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March 12, 2018

Senator Hertzberg
California State Senate
State Capitol, Room 4038
Sacramento, CA 95814

RE: SB 993 (Hertzberg) – Sales Tax on Services **OPPOSE**

Dear Senator Hertzberg,

On behalf of the 44,000 members of the California Society of CPAs representing the CPA profession working in large, medium and small public accounting firms, as well as businesses and industries throughout California, we are writing to inform you of our opposition to SB 993, which would impose a new tax on services purchased by businesses in California.

When CalCPA members met with legislators in January, they discussed their concerns with a tax on services and the importance of fair, effective and efficient tax policy that is practical and administrable for all California taxpayers. The business services tax contained in SB 993 is far from that. It will impose a massive new tax that will needlessly complicate an already complex state tax code and add a substantial new burden to California business and taxpayers.

Specifically, CalCPA opposes SB 993 for the following reasons:

Federal Tax Law Changes Do Not Justify a Massive New Tax. SB 993 contends that a sweeping shift in tax policy is warranted to “mitigate the negative impacts” of new federal tax laws and to “provide tax relief to middle-income and low-income Californians” impacted by reductions to federal programs. However, the full scope and impact of the federal tax reform on California taxpayers is yet to be determined. Based on the size, complexity and multitude of external factors, it may take years to fully understand the impact of the federal changes on taxpayer liabilities and decisions. Even then, the impact could be drastically different depending on each taxpayer’s unique situation.

As for reductions in federal programs, it is still unknown what federal programs may be changed, how they may be changed, when a change might occur or if they will be changed at all. It would be unwise to implement a complex and costly new tax policy based on speculation and unfounded assumptions.

Federal Tax Laws will Impact Each Type of Business Entity Differently. SB 993 argues that a business services tax would offset “significant financial benefits provided to businesses under the new federal law.” However, it is not accurate to say that every business will automatically see decreased tax liabilities under the new federal tax laws. The new laws on business are extremely complex and will impact different business entities differently. For example, professional service firms are treated much differently than other pass-through entities and may not be able to use the lower rates under the new federal laws. Further, many service providers are sole practitioners, who may not be able to take advantage of lower federal tax rates in the same way as other businesses. Even if a business does have a lower tax liability under the new federal tax laws, the added complexities and administrative costs of a new business services tax will outweigh any savings they may see.

Administrative Burden for the State and Businesses will be Costly. The California Department of Tax and Fee Administration (CDTFA) will be tasked with administering and collecting the new tax for a new set of businesses. The CDTFA will need to develop regulations, guidance and new publications. They will also face logistical challenges to reprogram computer and software systems, modify or create new tax forms, develop new internal procedures, manage a flood of taxpayer inquiries, perform more audit and collection activities and establish new refund and appeals programs among others. Further, the CDTFA will need to adequately train and hire qualified staff to facilitate these changes. These undertakings will be in addition to already navigating a massive reorganization, overseeing a new cannabis tax and processing requests for tax relief from recent natural disasters.

Service providers not already set up to collect a sales tax would face administrative complexities and costs as they create and maintain point-of-sale systems to account for and properly remit sales tax. In addition to the up-front costs of implementing the system, there are ongoing costs to maintaining a system to accurately track and manage transactions. Businesses that provide services and tangible goods would need to revamp their systems to be able to separate what is a tangible good versus what is service, and appropriately calculate and collect the different rates. Any inaccuracy or misinterpretation of how the tax applies could lead to delayed compliance, inadvertent non-compliance or an incorrect assessment. All of these could be detrimental for many small, unsophisticated service providers.

California Consumers Will Bear the Tax Burden. The cost of the goods or services to the final customer factors in all the costs associated with the development of a good or service. A business services tax will increase business costs that will ultimately translate into higher prices for the products and services a consumer uses. Consumers might not be taxed on the food they buy, but the cost of produce at the grocery store will likely increase since the grocery store overhead has gone up to include more costly accounting and tax services.

Many times the added cost will be unavoidable for services that are required by law for certain businesses to purchase. For example, a small business that elects to have a retirement plan for its employees is required by law to meet certain audit requirements, which requires the use of an external CPA. Either the business absorbs the added tax on the service they are required to get, passes the cost down to their consumers or elects to no longer offer a retirement plan to employees to avoid the need for an audit. This is just one example of a direct, negative impact to middle-income Californians.

California Businesses Will be at a Significant Competitive Disadvantage. SB 993 states that the business services tax would only apply to services "purchased by a business for benefit for use in California." Being subject to a costly and complex new tax will be detrimental to the health of businesses in California and put them at a serious competitive disadvantage to out-of-state competitors. The added burden in an already challenging business climate can force businesses to make decisions between expanding, hiring and even surviving.

Further, it would be nearly impossible for a multistate business, either providing or receiving a service, to decipher when the service has a nexus to California, what portion is subject to the tax or how to calculate the appropriate tax obligation. Multistate apportionment and nexus issues are already complicated under current tax laws and this would further convolute the challenges. For example, how would a business with a large plant in California and an out-of-state headquarters calculate their services tax obligation if they use a CPA firm for management consulting at their headquarters? If all the benefit of the services is for the business's management purposes, is there still an obligation to pay a services tax in California? If so, how will it be calculated? These types of issues are common and will lead to over or under collecting of taxes and the subsequent refund, appeals and legal challenges.

Small and Medium Sized Businesses will Be Most Impacted Despite Exemptions. The small-business exemption in SB 993 only applies to very small businesses. There are many small and self-employed businesses that exceed the $100,000 threshold, but still operate under very tight margins. These are the businesses that will be most negatively impacted by a business services tax. Large employers can avoid paying a services tax by shifting to in-house professional services instead of using the services of outside providers. Businesses that cannot afford to bring services in-house, must still engage the services of outside professionals and pay the new tax. Further, the added cost could drive many small businesses to a “do-it-yourself” approach or look at under-the-table arrangements–both of which can lead to costly mistakes and noncompliance.

Further, the exemptions are unclear. Who is exempt? The business paying for the service or the service provider? If service providers provide a service to a business, how would they know if the business customer is under the threshold and whether a tax should be assessed and collected? What happens if they mistakenly collect or do not collect the tax? If the service provider is exempt, how would it prove that it does not need to collect the tax? What happens if a provider crosses the exemption threshold and it had not been collecting the tax? Does it need to go back to collect the tax from past customers? The provisions of SB 993 raise many significant questions about who would really be subject to this tax.

A new business services tax would not provide any assistance for managing the impact of new federal laws; rather it will significantly exasperate the situation and have dramatic negative consequences for all Californians. We strongly oppose SB 993. Thank you for your consideration of our concerns and please contact us should you have any questions.

Respectfully,

Jason Fox, Director,
Government Relations

cc: Members, Senate Committee on Governance and Finance
Colin Grinnell, Staff Director, Senate Committee on Governance and Finance
Scott Chavez, Consultant, Senate Republican Caucus