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MAINE COULD TAX MORE SERVICES UNDER ITS SALES TAX

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Maine's sales tax could be modernized to yield more revenue and make the sales tax fairer. Maine taxes very few services under its sales tax; the sales tax is largely levied on purchases of tangible goods. Yet production and consumption have been shifting in the U.S. economy — and in Maine's economy — from goods to services over the past four decades.

Of all sales made in Maine, 51.3 percent were subject to sales tax in 1990. By 2003, that percentage had dropped to 45.6 percent, a decline of 5.7 percentage points in just over a decade.¹ In significant part, this occurred because most services are exempt under Maine's sales tax.

The Federation of Tax Administrators catalogs 168 services that states could include in their sales tax. Of the 168 services, Maine taxes only 24.

By contrast, Connecticut taxes 80 of the services cataloged by the Federation of Tax Administrators — or about half of the services provided in the economy that could potentially be taxed. For example, Connecticut taxes fees for health clubs, photographic services, landscaping services, public relations services, private investigations services, auto repair services, and types of leases and rentals that Maine does not tax. (See box at top of page 2.)

If Maine added the services taxed by Connecticut to its own sales tax, sales tax collections in Maine would increase by approximately \$120 million a year.²

Of course, Maine policymakers may wish to make somewhat different choices of which services to tax than Connecticut did. This analysis was undertaken to suggest the magnitude of the difference that taxing a modest number of additional services could make.

Other Benefits of a Broader Sales Tax Base

Increasing the number of services taxed under the sales tax has other benefits, in addition to enhancing revenues.

KEY FINDINGS

- **Maine taxes few services under its sales tax; the sales tax could be modernized to yield more revenue and improve fairness.**
- **If Maine included just the services taxed by Connecticut, it would collect an additional \$120 million a year.**

Reducing Volatility: Maine’s sales tax base is dominated by purchases of “big ticket” durable goods such as cars, boats and snowmobiles, appliances, and furniture. Such purchases often decline sharply during economic downturns; the timing of such purchases often is discretionary, and people may be reluctant to make large purchases in an uncertain economy even if they personally have not lost employment or income.

Expanding the base to include more services could modestly moderate the volatility of sales tax revenues over the course of the business cycle. For example, if people are not buying new vehicles they probably are having their older vehicles repaired more frequently; taxing repair services can offset in part the drop in sales tax revenue from flagging vehicle purchases. In addition, many other services such as computer services or janitorial services to non-residential buildings are likely to continue in significant part through an economic downturn.

Improving Fairness: Since the sales tax is intended to be a general tax on consumption, there is little reason to tax the consumption of goods and not tax the consumption of services, which can be substitutes for one another. For example, it is not equitable to tax the person who buys a lawnmower but not the person who hires a lawn care service.

Improving Allocation of Economic Resources: Taxing most goods but not most services can to some degree distort resource allocation throughout the economy by creating an artificial incentive to purchase services rather than goods. Increasing the number of services taxed can improve this situation.

MAJOR SERVICES TAXED BY CONNECTICUT BUT UNTAXED IN MAINE

- All leases and rentals
- Computer/data processing services
- Employment agencies
- Private investigation and protection
- Painting and lettering
- Advertising, graphic design
- Telephone answering
- Management consulting, public relations
- Repairs (appliances, auto, furniture, etc.)
- Landscaping
- Janitorial
- Photo studios
- Health clubs

¹ John L. Mikesell, “*State Retail Sales Taxes, 1999-2001: The Recession Hits*,” State Tax Notes, February 10, 2003; John L. Mikesell, “*State Retail Sales Tax Burdens, Reliance, and Breadth*,” State Tax Notes, July 12, 2004.

² The \$120 million figure was derived by identifying the services taxed in Connecticut, but not taxed in Maine, and determining the gross receipts from the industries providing those services as reflected in the Maine data in the U.S. Economic Census. State data in the U.S. Economic Census is for industries rather than specific services, so the national data on services from the U.S. Economic Census were used to adjust the state-level industry data. This allowed us to estimate only the portion of total industry receipts generated by the services of interest. The adjusted gross receipts for the specific services were then multiplied by the Maine tax rate to derive the potential sales tax revenue.

The data are for calendar year 2002. We did not adjust for inflation between 2002 and 2007, which could lead to an underestimate of potential revenues. However, a state never can collect the full amount of potential revenues; there always is “leakage” from non-compliance or cross-border sales. The assumption in this analysis is that the underestimate because of the lack of inflation adjustment and the overestimate because of potential leakage cancel each other out.