TAX EXECUTIVES INSTITUTE, INC.

State and Local Tax Policy Statement
Regarding Sales Taxation of Business Inputs

Retail sales taxes are designed to tax final consumption. Businesses are not the ultimate consumers of goods and services they purchase. Tax Executives Institute, Inc. therefore opposes the application of sales taxes to business inputs. Imposing sales taxes on business inputs increases consumer prices by imposing multiple instances of taxation as goods and services move through the supply chain. This disguises the true tax burden on goods and services and distorts consumer and business choices about which inputs to purchase, where to locate jobs and investments, and how to organize their business structures.

Sales taxes (and corresponding use taxes) were initially designed as a tax on the final consumption of goods and services by the ultimate consumer. Businesses, by their nature, are not ultimate consumers of anything; therefore, theoretically, business inputs i.e., goods and services used by businesses in production and sale of their goods and services, should not be subject to sales taxes.

TEI opposes the application of sales taxes to business inputs on the grounds it violates the tax policy principles of transparency, neutrality, simplicity, efficiency, and economic growth. Subjecting business inputs to sales taxes causes several issues, including:

Impact on Ultimate Consumers:

- Businesses are not the ultimate consumers of goods and services they purchase. The taxation of goods and services sold to businesses will either (a) be reflected in the price of property or services the business sells, resulting in higher consumer prices, or (b) result in reduced activity in the state by the business, resulting in lower wages or employment.

- Imposing sales tax on businesses' purchases of goods and services results in multiple instances of taxation as goods and services move through the supply chain. This problem is often referred to as "pyramiding" and is not fully addressed by allowing exemption certificates, as such certificates only apply to goods that businesses resell or use in further production. By embedding the sales tax paid by businesses in the final price of goods and services sold to consumers, the actual sales tax paid is a multiple of the sales tax stated on the final sale to the consumer.

- The Center on Budget and Policy Priorities (CBPP) states hidden sales taxes are even more regressive than the visible sales tax added at the cash register because necessities

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like food and utilities, which are often tax-exempt, may have substantial sales taxes hidden in their prices.[1]

- One of the Principles of Sound Tax Policy as defined by The Tax Foundation is transparency. The Tax Foundation states: "Tax policies should clearly and plainly define what taxpayers must pay and when they must pay it. Disguising tax burdens in complex structures should be avoided. Additionally, any changes to the tax code should be made with careful consideration, input, and open hearings."[2] Taxing business inputs violates the principle of transparency by disguising the true tax burdens paid by individuals and households.

- Estimates of the percentage of sales and use taxes collected on business-to-business inputs nationwide range from 40% to 44%,[3] indicating that a very high percentage of all sales and use tax collections are hidden from the ultimate consumers, i.e., individuals and households that ultimately bear the burden.

Economic Consequences:

- Tax pyramiding has a number of negative consequences, among them:

    - Hidden and regressive sales taxation obfuscates the actual tax burden, violating the tax principle of transparency.[3]

    - Creating artificial incentives for "vertical integration," i.e., producing goods or services in-house rather than purchasing them from third parties.

        - Vertical integration can lead to an inefficient allocation of resources as businesses in-source activities to avoid paying sales tax.[3]

        - Vertical integration can be particularly harmful to small businesses because they are too small to in-source the activities and because they are often the provider of the goods and services that larger businesses bring in-house.[3]

    - Pyramiding causes varying effective tax rates on products and services purchased by households. This distorts consumer and business choices about which inputs to purchase, where to locate jobs and investments, and how to

[1]Michael Mazerov, *Expanding Sales Taxation of Services: Options and Issues,* CBPP, July 2009, p. 26.
[2] https://taxfoundation.org/principles/
[3] Robert Cline, Andrew Phillips, and Thomas Neubig, *What's Wrong with Taxing Business Services?*, State Tax Notes, April 4, 2013, p. 2; Alan D. Viard, *Sales Taxation of Business Purchases: A Tax Policy Distortion*, State Tax Notes, June 21, 2010, p. 967; William F. Fox & LeAnn Luna, *How Broad Should State Sales Tax Bases Be? A Review of Empirical Literature*, State Tax Notes, September 4, 2006, p. 2.

organize their business structures, resulting in widespread distortions in all sectors of a state's economy.[2]

- The taxation of business inputs can impair the competitiveness of businesses and potentially impede state economic development.[3] For businesses that cannot pass on taxes to customers because they sell into competitive national or international markets, profitability from operations in the state will be reduced, likely resulting in less investment and employment in the state[2].

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