offset by reducing reliance on other taxes that have a regressive impact, for example, by lowering the general sales tax rate.

Overall it does not appear that there is much of a threat that lawmakers are going to rush into the area of taxing services. Taking the option of taxing services completely off the table raises difficult questions as to the ability of lawmakers to raise needed revenues when they are severely needed. The action also would preempt any attempt to revamp the tax system so that it is more equitable and better adjusted to changes in the economy.

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<sup>1</sup> Robert C. Lowry, "Fiscal Policy in the American States," in *Politics in the American States*, Virginia Gray and Russell L. Hanson, eds., Washington, D.C.: CQ Press, 2008: 287-315.

<sup>2</sup> Howard Fischer, Capitol Media Services August 21, 2018.

<sup>3</sup> David Brunori, "Don't Be Fooled – Services Should Be Subject To Sales Tax," <https://www.forbes.com/sites/taxanalysts/2015/09/24/dont-be-fooled-services-should-be-subject-to-sales-tax/#513f229650e7>

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