

December 4, 2015

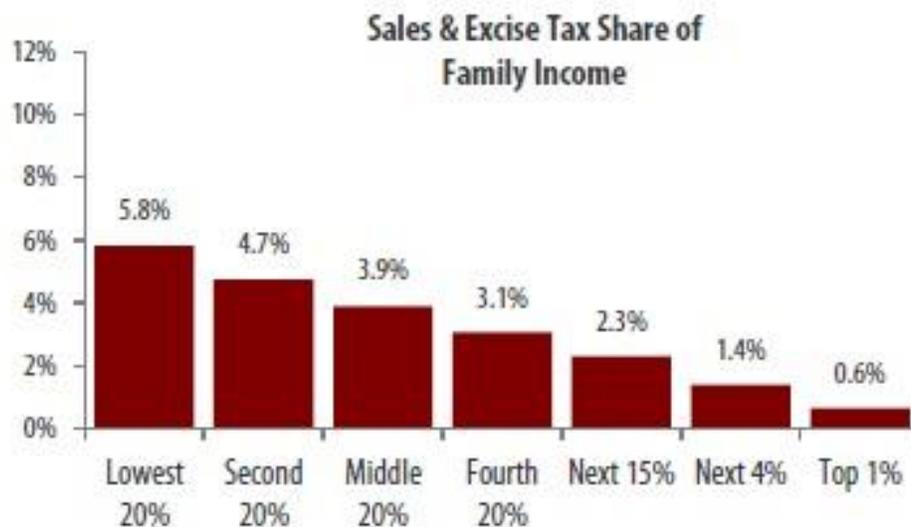
Expanding the Sales Tax in an Equitable Way

[It appears that legislators have decided to raise new, and necessary, revenue by expanding the sales tax base](#) to include more goods and services instead of increasing the sales tax rate. There are good reasons to broaden the base of the sales tax, *if* it is done in ways that make the tax more equitable. But a broader sales tax is still likely to fall more heavily on low-income families. Legislators can limit the burden on those least able to bear it by coupling the sales tax expansion with a new refundable sales tax credit.

The inequity of the sales tax

The original budget framework included a proposed 23% increase in the sales tax rate from 7% to 8.25% (and from 8% to 9.25% in Philadelphia). This proposal was abandoned, apparently because of lack of support among legislators. Some legislators remain opposed to any tax increase. Others were concerned that Pennsylvania businesses near our borders with other states would lose sales. A third group worried that the sales tax places too much of a burden on those with low incomes.

There is good reason to worry about the sales tax falling heavily on low-income families. According to the Institute on Taxation and Economic Policy, the lowest-income 20% of Pennsylvania families pay an average of 5.8% of their income in sales tax. The top 20%, by contrast, pay less than 2.3% of their income in sales tax. And families in the top 1% pay only .6% of their incomes in sales tax – one tenth as much as low-income families.



In a [recent, detailed report](#), we demonstrated that an increase in the personal income tax raises revenue in a far more equitable way than an increase in the sales tax.

Advantages of Broadening the Sales Tax

Instead of raising the sales tax, legislators are now prepared to broaden the base of the sales tax to include goods and services that have not previously been subject to the tax. We don't yet know how this will be done. As we wait for the details, we can take a quick look at the economics and politics of sales tax base broadening. It turns out that there are better and worse ways to get more revenue from the sales tax. If we broaden the tax in the right way, and, in addition, add sales tax forgiveness for those with low incomes, the sales tax could be made more equitable than it is today.

Both liberal and conservative policy analysts have, for three reasons, supported broadening sales taxes to include a wider range of goods and services.

First, a broader sales tax raises more revenue without raising rates – or even with a lower rate. The mantra among economists for taxes generally is “the broader the base, the lower the rate.” Broadening the sales tax may also be politically attractive. Polls show that the public tends to oppose sales taxes less than other taxes. Citizens are unlikely to know which goods and services are included in the sales tax and which are not, so broadening the sales tax may be less noticeable and generate less opposition among voters.

Second, a broader – and more universal – sales tax is fairer to different types of businesses than a tax on some businesses rather than others, when there is no obvious rationale for the difference.

And third, sales taxes applied to some businesses rather than others create what economists call “distortions” in the market – encouraging greater consumption of untaxed goods and services than those that are taxed. This is a source of minor economic inefficiency.

A Broader Sales Tax and Inequity

Despite these advantages, ***broadening the sales tax by itself does not fix the inherent unfairness in the sales taxes*** – the fact that the tax tends to fall more on low-income families than high-income families. There are, however, [as we have pointed out before](#), more and less equitable ways of broadening the sales tax.

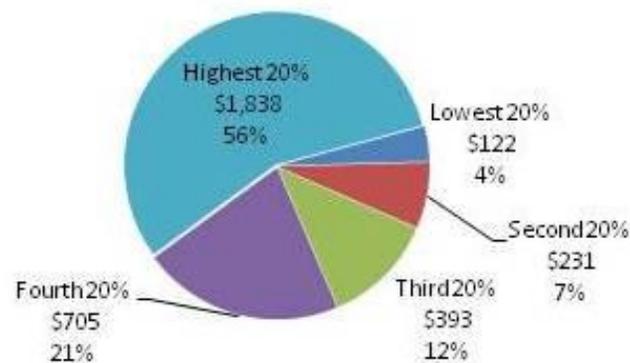
When goods and services that are necessities, such as food, clothing, and health care are excluded from the sales tax, the tax is more equitable, because low-income families spent a higher portion of their income on these goods and services than high-income families. Thankfully, Pennsylvania legislators do not seem to be considering including these items in the sales tax base this year.

When goods and services that are luxuries are excluded from the sales tax, however, the tax is less equitable. Pennsylvania excludes from the sales tax goods and services that are far more likely to be used by wealthier families than poorer ones. For example, lower-income families pay sales tax on laundry detergent and tax preparation software, but higher-income families don't pay sales tax on dry cleaners and accountants. Many luxury services are exempt from sales tax: swimming pool

maintenance and cleaning, health club memberships, spa and massage services, and golf lessons. Similarly, services provided to businesses are largely excluded. As legislators consider sales tax expansion, it is critical to that they include these and other luxury items in order to make the tax more equitable.

There are reports that legislators will subject a variety of forms of entertainment, amusement, and recreation to the sales tax. [PBPC has shown in the past that these services are taxed in most other states and that these taxes fall more on those with higher incomes](#) if all such cultural events are taxed. The most recent data we have, from 2007, shows that the top 20% of earners purchase more than half of all entertainment admissions. The bottom 20% of earners purchase only 4% of entertainment admissions.

On Average, the Top 1/5th of Earners Consume more than Half of All Entertainment Admissions



Expansion of the sales taxes to entertainment, amusement, and recreation makes it a more equitable way to raise revenue. But it is important that symphonies, museums, and ski slopes are included as well as bowling allies, amusement parks, and camp grounds.

Sales tax expansion can be done in an equitable or inequitable way. And it is critical that exclusions from the sales be determined by consideration of equity, not by which enterprises have the best lobbyists or other connections to legislators.

Refundable Sales Tax Credit

No matter how we broaden the base of the sales tax, the inherent inequity of sales taxes in Pennsylvania won't be overcome. But there is a way to make the sales tax fairer, even under the uniformity clause of the Pennsylvania Constitution: offer a refundable tax credit for low- and moderate-income families. The sales tax credit would be based on the typical consumption patterns of families at different income levels—no one would have to save receipts to claim it. It could be administered as a refundable credit on the personal income tax return. Families that do not have to file an income tax return would submit a separate form to receive their rebate.

A refundable sales tax credit was originally put forward in 2003 by the [Pennsylvania 21st Century Tax Project \(PA21\)](#) as part of a comprehensive proposal for reforming Pennsylvania taxes. PA21 was co-chaired by the Pennsylvania Business Roundtable and the Pennsylvania AFL-CIO, and it included representatives of a wide range of business, labor, and other groups.

A modest sales tax credit could offset the increase in sales taxes paid by low-income families as a result of broadening the sales tax base. A slightly larger tax credit would not only do that, but it would reduce the burden of the existing sales tax on low- and moderate-income families, taking an important step towards making Pennsylvania's tax system fairer.

Conclusion

Broadening the sales tax base in the right way and adding a refundable sales tax credit would give Pennsylvania's low- and middle-income families something for which to be grateful this holiday season.