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Netflix and (Tax) Bill: Retail Sales Taxation of Services

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Netflix and (Tax) Bill: Retail Sales Taxation of Services

*Grace Stephenson Nielsen**

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On January 28, 2020, the Utah Legislature quietly – but almost unanimously – voted to repeal Senate Bill 2001.¹ The law, which had been passed by the Legislature during a special legislative session in December 2019, was an attempt to restructure Utah’s tax regime.² Although the state has run a total budget surplus for several years,³ many politicians and policy experts alike believed – and still *do* believe⁴ – that Utah’s tax structure is “out of whack.”⁵ The Utah Constitution currently requires that all income tax revenue be earmarked for education spending.⁶ Utah’s General Fund, on the other hand, is supported primarily by sales tax revenues.⁷ While the state’s income tax revenue is strong, and Utah currently has enough cash on hand in its General Fund to keep up

1. H.B. 185, 63d Leg., Gen. Sess. (Utah 2020), <https://le.utah.gov/~2020/bills/static/HB0185.html> (bill text and legislative record). The repeal bill passed the House 70-1-4 and the Senate 27-0-2, and it was signed into law the next day by Governor Gary Herbert. *Id.* (bill status report).

2. S.B. 2001, 63d Leg., 2d Spec. Sess. (Utah 2019), <https://le.utah.gov/~2019s2/bills/static/SB2001.html> (bill text and legislative record).

3. See *Budget Information Archive*, GOVERNOR’S OFF. OF MGMT. & BUDGET, <https://gomb.utah.gov/budget-policy/budget-information-archive/> (last visited Oct. 21, 2020).

4. See, e.g., *With Week to Go, Utah Lawmakers Try to Tackle Revenue ‘Imbalance’ with Constitutional Amendment*, DESERET NEWS (Mar. 5, 2020, 9:06 AM), <https://www.deseret.com/utah/2020/3/5/21166066/revenue-imbalance-lawmakers-constitutional-amendment-school-funds-income-taxes> (describing proposals to correct “a structural imbalance in revenue streams” floated by Utah legislators *after* the 2019 reform package was repealed).

5. Bob Bernick, *Utah is Running a Projected Budget Surplus of More than \$100 Million, Which Could Complicate Tax Reform Efforts*, UTAHPOLICY.COM (Nov. 27, 2019), <https://utahpolicy.com/index.php/features/today-at-utah-policy/22301-utah-is-running-a-projected-budget-surplus-of-more-than-100-million-which-could-complicate-tax-reform-efforts>; see also, e.g., S.B. 2001, 63d Leg., 2d Spec. Sess., at 29:10 (Utah 2019) <https://le.utah.gov/av/floorArchive.jsp?markerID=108731> [hereinafter S.B. 2001 House Debate] (statement of Rep. Francis D. Gibson); OFF. OF THE GOVERNOR, *FAQ: Answers to Your Questions on Utah’s New Tax Law* (Dec. 19, 2019) [hereinafter Governor’s FAQ], <https://governor.utah.gov/2019/12/19/faq-answers-to-your-questions-on-utahs-new-tax-law/> (citing a budget “imbalance”).

6. UTAH CONST. art. XIII, § 5(5) (“All revenue from taxes on intangible property or from a tax on income shall be used to support the systems of public education and higher education . . .”). Note that, by default, “a tax on income” covers *all* types of income, including both individual and corporate income taxes. See *id.*

7. *Sales Tax Growth Improving, Not Enough to Close Gap in Education and General Funds*, UTAH LEG. (Feb. 20, 2020) [hereinafter UTAH LEG., *Not Enough*], <https://budget.utah.gov/index.php/2020/02/20/sales-tax-growth-improving-not-enough-to-close-gap-in-education-and-general-funds/> (“[S]ales and use tax . . . is the largest contribution to the General Fund.”).

with budget commitments,⁸ sales taxes nationwide may not be able to keep pace for long.⁹ Utah is no exception.¹⁰

This is in part because consumers today are spending more on services and less on goods,¹¹ and Utah, like most states,¹² does not tax most services.¹³ For example, while I paid state sales tax on the (very bingeable) boxed set of *Grey's Anatomy* DVDs I purchased in 2006, I don't pay tax on my Netflix subscription — at least, not yet.¹⁴ My neighbor who does her own gel manicures at home paid state sales tax on all the equipment and colors she bought, but the manicures I get at the salon are untaxed service transactions.¹⁵

8. Katie McKellar, *Utah Sales, Income Taxes Grow, But Lawmakers Say Tax Reform Still Needed*, DESERET NEWS (Feb. 18, 2020, 6:09 PM), <https://www.deseret.com/utah/2020/2/18/21142389/tax-reform-revenue-collections-projections-2020-legislature-sales-income-grow-reform>.

9. *FTA Survey of Services Taxation: Update*, BY THE NUMBERS (Fed'n of Tax Adm'rs, Washington D.C.), July–Aug. 2017, at 1 [hereinafter FTA 2017 Newsletter], https://www.taxadmin.org/btn-0817_services (explaining that increased consumer spending on services relative to goods has hampered sales tax revenue collection in many states).

10. See, e.g., OFF. OF LEGIS. RSCH. AND GEN. COUNS., UTAH'S SALES AND USE TAX: WHERE ARE WE? HOW DID WE GET HERE? WHERE ARE WE GOING? 5 (Sept. 2011) [hereinafter OLRGC Report], <https://le.utah.gov/lrgc/briefings/SalesTaxBriefingPaper.Sept11.pdf> (“[T]he sales tax base is gradually declining relative to the economy as a whole.”); Press Release, Utah Senate, *Why the Utah Legislature Will Not Be Moving Forward with HB 441 This Session* (Mar. 7, 2019), <https://senate.utah.gov/majority-newsroom/2019/3/7/why-the-utah-legislature-will-not-be-moving-forward-with-hb-441-this-session> (Statement of Senate President Adams: “[O]ur general fund is not growing at the same pace as our population. It’s not a sustainable practice.”).

11. See, e.g., FTA 2017 Newsletter, *supra* note 9 (attributing the “growing share of consumer spending on [largely untaxed] services” to weakening sales tax revenues); Rich McKeown, *Questioning the Viability of the Sales Tax: Can It be Simplified to Create a Level Playing Field?*, 2000 BYU L. REV. 165, 172 (2000) (“One cause of erosion has been the natural shift in our economy from manufacturing to service. Because few services are taxable, this shift in the economy has resulted in fewer taxable transactions in the marketplace.”).

12. See, e.g., FTA 2017 Newsletter, *supra* note 9 (noting that although many states tax services like hotels, event admissions, utility, and repair services, only a small minority of states tax personal and professional services that make up the majority of service transactions).

13. OLRGC Report, *supra* note 10, at 5–6.

14. See Greg Iacurci, *The Netflix and Spotify Tax: States Are Making Streaming Services More Expensive*, CNBC (Feb. 24, 2020, 8:00 AM), <https://www.cnbc.com/2020/02/24/states-are-imposing-a-netflix-and-spotify-tax-to-raise-money.html> (noting that both Utah and Kansas lawmakers are considering taxing streaming services).

15. Salon services are not included in Utah’s list of enumerated taxable services. See UTAH CODE ANN. § 59-12-103 (West 2020).

The Utah Legislature realized that it was leaving money on the table by failing to capture all but a few services in its sales tax base.¹⁶ During the last two weeks of the 2019 General Session, lawmakers introduced a bill that proposed to tax *all* services by default and then grant certain exceptions, effectively shifting future revenues from the Education Fund into the General Fund.¹⁷ This shift was – and Utah’s education budget in general remains – controversial, but a deeper dive into Utah education spending is outside the scope of this Note.¹⁸

The bill proved politically infeasible, and it ultimately failed.¹⁹ But before the end of the session, the Utah Legislature created a task force to “mak[e] recommendations to address structural imbalances among revenue sources.”²⁰ That task force worked through the summer and fall, holding several public hearings in addition to behind-the-scenes work,²¹ and it ultimately drafted a bill for the Legislature to consider.²² The full Legislature took up the

16. See, e.g., Ben Winslow, *The Utah Legislature Wants a Sales Tax on Services and a Cut to Income Taxes*, FOX13 NOW (Feb. 28, 2019, 8:09 PM), <https://fox13now.com/2019/02/28/the-utah-state-legislature-wants-a-sales-tax-on-services-and-a-cut-to-income-taxes/> (reporting lawmaker’s arguments that a broader sales tax base that captures services transactions “will boost revenues”).

17. H.B. 441, 63d Leg., Gen. Sess. (Utah 2019), <https://le.utah.gov/~2019/bills/hbillint/HB0441S01.pdf>; see also UTAH OFF. OF LEGIS. RSCH. AND GEN. COUNS., OFF. OF THE LEGIS. FISCAL ANALYST, HB 441 – TAX EQUALIZATION AND REDUCTION ACT BILL SUMMARY [hereinafter HB 441 Bill Summary], <https://senate.utah.gov/majority-newsroom/2019/3/2/hb-441-tax-equalization-and-reduction-act-summary>; Lisa Riley Roche, *Despite Business Backlash, Utah’s Tax Reform Bill Headed to House Floor*, DESERET NEWS (Mar. 1, 2019, 6:22 PM), <https://www.deseret.com/2019/3/1/20667230/despite-business-backlash-utah-s-tax-reform-bill-headed-to-house-floor#rep-tim-quinn-r-heber-city-discusses-the-gop-leadership-backed-tax-reform-bill-during-a-meeting-of-house-revenue-and-taxation-standing-committee-at-the-capitol-in-salt-lake-city-on-friday-march-1-2019>.

18. See, e.g., Benjamin Wood, *Utah House Passes ‘Monumental Solution’ for Education Funding*, SALT LAKE TRIB. (Mar. 7, 2020), <https://www.sltrib.com/news/politics/2020/03/07/utah-house-passes/> (describing controversy surrounding a 2020 General Session law that that may restructure education funding in Utah starting in 2021).

19. H.B. 441, 63d Leg., Gen. Sess. (Utah 2019) (bill not passed).

20. H.B. 495, 63d Leg., Gen. Sess. (Utah 2019), ll. 30–81, <https://le.utah.gov/~2019/bills/hbillenr/HB0495.pdf> (“The task force shall study state and local revenue systems with the purpose of making recommendations to address structural imbalances among revenue sources.”).

21. S.B. 2001 House Debate, *supra* note 5, at 30:16 (statement of Rep. Francis D. Gibson) (citing over 60 hours of public testimony).

22. *Draft Minutes of Dec. 9, 2019 Tax Restructuring and Equalization Task Force Meeting*, 63d Leg. (Utah 2019), <https://le.utah.gov/asp/interim/Commit.asp?year=>

bill—Senate Bill 2001—during the 2019 Second Special Session on December 12, 2019.²³

While the Legislature had initially set out to raise sales tax revenues by broadening the base to include services, the revised tax reform package was much less ambitious. Instead of taxing all services by default and then granting exemptions where appropriate, Senate Bill 2001 proposed to tax a relatively short list of retail services.²⁴ In what seemed to be a hard-left turn, the bill filled the gap in part by eliminating some tax exemptions and, most controversially, raising the state tax on groceries from 1.75% to the default state rate of 4.85%.²⁵ To soften the blow, the Legislature reduced the state's flat-rate income tax on business and individuals²⁶ and added a refundable grocery tax credit.²⁷

The bill ultimately passed both houses by a comfortable margin and was signed into law by Governor Gary Herbert on December 18, 2019.²⁸ For a brief moment, it looked as if the tax reform package would go into effect in early 2020.²⁹

However, the law's success was short-lived. Almost immediately, Utahns began organizing a referendum on the bill.³⁰ State law permits citizens to petition to place a law enacted by less than two-thirds of the Legislature on the ballot for an up or down vote.³¹ A broad coalition of Utahns from across the political

2019&comTSKTRE [hereinafter *Draft Minutes*]. However, the Task Force vote to send the bill to the legislature for consideration was not unanimous: six Republicans voted in favor of the draft bill, but one Republican and two Democrats voted against it. *Id.*

23. S.B. 2001, 63d Leg., 2d Spec. Sess. (Utah 2019).

24. *Id.* ll. 3380–98, 4282–4307.

25. *Id.* ll. 4331–32.

26. *Id.* ll. 1272, 1280, 1515–18.

27. *Id.* ll. 2347–99.

28. See generally *id.* (passing the Senate 20-7-2 and the House 43-27-5).

29. Benjamin Wood, *What's Next for Utah's Tax Reform Bill and What Does It Mean for You?*, SALT LAKE TRIB. (Dec. 14, 2019), <https://www.sltrib.com/news/politics/2019/12/13/whats-next-utahs-tax/> (explaining that most pieces of the tax reform bill would take effect 60 days after enactment, in mid-February 2020, but that the grocery tax would not be implemented until April 2020).

30. Dennis Romboy, *Tax Reform Referendum Is Nonpartisan 'Utahns Revolt,' Supporters Say*, DESERET NEWS (Dec. 23, 2019, 5:23 PM), <https://www.deseret.com/utah/2019/12/23/21035342/taxes-revolt-nonpartisan-food-gas-referendum>.

31. UTAH CODE ANN. §§ 20A-7-102(2), -7-301 (West 2020); see also Utah Lieutenant Governor's Off., *Instructions for a Statewide Referendum*, <https://voteinfo.utah.gov/instructions-for-a-statewide-referendum/> (last visited Sept. 28, 2020).

spectrum³² began collecting the required 116,000 signatures,³³ including by canvassing at grocery stores.³⁴ By January 22, 2020, the organizers had collected 170,000 signatures, and although the county clerks had only verified some 66,000 as registered Utah voters to that point,³⁵ the Legislature saw the writing on the wall.³⁶ The next day, the Governor, the Senate President, and the House Speaker issued a joint statement announcing they would repeal the tax package at the start of the 2020 General Session,³⁷ which they did on January 28, 2020.³⁸

Correcting Utah's apparent tax imbalance is, at least for the moment, on hold. But the economic crisis triggered by the COVID-19 pandemic has hit state budgets hard, and state legislatures may be more willing to think creatively about their tax bases.³⁹ After all, state sales taxes were born during the twentieth century's worst economic downturn.⁴⁰

32. See, e.g., Romboy, *supra* note 30 ("[T]he referendum has bipartisan support.").

33. Organizers needed to collect about 116,000 signatures from registered voters across the state in order to get the tax reform referendum on the ballot. Utah Lieutenant Governor's Off., *Signature Requirements for a Statewide Referendum*, <https://voteinfo.utah.gov/wp-content/uploads/sites/42/2019/07/Signature-Requirements-for-Statewide-Referenda.pdf> (last visited Sept. 28, 2020). The number of signatures varies year to year since, by statute, a qualifying petition must include signatures from "8% of the number of active voters in the state" and "8% of the number of active voters in [at least 15 counties] on January 1 immediately following the last regular general election." UTAH CODE ANN. § 20A-7-301(1)(a) (West 2020).

34. See, e.g., Meg Major, *Harmons Leads Race to Oppose Utah Food Tax Increase*, WINSIGHT GROCERY BUS. (Jan. 21, 2020), <https://www.winsightgrocerybusiness.com/retailers/harmons-leads-race-oppose-utah-food-tax-increase>; McKenzie Stauffer, *Harmons Opposes 4.8% Food Tax, Opens Doors to Gather Tax Referendum Signatures*, KUTV (Jan. 10, 2020), <https://kutv.com/news/local/harmons-opposes-48-food-tax-opens-doors-to-gather-tax-referendum-signatures>; Ben Winslow, *More Utah Grocery Stores Are Helping with Signature-gathering for the Tax Referendum*, FOX13 (Jan. 10, 2020, 5:38 PM), <https://www.fox13now.com/2020/01/10/more-utah-grocery-store-chains-open-their-doors-to-signature-gathering-for-the-tax-referendum/>.

35. Emily Means, *Tax Reform Referendum Will Likely Go to Voters in November*, KPCW (Jan. 22, 2020), <https://www.kpcw.org/post/tax-reform-referendum-will-likely-go-voters-november#stream/0>.

36. Lisa Riley Roche, *Amid Voter Backlash, Lawmakers Will Repeal Tax Reform Package*, DESERET NEWS (Jan. 23, 2020, 6:26 PM), <https://www.deseret.com/utah/2020/1/23/21078584/utah-tax-reform-repeal-voter-backlash-lawmakers-governor>.

37. *Id.*

38. H.B. 185, 63d Leg., Gen. Sess. (Utah 2020).

39. UNIV. OF VA. SCH. OF L.: PROJECT SAFE, *About the Project*, <https://www.law.virginia.edu/academics/program/project-safe> (last visited Oct. 22, 2020).

40. See text accompanying *infra* notes 42–44.

The aim of this Note is to explore what motivated the Utah Legislature's attempted reform packages and analyze each proposal's advantages and shortcomings. This Note proceeds in four Parts: Part I examines the implications of changing consumer behavior on state tax revenues and evaluates service taxes from a normative perspective, considering questions of efficiency, equity, administrability, and political feasibility. Part II examines other states' approaches to changing tax revenue streams in the service economy. Part III takes a close look at Utah's two tax restructuring attempts, Utah House Bill 441 and Utah Senate Bill 2001, applying the normative lenses developed in Part I to both the bills' actual structures and to lawmakers' narratives of fairness and efficiency. Finally, operating from the presumption that taxes on some services—especially those that look most like true consumption—should be captured in the sales tax base, Part IV concludes by proposing that, should Utah elect to take up tax reform again, it should move toward a state retail sales tax on consumer goods *and* services and grant general refundable credits to offset the tax's potential regressive effects and insulate consumer spending on essential services.

I. POLITICAL AND POLICY IMPLICATIONS OF SERVICE TAXES

There are a few key reasons states like Utah have considered expanding their retail sales tax (RST) bases to include services. First, the tax base is shrinking: most states primarily tax goods, not services, and services now account for a majority of consumer spending.⁴¹ This means many state budgets look increasingly anemic. The effect may be especially pronounced in states that collect no income tax or, like Utah, restrict how income tax revenues may be spent, leaving the heavy lifting to general revenue funds

41. Jonathan D. Church, *Explaining the 30-Year Shift in Consumer Expenditures from Commodities to Services, 1982–2012*, MONTHLY LAB. REV., 2 (Apr. 2014), <https://www.bls.gov/opub/mlr/2014/article/pdf/explaining-the-shift-in-consumer-expenditures.pdf> (analyzing consumer spending and showing that since around 1990, Americans have “spen[t] more money on services than on commodities”). The most recent consumer spending data from the Bureau of Labor Statistics (BLS) shows that nationwide, services represent 62.482% of consumer spending, and goods (“commodities” in the BLS tables) represent only 37.518%. BUREAU OF LAB. STAT., TABLE 1 (2017-2018 WEIGHTS): RELATIVE IMPORTANCE OF COMPONENTS IN THE CONSUMER PRICE INDEXES: U.S. CITY AVERAGE, DECEMBER 2019, <https://www.bls.gov/cpi/tables/relative-importance/2019.pdf> (last visited Oct. 22, 2020) [hereinafter BLS December 2019 CPU-I].

fed by an RST. Taxing services opens up another channel in the revenue stream *and* makes that stream more predictable. Further, like transactions should generally be treated alike: taxing goods but *not* services creates market distortions and inefficiencies.

On the other hand, service taxes pose some of the same design problems that all consumption taxes do. First, a service tax that captures business-to-business transactions creates a “cascading” effect, where taxes paid on business inputs are rolled downhill to the ultimate consumer. Second, consumption taxes are generally considered regressive since they disproportionately burden low-income taxpayers. Service taxes must be designed with the total tax burden in mind, balancing property, income, wage, wealth, and other taxes. Third, service taxes that reach essential services like healthcare and housing are unfair and inefficient, since they do not reflect elective consumer spending—the ideal retail sales tax base. Finally, these design concerns can lead to a web of exemptions that may make services taxes administratively complex, though including more services in the sales tax base may resolve some current administrability problems that arise from what is often an artificial line between taxable goods and untaxed services.

However, at the end of the day, politicians may struggle to clearly communicate the value of even the most carefully designed retail sales tax on services.

A. Advantages of an RST on Services

1. Base erosion: More money, more ~~problems~~ consistency

Retail sales taxes were first introduced in the 1930s.⁴² When property and income tax revenues fell sharply during the Great Depression, many states—including Utah in 1933⁴³—turned to a new tax base to fill the gap: consumer spending.⁴⁴ State lawmakers in Utah and elsewhere initially thought RSTs would be a temporary stop-gap measure until other sources of revenue picked back up

42. See, e.g., Kirk J. Stark, *The Uneasy Case for Extending the Sales Tax to Services*, 30 FLA. ST. U. L. REV. 435, 440 (2003).

43. OLRGC Report, *supra* note 10, at 1–2. Before the 1930s, the bulk of Utah’s state revenues came from property taxes. *Id.* Utah enacted both an income and a retail sales tax in response to falling revenues during the Great Depression. *Id.*

44. See, e.g., Stark, *supra* note 42.

during economic recovery.⁴⁵ Utah, in fact, deposited all RST revenue into an Emergency Relief Fund until 1955.⁴⁶ However, RST revenue has become an indispensable part of most states' general funds.⁴⁷ Today, in all of the jurisdictions where they have been adopted, RSTs appear to be here to stay.

Since the 1930s, the primary tax base of state RSTs has been sales of tangible personal property.⁴⁸ Some early RSTs captured a few services⁴⁹ where transactions were relatively easy to track and report.⁵⁰ For example, Utah's 1933 RST taxed utilities and entertainment admissions.⁵¹ Still, these services represented a fraction of taxable sales, and sales of goods, *not services*, drove the consumer economy at large.⁵²

But the American economy looks very different in 2020 than it did ninety years ago. Just as American manufacturing has shrunk relative to the service sector since midcentury, consumers spend a growing proportion of their annual budgets on services rather than goods.⁵³ Indeed, the most recent data from the Bureau of Labor Statistics reports that services account for nearly 63% of consumer spending.⁵⁴ Most states have accordingly added more services to

45. *Id.*; OLRGC Report, *supra* note 10, at 2 ("Although a sunset date in [Utah's] original bill indicated the sales tax would only last for about two years, a special session bill several months later repealed the sunset date . . .").

46. OLRGC Report, *supra* note 10, at 2.

47. Stark, *supra* note 42.

48. *See, e.g., id.*; HELLERSTEIN & HELLERSTEIN, *STATE TAXATION* ¶ 12.05 (3d. ed. July 2020); OLRGC Report, *supra* note 10, at 1–2.

49. HELLERSTEIN & HELLERSTEIN, *supra* note 48 (describing early RSTs on "utility services and admission fees") (citing J. DUE & J. MIKESSELL, *SALES TAXATION: STATE AND LOCAL STRUCTURE AND ADMINISTRATION* 89 (2d ed. 1994); J. DUE, *SALES TAXATION* 296–97 (1957)).

50. Robert Tannenwald, *Are State and Local Revenue Systems Becoming Obsolete?* 4 *NEW ENG. ECON. REV.* 27, 31 (2001) (describing administrability concerns for taxing service transactions "undertaken primarily by very small firms with minimal record-keeping capacity").

51. OLRGC Report, *supra* note 10, at 2.

52. *See, e.g.,* Tannenwald, *supra* note 50, at 31; Stark, *supra* note 42, at 442.

53. Stark, *supra* note 42, at 442; Tannenwald, *supra* note 50, at 32 (describing "shifts in the mix of consumption" away from goods and toward services).

54. BLS December 2019 CPU-I, *supra* note 41.

the RST base,⁵⁵ like hotel stays and vehicle rentals⁵⁶—convenient, since the burden mostly falls on out-of-staters—and repair services.⁵⁷ Yet state budgets are suffering sluggish growth in part because state tax systems have not caught up with “the shift in the nation’s mix of production and consumption from goods to services.”⁵⁸ Put simply, the tax base has “eroded,” or shrunk relative to the size of the economy.⁵⁹ In fact, one Utah lawmaker has suggested that while Utah’s first RST captured 76% of all purchases, it captured only 34% in 2019, due in large part to the shift toward a service economy.⁶⁰

States with no, low, or restricted income taxes may feel this pressure even more strongly.⁶¹ For example, the Florida Constitution prohibits an individual income tax.⁶² In 1987 and again in 2003, the state legislature considered broadening its sales tax base to include all service transactions.⁶³ While both attempts ultimately failed, economists have suggested that Florida’s constitutional ban on individual income taxes puts extra pressure

55. See, e.g., Stark, *supra* note 42, at 441 (“[M]ost states [now] tax lodging services, utilities, and admissions to various amusement events.”); Michele E. Hendrix & George R. Zodrow, *Sales Taxation of Services: An Economic Perspective*, 30 FLA. ST. U. L. REV. 411, 413 (describing utility services, rental of tangible personal property, and admissions as commonly included in state RST bases).

56. FED’N OF TAX ADM’RS, *Online Searchable Summary of 2017 Services Taxation Survey*, <https://www.statetaxissues.org/services/2017/> (last visited Sept. 29, 2020). Only two states, Oregon and Alaska, exempt short-term automobile rentals from tax. *Id.* Hotels and lodging in all 50 states and D.C. are subject to either state or local taxes. *Id.*

57. FTA 2017 Newsletter, *supra* note 9, at 1.

58. Tannenwald, *supra* note 50, at 27; see also Stark, *supra* note 42, at 447 (describing an “era of declining tax receipts and budget shortfalls” due in part to the failure of states to capture services in RST base); McKeown, *supra* note 11, at 172 (“Because few services are taxable, this shift in the economy has resulted in fewer taxable transactions in the marketplace.”).

59. McKeown, *supra* note 11, at 172.

60. S.B. 2001, 63d Leg., 2d Spec. Sess., at 36:33 (Utah 2019), <https://le.utah.gov/av/floorArchive.jsp?markerID=108711> [hereinafter S.B. 2001 Senate Debate] (statement of Sen. Lyle Hillyard).

61. See, e.g., Hendrix & Zodrow, *supra* note 55, at 412 (speculating that Florida’s “constitutional prohibition of state personal income tax” motivated the state’s 2003 attempt to expand the RST base to include services).

62. FLA. CONST. art. VII, § 5(a) (“No tax upon . . . the income of natural persons who are residents or citizens of the state shall be levied by the state . . .”).

63. E.g., Hendrix & Zodrow, *supra* note 55, at 411.

on the state's lawmakers to find new revenue sources, which explains the appeal of including services in the RST base.⁶⁴

Utah, on the other hand, does levy a flat-rate income tax of 4.95% on corporations and individuals.⁶⁵ However, since 1946, the state's constitution has required all income tax revenues to be spent on education.⁶⁶ When Utahns first voted to add that provision to the Utah Constitution, "education" included only K-12 public schools, and higher education was funded by other tax revenues.⁶⁷ The earmark was expanded to include higher education by a 1996 constitutional amendment, primarily to free up dollars in the state's General Fund for other spending programs.⁶⁸

Nevertheless, lawmakers and policy analysts believe that Utah's education earmark has created an "imbalance" between the Education Fund and the General Fund that, while not an immediate crisis, creates foreseeable problems for the state in the medium to long term.⁶⁹ Ending the constitutional earmark to divert income tax revenues to general spending is not politically feasible: an overwhelming majority of Utahns favor keeping it.⁷⁰ So when lawmakers began to look elsewhere for General Fund revenue, they landed on a sales tax on services.⁷¹

64. Hendrix & Zodrow, *supra* note 55, at 412.

65. UTAH CODE ANN. §§ 59-7-104, 201 (West 2020) (corporate); UTAH CODE ANN. § 59-10-104 (West 2020) (individual).

66. UTAH CONST. art. XIII, § 5(5); UTAH FOUND., REP. NO. 751, THE EDUCATION TAX: INCOME TAXATION IN UTAH 5 (2018), <https://www.utahfoundation.org/uploads/rr751.pdf>.

67. UTAH FOUND., *supra* note 66.

68. *Id.*

69. Gary Herbert, Opinion, *Why Utah Needed Tax Reform*, DESERET NEWS (Dec. 15, 2019), <https://www.deseret.com/opinion/2019/12/15/21020561/gov-gary-herbert-why-utah-needed-tax-reform> [hereinafter Herbert OpEd]; Bryan Schott & Bob Bernick, *Lawmakers Grappling with Bleak Budget Picture After Collapse of Tax Reform*, UTAHPOLICY.COM (Feb. 2, 2020), <https://utahpolicy.com/index.php/features/today-at-utah-policy/22834-lawmakers-grappling-with-bleak-budget-picture-after-collapse-of-tax-reform>; see also UTAH LEG., *Not Enough*, *supra* note 7 (citing a budget "disparity").

Note that while the Utah budget looked healthy in 2019 and 2020, as a result of the COVID-19 pandemic, Utah is now facing a major budget crisis that will likely result in major spending changes. See, e.g., Bethany Rodgers, *State Lawmakers Lay Groundwork for Steep COVID-19 Budget Cuts*, SALT LAKE TRIB. (May 13, 2020), <https://www.sltrib.com/news/politics/2020/05/13/state-lawmakers-lay/>.

70. Lisa Riley Roche, *Two-Thirds of Utahns Want to Keep Constitutional Earmark on Income Taxes for Education*, DESERET NEWS (Jan. 6, 2020), <https://www.deseret.com/utah/2020/1/6/21051840/poll-utah-education-constitution-amendment-earmark-income-taxes> (citing a poll by Y2 Analytics).

71. See, e.g., Winslow, *supra* note 16.

An RST that includes services in the tax base not only provides *more* money for state budgets⁷²—and in Utah, more *flexible* money⁷³—but may also stabilize revenues. Recall that general RSTs were first introduced during the Great Depression to tax more stable consumer spending when revenues from property and income taxes dried up.⁷⁴ Modern attempts to add services to the RST base follow a similar rationale: expand the base to offset economic swings. As Darien Shanske explains,

You still need to pay the sales tax when you consume even if you have just lost your job. This is certainly a limitation of a consumption tax, but it is also a virtue because this is what makes the tax a good way to finance social services that people need even more of in recessions.⁷⁵

While the actual effect on budget volatility will depend on which services are included in the tax base,⁷⁶ service tax revenues generally fluctuate less than revenues from income taxes during an economic downturn because “consumer services . . . are difficult to stockpile and thus vary relatively little over the business cycle.”⁷⁷

Stability was a primary reason Utah attempted tax reform in 2019. In a 1,500-word opinion piece just after Senate Bill 2001 was enacted, Governor Gary Herbert cited budget stability concerns nine times.⁷⁸ “Diversifying from where we collect taxes, while

72. Ann L. Kamasky & Alan R. Bembeneke, *The Polarities of Sales Tax and Services*, 10 J. STATE TAX’N 1, 2 (1992) (“No one seems to dispute that a broad-based sales tax upon services offers immediate revenue generating potential.”).

73. Both of Utah’s recent tax reform proposals attempted to offset the expanded RST base with a lower income tax rate. See H.B. 441, 63d Leg., Gen. Sess. (Utah 2019), ll. 452, 460, 691–92 (reducing rates from 4.95% to 4.75%); S.B. 2001, 63d Leg., 2d Spec. Sess. (Utah 2019), ll. 1272, 1280, 1515–18 (reducing rates from 4.95% to 4.66%). The net effect was less revenue for the Education Fund, but more for the General Fund. Governor Gary Herbert argued this was the right cumulative effect: “[W]e don’t need to collect more tax revenue, but we do need to change how we collect it.” Herbert OpEd, *supra* note 69.

74. See *supra* text accompanying notes 42–44.

75. Darien Shanske, *Expanding State Fiscal Capacity, Part I: A New and Improved Consumption Tax Paired with a Tax on a Federal Windfall (the QBI Deduction)*, FLA. TAX REV. (forthcoming 2020) (manuscript at 11), <https://ssrn.com/abstract=3324557>.

76. Stark, *supra* note 42, at 448 (contrasting relatively elastic demand for services like construction and repair with more stable demand for rental and professional services); see also Kamasky & Bembeneke, *supra* note 72, at 3 (contrasting more elastic demand for auto body repair and more stable demand for optometry).

77. Hendrix & Zodrow, *supra* note 55, at 418.

78. Herbert OpEd, *supra* note 69.

keeping the total tax revenue collected in check, is critical to creating a more stable system,” he wrote.⁷⁹

2. *Correcting economic distortions*

Beyond practical concerns about state revenue streams, including (at least some) services in the RST base is arguably the right normative approach because like transactions should be treated alike. Recall the *Grey’s Anatomy* and manicure examples above.⁸⁰ There is no principled reason my nailcare and my neighbor’s should be treated differently by the tax system, or that the DVDs should be taxed but my Netflix subscription should not be. In both cases, the end result—elective consumer spending—is effectively the same.⁸¹

Taxing such close equivalent transactions differently can distort consumer behavior not based on any external metric—like convenience or pre-tax price—but based solely on tax consequences.⁸² By extension, general disparate tax treatment of goods and services unintentionally subsidizes services.⁸³ Taxing services under an RST should, at least in theory, make the sales tax system as a whole more efficient.⁸⁴

B. *Design Concerns*

The policy concerns surrounding a service tax echo concerns with consumption taxes generally. Many of these concerns can be mitigated through effective design, and where applicable, this Section explores parallels with established design mechanisms in existing tax regimes.

79. *Id.* However, Herbert may have also been emphasizing stability concerns to justify raising the grocery tax rate, since consumer spending on unprepared foods is especially inelastic. See *infra* Section III.B.2.b.

80. See *supra* text accompanying notes 14–15.

81. HELLERSTEIN & HELLERSTEIN, *supra* note 48, ¶ 12.05[1] (“From an economic standpoint, the distinction between a service and a commodity is not a very significant one, since both satisfy personal wants.”) (quoting JOHN DUE, SALES TAXATION 374–75 (1957)).

82. See, e.g., Alan R. Romero, *Including Legal Services in State Sales Taxes*, 29 HARV. J. ON LEGIS. 280, 286; Stark, *supra* note 42, at 448.

83. E.g., Romero, *supra* note 82, at 286.

84. E.g., *id.*

1. *Tax cascading: Exempting business-to-business services*

Business inputs are generally exempt from tax under most current tax regimes. For example, under the U.S. federal income tax, taxpayers may deduct business expenses against their income as a cost of doing business.⁸⁵ Likewise, goods purchased by a business for resale are generally exempt from sales tax,⁸⁶ since the purpose of a *retail* sales tax is to isolate consumer transactions.⁸⁷ Moreover, if business inputs—goods or services—are subject to the RST, “tax paid at an earlier stage of production . . . is not itself included in the sales tax base,” increasing the amount paid by the end consumer at the till.⁸⁸ In other words, taxes are included in the cost of intermediate transactions, raising the still-taxable price paid by the ultimate consumer.⁸⁹ This phenomenon is called “tax cascading.”⁹⁰

For example, in a world where *all* transactions—even business-to-business (B2B) sales—are taxable at 8%, a company that purchases an LED lamp for a pre-tax price of \$40 to resell in a home manicure kit would include the \$3.20 it pays in tax in the price it charges the consumer. But that consumer would again pay the 8% tax on the purchase of the manicure kit, meaning she pays tax on the lamp’s base price, the company’s profit margin, *and* the \$3.20 in tax costs the company has passed on to her. The net effect is to increase the effective rate of tax paid by the consumer.⁹¹ And since that effective rate increases—*cascades*—with every intermediate B2B transaction, “household sales tax burdens will vary depending

85. I.R.C. § 162.

86. See HELLERSTEIN & HELLERSTEIN, *supra* note 48, ¶ 14.02 (“Many states exclude sales for resale from the sales tax base . . . to prevent pyramiding of the sales tax . . .”); see also ROBERT CARROLL & ALAN D. VIARD, PROGRESSIVE CONSUMPTION TAXATION: THE X TAX REVISITED 20 (2012) (“Sales from one business firm to another are excluded from the tax base.”).

87. Stark, *supra* note 42, at 456.

88. See, e.g., *id.*

89. See, e.g., Manoj Viswanathan, *Rethorizing Progressive Taxation*, UC Hastings Research Paper No. 365, (manuscript at 35–36), <https://ssrn.com/abstract=3465029>; Eric Duey, Note, *Unbundling Bundled Transactions*, 49 CONN. L. REV. 659, 668 (2016).

90. See, e.g., CARROLL & VIARD, *supra* note 86, at 160; cf. Hendrix & Zodrow, *supra* note 55, at 416 (describing this same phenomenon as “pyramiding”); MICHAEL MAZEROV, CENTER ON BUDGET AND POLICY PRIORITIES, EXPANDING SALES TAXATION OF SERVICES: OPTIONS AND ISSUES 25–26 (July 2009), <https://www.cbpp.org/sites/default/files/atoms/files/8-10-09sfp.pdf> (“pyramiding”); Shanske, *supra* note 75, at 14–15 (“pyramiding”).

91. Cf. Stark, *supra* note 42, at 457.

upon how many stages of production their particular consumption bundle went through.”⁹² Such variation pegs the effective tax rate to an arbitrary metric – degree of supply chain integration – which, like the disparate treatment of goods and services discussed above in Section I.A.2, distorts behavior and favors large firms with integrated production and distribution over smaller, less integrated ones.⁹³ It also makes goods and services in places that capture B2B transactions in the RST base more expensive and thus less competitive against jurisdictions that do not.⁹⁴

In practice, most state RSTs *do* currently capture some business inputs.⁹⁵ This is, from a normative perspective, the wrong design. And unfortunately, as states consider expanding their RST bases to include services, the temptation to tax business services may be particularly great because, to be frank, it would bring in a lot of money.⁹⁶ Nevertheless, service transactions between businesses should be tax exempt to avoid tax cascading.⁹⁷

92. *Id.* at 456–57.

93. *See, e.g.,* Hendrix & Zodrow, *supra* note 55, at 416 (arguing that tax cascading incentivizes vertical integration and “favor[s] large established firms over newer and smaller” ones); Stark, *supra* note 42, at 457 (“[A] household whose consumption bundle contains a disproportionate share of multistage products will thus bear a heavier burden than a household whose products are produced entirely within a single, vertically-integrated business.”); Kamasky & Bembenek, *supra* note 72, at 4–5 (asserting that small business would suffer disproportionately under a service tax that did not exempt business inputs because “[t]hey routinely contract out for . . . accounting, computer programming, consulting, debt collection, engineering, janitorial, legal, secretarial, and security” services, unlike large firms that “provide these services internally and without the need to pay additional sales tax”); Shanske, *supra* note 75, at 15–16 (“This is the unfairness [of tax pyramiding]: advantage to large vertically integrated businesses over smaller competitors.”).

94. *See, e.g.,* Hendrix & Zodrow, *supra* note 55, at 416 (“[T]axing business inputs is also likely to hamper exports to other states, as it raises the cost of producing those goods and services, relative to the costs experienced by firms in states that do not tax business inputs or tax them at lower effective rates.”).

95. CARROLL & VIARD, *supra* note 86, at 160; Stark, *supra* note 42, at 456.

96. Stark, *supra* note 42, at 457–58.

97. Darrien Shanske has suggested this could be accomplished with an entity-level consumption tax – effectively a gross receipts tax like Delaware or New Mexico, *see infra* note 155 – that permits a deduction for business inputs. *See* Shanske, *supra* note 75, at 14.

As an aside, value added taxes (VATs) avoid cascading by taxing B2B transactions, but then permitting business to deduct or take a credit for taxes paid on those business inputs. JOSEPH M. DODGE, J. CLIFTON FLEMING, JR., FRANCINE J. LIPMAN & ROBERT J. PERONI, *FEDERAL INCOME TAX: DOCTRINE, STRUCTURE, AND POLICY* 17–18 (5th ed. 2019) (“The advantage of the VAT over an RST is that there are no ‘cascading’ (multiple) taxes on the same item, but at the same time no sale for consumption escapes tax. Thus, the ultimate tax is always the amount

2. *Vertical equity concerns*

Whether they reach only goods or also reach services, consumption taxes are usually considered regressive because they tend to place a heavier burden on those with less.⁹⁸ In general, RSTs disproportionately affect the poor who are forced to spend a greater proportion of their incomes on transactions that are subject to sales taxes.⁹⁹ The wealthy have more room in their post-consumption budgets to save and invest, and those amounts, while they may be subject to other taxes,¹⁰⁰ are exempt from RSTs.¹⁰¹

On the other hand, some scholars have suggested service RSTs might be *less* regressive than consumption taxes generally because the wealthy may consume more services than the poor.¹⁰² This may sound intuitively right at first blush: we might reasonably think few low-income families hire a private Pilates instructor or take their poodle to the groomer twice a month.

However, the empirical support for this claim is at best unclear, and the ultimate impact of a service tax on the most economically vulnerable taxpayers depends on which services are included in the mix.¹⁰³ For example, families across the income distribution depend on childcare services, but given that childcare costs are not currently deductible business expenses for income tax purposes,¹⁰⁴

paid by the end consumer no matter how many, or how few, intermediate sellers there are . . .”). VATs generally *do* capture service transactions. CARROLL & VIARD, *supra* note 86, at 160. The VAT credit-invoice method is an “elegant solution” to the problem of tax cascading, but it is ultimately unworkable at the state level because of the complexities of multistate taxation. Shanske, *supra* note 75, at 15–16.

98. See, e.g., DODGE ET AL., *supra* note 97, at 152–53; Elaine S. Povich, *Why States Are Struggling to Tax Services*, PEW (June 27, 2017), <https://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2017/06/27/why-states-are-struggling-to-tax-services>. But see generally Viswanathan, *supra* note 89 (questioning the label of “progressivity” and urging more careful parsing of different taxes’ effects on differently-situated taxpayers).

99. DODGE ET AL., *supra* note 97, at 152–53; Povich, *supra* note 98.

100. For example, amounts saved and invested by individual consumers are usually subject to income tax because they are nondeductible. DODGE ET AL., *supra* note 97, at 160, 179 (describing the “capitalization principle”). But the same is true of cash spent in consumption, which transactions are taxable under an RST in most states but are expressly nondeductible under the federal income tax. See I.R.C. § 262.

101. DODGE ET AL., *supra* note 97, at 152–53.

102. Stark, *supra* note 42, at 449–51.

103. See *id.*

104. Childcare costs may be offset by an income tax credit, see I.R.C. § 21, but are not deductible as, for example, “ordinary and necessary” business expenses, see I.R.C. § 162.

they might not be exempted as “business inputs” under the anti-cascading policy of RSTs. The effect of higher childcare costs would be compounded for low-income families, who spend a greater share of their income on childcare.¹⁰⁵ Taxing “housing services” like residential leases would disproportionately hurt the poor for the same reason.¹⁰⁶

Nevertheless, service taxes can be designed in ways that mitigate this regressive effect. Manoj Viswanathan has pointed out that although “progressivity” broadly means that those who have more should pay more tax, the term is in fact ambiguous and easy to manipulate.¹⁰⁷ This, he argues, is in part because measures of progressivity generally fail to account for (1) the overall taxable burden and base—the relative rates and the mix of income, wage, property, consumption, etc. taxes paid¹⁰⁸—and (2) government spending programs.¹⁰⁹

An RST that includes consumer services should be carefully designed to consider the impact on individuals’ overall tax liability at both the state and federal levels. For example, in a state with a flat-rate income tax like Utah, a larger RST base that includes services might justify introducing progressive income tax rate brackets to rebalance the overall tax burden. On the other hand, higher state income tax rates for the wealthy could increase the

See also Lawrence Zelenak, *Giving Credits Where Credits Are (Arguably) Due: A Half-Century’s Evolution in the Design of Personal Tax Expenditures* 45–55 (2020) (unpublished manuscript) (on file with author). This is arguably the wrong result as a policy matter, since in most cases childcare is probably best conceived of as an income-producing expense that should therefore reduce the earner’s tax base, but such is the world we live in. *See id.* at 46 (arguing that childcare costs be deductible in order to properly measure a taxpayer’s net income, not a credit conceived of as a personal tax expenditure).

105. Rasheed Malik, *Working Families Are Spending Big Money on Child Care*, CTR. FOR AM. PROGRESS (June 20, 2019, 10:01 AM), <https://www.americanprogress.org/issues/early-childhood/reports/2019/06/20/471141/working-families-spending-big-money-child-care/> (citing U.S. Census Bureau, 2014 Survey of Income and Program Participation, Wave 3).

106. David G. Davies & David E. Black, *Equity Effects of Including Housing Services in a Sales Tax Base*, 28 NAT’L TAX J. 135 (1975); Alex Morrell & Andy Kiersz, *Seeing How the Highest and Lowest Earners Spend Their Money Will Make You Think Differently About “Rich” vs. “Poor,”* BUSINESS INSIDER (Dec. 4, 2017, 9:45 AM), <https://www.businessinsider.com/how-high-income-and-low-income-americans-spend-their-money-2017-3> (“[L]ow-income Americans spend a significantly larger proportion of their money on housing . . .”).

107. *See generally* Viswanathan, *supra* note 89.

108. *Id.* at 12–24.

109. *Id.* at 41–45.

available federal income tax deduction under I.R.C. § 164 for state and local taxes (SALT) paid, especially after the temporary \$10,000 deduction cap is lifted starting in 2026.¹¹⁰ The lower brackets in progressive state income tax rates don't do much to help a state's working poor offset their federal income tax liability because their SALT deduction will be much smaller, and low-income taxpayers probably take the standard deduction and don't itemize anyway.¹¹¹ This is all to say that tax systems are complex and interconnected, and pulling what may seem like a small lever can have far-reaching consequences. A proper progressivity analysis should fully account for that complexity.¹¹²

Government spending programs—both direct spending and indirect tax expenditures¹¹³—can also change the calculus.¹¹⁴ For example, a state might elect to create a refundable services tax credit against state income tax liability with an income phaseout to offset the burden of an expanded RST on low-income households.¹¹⁵ And revenues from a services RST that are spent on programs that primarily benefit those with less, like Medicaid

110. See I.R.C. § 164(b)(6). Note that taxpayers may elect to deduct sales taxes “in lieu of [s]tate and local income taxes” but may not deduct both. *Id.* at (5). While this helps taxpayers in states like Florida that impose no income tax, see FLA. CONST. art. VII, § 5(a), it would be of little help to taxpayers in, for example, Utah, where virtually all individuals who pay state *income* taxes will use the federal § 164 deduction for those state *income* taxes, not for state sales taxes.

111. I.R.C. § 63(c)(7) (increasing the standard deduction for federal income taxes for taxable years 2018–2025); see also, e.g., Kimberly Clausen, *Fixing Five Flaws of the Tax Cuts and Jobs Act 20–21* (Feb. 3, 2020) (unpublished manuscript), <https://ssrn.com/abstract=3397387> (“[D]ue to the higher standard deductions, the share of taxpayers that itemize will shrink substantially, . . . eliminating these tax incentives for some taxpayers, while leaving them intact for the (typically wealthier) taxpayers . . .”).

112. See generally Viswanathan, *supra* note 89.

113. See *id.* at 41 (“There is no economic distinction between transfers effectuated via the tax code and transfers dispensed via budgetary allocation.”).

114. *Id.* at 41–45.

115. MAZEROV, *supra* note 90, at vi (“[T]argeted credits administered through the income tax or rebates of sales taxes paid can be used to mitigate the increased sales tax burden low-income families could experience when a sales tax is broadly expanded to include services.”); cf. S.B. 2001, 63d Leg., 2d Spec. Sess. (Utah 2019), ll. 2347–99.

This is the approach taken by the Utah legislature in Senate Bill 2001. See *infra* Section III.B.1. Because many criticized raising the tax rate for unprepared foods as “regressive,” legislators created a grocery tax credit to mitigate the effects on low-income taxpayers. See text accompanying *infra* notes 213–214.

expansion,¹¹⁶ may reduce inequality in ways that achieve progressive taxation's fundamental aim: reducing inequality.¹¹⁷

Ultimately, a close look at spending programs and tax burden and base is impossible without significantly more data. Such an in-depth analysis is outside the scope of this Note. But a nuanced progressivity analysis will be essential for legislatures that consider expanding the RST base to capture services.

3. *Essential services exemptions*

If a state decides to expand its RST to include (more) services, it should strongly consider also exempting essential services. This concern is closely related to the vertical equity concerns discussed in Section I.B.2, since those with less must spend a greater share of their income on services and goods they truly need. Spending on essential goods (like groceries and feminine hygiene products) and services (like medical care) tends to fluctuate less over the course of the economic cycle than consumer spending overall: it is much easier to put off upgrading one's home theater system than to put off buying milk or having an appendectomy. These relatively recession-proof transactions can make them an appealingly stable tax base.¹¹⁸ However, *elective*, not essential, consumer spending is the "ideal retail sales tax base."¹¹⁹

Just as most states have opted to exempt prescription drugs from sales tax because they are necessities,¹²⁰ basic health care should not be taxed,¹²¹ even though the potential revenues from a medical services tax make it a tempting proposition.¹²² Most VAT regimes around the world—which generally "us[e] broad and stable consumption taxes to fund social insurance programs"¹²³—

116. Cf. UTAH DEP'T OF HEALTH, *Medicaid Expansion: Program History*, <https://medicaid.utah.gov/expansion/> (last visited Sept. 30, 2020).

117. Viswanathan, *supra* note 89, at 51–52 ("[S]pending programs could explicitly address redistribution, which is an often stated (but generally unaccomplished) goal of progressive taxation.").

118. See, e.g., Shanske, *supra* note 75.

119. HELLERSTEIN & HELLERSTEIN, *supra* note 48, ¶ 12.05.

120. See, e.g., Robert H. Gleason, *Reevaluating the California Sales Tax: Exemptions, Equity, Effectiveness, and the Need for a Broader Base*, 33 SAN DIEGO L. REV. 1681, 1716 (1996).

121. See, e.g., Hendrix & Zodrow, *supra* note 55, at 420.

122. Cf. Gleason, *supra* note 120, at 1766 n.403 (arguing that to exempt medical services from an RST would "constrict the base").

123. Shanske, *supra* note 75, at 19.

follow this reasoning and exempt health care services.¹²⁴ The same argument can be made for exempting other necessary services like utilities, housing, education, and local transportation.¹²⁵

However, it can be difficult to parse out “elective” from “essential” spending in some areas: taxpayers can choose to rent a larger house and heat it to seventy-five degrees or choose to attend a private college instead of a public one. A legislature might therefore reasonably conclude that elective cosmetic medical procedures should be captured by a services tax because they look like classic consumer spending. Nevertheless, at least to the extent such services are *necessary*, they should not be taxed. This is part of what makes a refundable income tax credit, discussed above in Section I.B.2, appealing. An RST that captures *all* services but grants such a credit can be designed to effectively exempt necessity-level spending from tax—say, enough to cover the RST paid on a small apartment heated to sixty-eight degrees—rather than granting blanket exemptions that would cover elective luxury spending in “essential” areas like housing.

4. Administrability

Beyond the general administrability concerns for multistate service transactions discussed elsewhere in the service tax literature,¹²⁶ a complex web of exemptions also risks making the tax administratively complex, even though insulating B2B transactions, the poor, and essential services from a services tax is normatively the right design. How, for example, should a services

124. See, e.g., Itai Grinberg, *Where Credit Is Due: Advantages of the Credit-Invoice Method for a Partial Replacement VAT*, 63 TAX L. REV. 309, 328 (2010) (“In the rest of the OECD, services like health care and education often are referred to as politically ‘untouchable,’ and exempted, or given more preferential treatment through zero-rating.”); GOV’T OF NETHERLANDS, *VAT Rates and Exemptions*, <https://www.government.nl/topics/vat/vat-rates-and-exemptions> (last visited Sept. 27, 2020); EUROPEAN UNION, *VAT Exemptions*, https://europa.eu/youreurope/business/taxation/vat/vat-exemptions/index_en.htm (last visited Sept. 27, 2020).

125. HELLERSTEIN & HELLERSTEIN, *supra* note 48, ¶ 12.05 (identifying exemptions for medical, education, local transportation, and utility services); Gleason, *supra* note 120, at 1766 n.403 (describing a VAT that exempted, among other services, housing, health care, and education); see generally Davies & Black, *supra* note 106 (arguing that housing services should be exempt).

126. Stark, *supra* note 42, at 459 n.88 (citing William F. Fox, *Sales Taxation of Services: Has Its Time Come?*, SALES TAXATION: CRITICAL ISSUES IN POLICY AND ADMINISTRATION 51, 58–60 (1992)).

tax that exempts business inputs treat architectural services? Design is a professional service used by individuals in ways that look like elective consumer spending *and* by businesses in ways that clearly do not. And a single architectural firm may serve both types of clients. While the normative policy concerns discussed above would suggest that blueprints for a small business tenant fit-out should be tax exempt, that rationale breaks down for a beachfront designer home: the wealthy property owner would only pass on taxes paid on architectural services to the next (presumably wealthy) owner at sale; she can certainly afford to pay the tax; and while housing itself is “essential,” beach access and a butler’s pantry are not.

This tension may be even stronger for legal services, where some individual “consumers” may already be especially vulnerable and access to justice concerns are ever-present,¹²⁷ but many wealthy individuals use legal services to preserve and grow dynastic wealth through estate planning. While it would seem to make normative sense to tax estate planning services for the wealthy and exempt legal representation in bankruptcy and divorce proceedings for the poor, line-drawing can be difficult. Which legal services are really “essential”? When does having a good attorney in, say, a divorce become a “luxury”? Don’t people across the income distribution need a plan for what will happen to their assets when they die?

Moreover, a patchwork of exemptions may open up the service tax to lobbying by special interest groups. Utah’s own experience shows that well-organized professional services providers like accountants and attorneys can make their influence felt at the legislature in ways that, for example, gig workers cannot.¹²⁸

127. Cf. *id.* at 458 (pointing out tension between the B2B exemption and the apparent unfairness of taxing “the elderly couple who hires a lawyer to devise a living trust”); Roche, *supra* note 17 (quoting an attorney who “already has to turn away some clients unable to afford legal representation,” and speculating that legal services will become even more expensive “if sales taxes are added to the cost”); see generally *What Is Access to Justice*, TEX. ACCESS TO JUST. COMM’N, <https://www.texasatj.org/what-access-justice> (last visited Sept. 27, 2020) (“The term ‘access to justice’ describes the ability of any person, regardless of income, to use the legal system to advocate for themselves and their interests.”).

128. Compare Stephen Brown, Opinion, *Why Taxation of Services with Utah House Bill 441 Is A Bad Move*, MEDIUM (Mar. 6, 2019), <https://medium.com/silicon-slopes/opinion-why-taxation-of-services-with-utah-house-bill-441-is-a-bad-move-986beee87170>, with text accompanying *infra* note 197.

Some of this complexity could be resolved by the refundable income tax credit discussed above in sections I.B.2 and 3. Instead of granting blanket exemptions for all “essential” services, no matter how much “luxury” they hide, the credit could be designed to exempt a fixed dollar amount to cover the service tax liability on the level of necessary services required by a typical low- or middle-income household. While this solution is relatively administratively simple, it still requires lawmakers to decide which services are truly necessary, where the income phaseout should begin, and whether the credit should be adjustable for family size. This might also pose a cash flow problem for taxpayers that run on tight budgets: although they’d get their tax costs back on an income tax return filed the next year, that money would not be available up front.

What is more, the credit would likely be both over- and underinclusive, especially for necessary services like education, legal services, and healthcare, where costs tend to cluster in certain years and for certain individuals. For example, a low-income family that spent an extraordinary amount on legal services in a given year would probably not see the full tax costs on those services covered by the credit. And if the credit accounted for the average cost of in-state university tuition, families without kids in college would benefit from a credit they don’t actually need. In other words, a fixed dollar credit is easy to administer but an imprecise measure of taxpayers’ true yearly service needs.

In the alternative (or perhaps in addition to a relatively smaller fixed dollar credit), the Utah Legislature might also consider creating specific fixed-*percentage* tax credits—still with income phaseouts—for individual taxpayers who must pay extraordinary costs on a particular necessary service in a particular year. For example, an eligible low-income taxpayer who experienced a particularly nasty and prolonged divorce might be able to claim a credit equal to the RST she paid on the legal services. While this would more precisely measure taxpayer need, it does shift the administrative burden onto taxpayers who may struggle to deal with the added complexity.

On the other hand, an RST regime that reaches goods but few if any services creates its own set of administrability problems because “the line of distinction between service and commodity is by no means a sharp one” and can at times look

“highly arbitrary.”¹²⁹ If a real estate broker buys printed mailing lists—presumably not for the paper but for the *information* printed on them—is that a taxable good or an untaxed service?¹³⁰ In 1990, the Utah Supreme Court said such a list was a taxable good.¹³¹ Would the answer be different today if the mailing list was instead a database real estate brokers could subscribe to? Probably so, since subscriptions are more clearly a service, not a good. But does the distinction make sense, given that the underlying information is the same?¹³²

Likewise, state tax authorities and courts have struggled to create clear standards for taxing “mixed” and “bundled transactions” that involve the delivery of both taxable goods *and* untaxed services.¹³³ For example, Xfinity provided me with a wireless modem when I signed up. The modem itself is tangible personal property but is arguably “incidental” to the “dominant purpose” of the transaction—internet services.¹³⁴

In short, including services in the RST base may resolve some administrability concerns even as it creates new ones, especially if the legislature pairs the broader base with refundable income tax credits to remedy regressivity and essential services problems.

C. Political Feasibility

Even if a state legislature successfully creates an efficient, fair, and administratively feasible services tax, it may still face significant pushback from constituents. Over the last thirty-five years, several states have attempted to expand their RST bases to

129. HELLERSTEIN & HELLERSTEIN, *supra* note 48, ¶ 12.05 (quoting JOHN DUE, SALES TAXATION 374–75 (1975)). See generally *id.* ¶ 13.03 (“[T]he taxability of transactions involving information services typically turn[s] . . . on the question of whether the ‘essence’ or ‘true object’ of the transaction was the information service or the tangible property in which the results of the service were embodied.”).

130. See *Mark O. Haroldsen, Inc. v. State Tax Comm’n*, 805 P.2d 176, 178 (Utah 1990).

131. *Id.* at 181–82.

132. Of course, we might reasonably also ask why real estate mailing lists—whether a good or a service—should be subject to retail sales tax at all, given that the brokers who use it are presumably using the data for business purposes.

133. HELLERSTEIN & HELLERSTEIN, *supra* note 48, ¶ 19A.04(2)(a)(v) (“State tax administrators, courts, and taxpayers have perennially struggled with the tax treatment of bundled transactions. . . . [A] taxing authority might try to treat a mixed transaction . . . as fully taxable even though there is a reasonably accurate way to disaggregate the purchase prices of the taxable and nontaxable items.”).

134. See generally *id.* ¶ 13.03.

capture services.¹³⁵ Most have failed.¹³⁶ When Michigan tried to tax services in 2007, “widespread public opposition” meant the state legislature was forced to repeal the tax on the day it was scheduled to go into effect.¹³⁷ In 1991, Massachusetts tried and failed to broaden its sales tax base to capture significantly more services,¹³⁸ as did Florida in 1987 and again in 2002.¹³⁹

However, these proposals’ fatal flaw appears to have been taxing business-to-business service transactions, provoking strong opposition from the states’ business communities. Michigan’s law would have captured many services used primarily by businesses, like management, scientific, and technical consulting; office administration; merchandise warehousing and storage; and industrial and graphic design.¹⁴⁰ The same was true of Florida’s attempts.¹⁴¹ Worse, Massachusetts’s 1991 law would have taxed professional services like legal, accounting, engineering, and

135. See, e.g., FLA. STAT. § 212.059 (1987), *repealed by* 1988 Fla. Laws 19; Fla. S.J. Res. 938 (2002) (never passed); MASS. GEN. LAWS ch. 64H, §§ 1–33 (1991), *amended and partially repealed by* 1991 Mass. Acts 4; MASS. GEN. LAWS ch. 64H, § 1 (amending the sales tax to include “computer system design services”) (2013), *repealed by* 2013 Mass. Acts ch. 95; 2007 Mich. Pub. Acts 92, *repealed by* H.B. 5408, 94th Leg., Reg. Sess. (Mich. 2007); see also, e.g., IND. FISCAL POL’Y INST., SALES TAXATION OF SERVICES IN INDIANA: CONCEPTS AND ISSUES 6–7 (2009), <http://www.state.in.us/dor/files/indiana-fiscal-policy-institute-sales-tax.pdf> (describing unsuccessful attempts to expand service taxes in Florida, Massachusetts, Maryland, and Michigan, but noting New Jersey’s successful but significantly more narrow expansion of taxable services).

136. *Supra* note 135.

137. Monica Davey, *States Seeking Cash Hope to Expand Taxes to Services*, N.Y. TIMES (Mar. 27, 2010), <https://www.nytimes.com/2010/03/28/us/28taxes.html>; Mich. H.B. 5408 (2007).

138. MASS. GEN. LAWS ch. 64H, §§ 1–33 (1991), *amended and partially repealed by* 1991 Mass. Acts 4; see generally Romero, *supra* note 82 (explaining that the state legislature “passed and quickly repealed” its own expanded service tax, thanks in large part to resistance from the state bar, which strongly objected to taxing legal services); Samuel B. Bruskin & Kathleen King Parker, *State Sales Taxes on Services: Massachusetts as a Case Study*, 45 TAX LAW. 49 (1991) (detailing and analyzing Massachusetts’s attempt to tax a long list of services).

139. FLA. STAT. § 212.059 (1987), *repealed by* 1988 Fla. Laws 19; Fla. S.J. Res. 938 (2002) (never passed); see generally Vicki L. Weber, *Florida’s Fleeting Sales Tax on Services*, 15 FLA. ST. U. L. REV. 613 (1987); Stark, *supra* note 42.

140. H.B. 5198, 94th Leg., Reg. Sess. (Mich. 2007) (incorporating specific industry codes from the 2002 North American Industry Classification System (NAICS 2002) by reference, including NAICS 2002 codes 5416, 5611, 4931, and 5414).

141. See Weber, *supra* note 139, at 626 (explaining that under the 1987 Florida law, all services purchased by nearly all businesses would be subject to sales tax); Hendrix & Zodrow, *supra* note 55, at 411, 427 (stating that the 2007 Florida proposal would have “expand[ed] the tax base to include a wide variety of both consumer and business services” and provided “limited exceptions” for business-to-business transactions).

architectural services *only* when provided to businesses—not to individual consumers.¹⁴²

Still, most states tax some services, a few states tax most,¹⁴³ and in light of the current pandemic-induced budget crises, some states may wish to tax more.¹⁴⁴ The next Part describes the ways various state tax regimes currently treat services.

II. CURRENT TREATMENT OF SERVICES UNDER STATE RST REGIMES: POSITIVE LAW

Broadly speaking, states take one of two approaches to sales taxation of services. Section II.A describes the majority approach: expressly tax a discrete list of service transactions. Section II.B describes the minority approach: tax all services by default and then grant exemptions where appropriate.

A. Majority Approach: Enumerated Services Taxes

Most states' RST regimes capture all sales of goods by default unless the legislature grants a specific exemption, whereas they tax only specifically identified services,¹⁴⁵ often by including a list of taxable services in the statutory definition of "retail sale."¹⁴⁶ For example, Washington state statute makes the sale of all tangible personal property taxable by default,¹⁴⁷ but also provides that "'retail sale' includes the sale of . . . labor and services rendered in respect to . . . [t]he installing, repairing, cleaning, altering, imprinting, or improving of tangible personal property of or for consumers," "cleaning, fumigating, razing, or moving of existing buildings," and "automobile towing," among other services.¹⁴⁸

142. 1990 Mass. Acts ch. 121 § 42 (defining many "services" for consumption tax purposes to include services *only* if "provided to businesses").

143. See *infra* Section II.B.

144. See generally Gladriel Shobe, Grace Stephenson Nielsen, Darien Shanske & David Gamage, *Why States Should Consider Expanding Sales Taxes to Services, Part 1*, 98 TAX NOTES STATE (forthcoming Dec. 21, 2020).

145. See generally FTA 2017 Newsletter, *supra* note 9, at 1–2 ("[M]ost states tax services to a certain degree.").

146. MAZEROV, *supra* note 90, at 31.

147. WASH. REV. CODE § 82.04.050(1)(a) (2017) ("'Sale at retail' or 'retail sale' means every sale of tangible personal property . . .").

148. WASH. REV. CODE § 82.04.050(2) (2020).

New Jersey expressly includes the sale of consumer services like tanning, massages, and tattooing in its RST base.¹⁴⁹

Utah currently follows the majority rule. The state RST applies to “retail sales of tangible personal property made within the state.”¹⁵⁰ Enumerated taxable services include telecommunications;¹⁵¹ admission to “theaters, movies, operas, museums,” and the like;¹⁵² repair and “assisted cleaning” of tangible personal property;¹⁵³ and dry cleaning.¹⁵⁴

B. Minority Approach: Default Taxation of Services

A small group of states—including Hawaii, New Mexico, South Dakota, and West Virginia—impose a consumption tax on all services by default unless specifically exempted by statute.¹⁵⁵ For example, unlike the Washington, New Jersey, and Utah statutes cited above, Hawaii defines a retail sale to “include[] the sale of tangible personal property . . . and the rendering of services.”¹⁵⁶ West Virginia expressly provides that “sales” subject to the state RST include “any transfer of the possession or ownership of tangible personal property” and “the furnishing of a service.”¹⁵⁷

149. N.J. STAT. ANN. § 54:32B-3(b)(8–9) (West 2020).

150. UTAH CODE ANN. § 59-12-103(1)(a) (West 2018).

151. UTAH CODE ANN. § 59-12-103(1)(b) (West 2018).

152. UTAH CODE ANN. § 59-12-103(1)(f) (West 2018).

153. UTAH CODE ANN. § 59-12-103(1)(g–h) (West 2018).

154. UTAH CODE ANN. § 59-12-103(j) (West 2018).

155. West Virginia includes services in its retail sales tax base. W. VA. CODE §§ 11-15-2 & 11-15-3 (2017). Hawaii, New Mexico, and South Dakota impose gross receipts taxes on businesses that provide services. HAW. REV. STAT. § 273-13 (2020) (4% tax on “gross proceeds of sales, or gross income” of service businesses); N.M. STAT. ANN. §§ 7-9-3.5(1) & 7-9-4 (2020) (5.125% tax on “gross receipts is imposed on any person engaging in business in New Mexico,” where “‘gross receipts’ means the total amount of money or the value of other consideration received from selling property . . . [or] services” in the state); S.D. CODIFIED LAWS §§ 10-45-2, 10-45-4, 10-45-4.1, & 10-45-5 (2020) (4.5% tax on “gross receipts of all sales of tangible personal property” and “the gross receipts of any person from the engaging or continuing in the practice of any business . . . unless the service is specifically exempted”). Although in Hawaii, New Mexico, and South Dakota the tax is paid by businesses, not the consumer, the end result—a consumption tax on services—is the same, since businesses will pass the gross receipts tax costs on to consumers through higher prices.

156. HAW. REV. STAT. ANN. § 237-1 (West 2020) (emphasis added).

157. W. VA. CODE § 11-15-2(17) (2020) (emphasis added).

Just as all states that tax goods exempt at least *some* sales, like purchasing inventory¹⁵⁸ and prescription drugs,¹⁵⁹ the few states that automatically tax all services have carved out exemptions like those discussed above in Section I.B.3. South Dakota, for example, expressly exempts healthcare, education, and local transportation (except for limousines!).¹⁶⁰ West Virginia exempts all “professional and personal services,”¹⁶¹ which includes medical services.¹⁶²

It is also worth noting that whether a state’s statutory scheme follows the majority or the minority approach may not actually reflect the proportion of services taxed in practice: states that tax all services by default do not necessarily tax more services by volume.¹⁶³ In fact, according to a 2017 Federation of Tax Administrators (FTA) survey, Washington state—which follows the majority approach—taxes 167 of the 176 services the FTA inquired about.¹⁶⁴ West Virginia—which follows the minority approach—taxes only 115.¹⁶⁵

III. UTAH’S RECENT TAX OVERHAUL ATTEMPTS

In 2019, Utah unsuccessfully attempted to restructure its state tax regime twice: first, during the General Session with House Bill 441, and then during a special legislative session in December with Senate Bill 2001. This Part examines the structure and merits of each proposal, and where a robust legislative record exists, analyzes lawmakers’ policy arguments.

158. HELLERSTEIN & HELLERSTEIN, *supra* note 48, ¶ 12.01 (“Every state excludes sales for resale from the retail sales tax base.”).

159. See *supra* Section I.B.3 (describing exemptions for essential goods and services).

160. S.D. CODIFIED LAWS § 10-45-12.1 (2020).

161. W. VA. CODE § 11-15-8 (2020).

162. W. VA. STATE TAX DEP’T, PUB. NO. TSD-377, SALES AND USE TAX AND DOCTORS (rev. Aug. 2013), <https://tax.wv.gov/Documents/TSD/tsd377.pdf>.

163. See FTA 2017 Newsletter, *supra* note 9, at 1-2.

164. *Id.* at 2.

165. *Id.*

A. 2019 General Session: House Bill 441, "Tax Equalization and Reduction Act"

1. Structure

On February 28, 2019, just two weeks before the end of the General Session on March 14, 2019, Utah lawmakers began consideration of House Bill 441, which would have moved Utah from the majority—states that selectively tax services—into the minority—states that tax all services by default and then grant exemptions as appropriate.¹⁶⁶ Because the bill proposed to "include[] *all* services in the new base," lawmakers anticipated that it was better designed to grow with the state's economy as novel services appear in the marketplace.¹⁶⁷

Like other states that follow the minority approach, House Bill 441 granted some exceptions to the broad-based service tax.¹⁶⁸ This included—predictably and rightly¹⁶⁹—education, transit and non-cosmetic medical services, although it also created a new 1% medical insurance premium tax.¹⁷⁰ It also exempted housing services like residential leases and real estate broker fees, though it did impose a new 0.075% real estate transfer tax.¹⁷¹ The bill also eliminated some existing RST exemptions for goods and services, including for off-campus college textbook sales, coin-op laundry, and electricity for ski lifts.¹⁷²

Importantly, in expanding the RST base, House Bill 441 did *not* exempt many services used by businesses, like accounting, legal, and architectural services.¹⁷³ It did reduce both the RST rate (first from 4.7% to 3.9% and then later to 3.1%)¹⁷⁴ and the state's flat-rate corporate and individual income tax (from 4.95% to 4.75%).¹⁷⁵ The

166. HB 441 Bill Summary, *supra* note 17.

167. *Id.* at 1 (emphasis added) ("[T]he bill is structured to automatically apply to future services that do not exist today.").

168. *Id.*

169. *See supra* Section I.B.3.

170. HB 441 Bill Summary, *supra* note 17, at 1.

171. *Id.*

172. *Id.* Utility services are taxable under Utah Code § 59-12-103(1)(c)–(d), and electricity for ski lifts was (and still remains) tax exempt under Utah Code § 59-12-104(37).

173. HB 441 Bill Summary, *supra* note 17, at 1.

174. H.B. 441, 63d Leg., Gen. Sess. (Utah 2019), ll. 3003–11.

175. *Id.* ll. 452, 460, 691–92.

cumulative effect of the expanded RST base and reduced income tax rate would have been to shift funds from the earmarked Education Fund into the state's General Fund, freeing up funds for non-education spending programs.¹⁷⁶

The bill also included measures specifically targeting low- and middle-income taxpayers, perhaps in an attempt to offset the potential regressive effect of an expanded sales tax base.¹⁷⁷ First, to counter the 2017 Tax Cuts and Jobs Act's suspension of the personal and dependency exemptions,¹⁷⁸ the bill would have expanded the *state* personal and dependency exemption¹⁷⁹ to better account for Utah's larger-than-average family sizes. Second, it would have created a new refundable state earned income tax credit (EITC) for those "experiencing intergenerational poverty."¹⁸⁰ Third, House Bill 441 would have created a nonrefundable social security benefits tax credit.¹⁸¹

2. Policy analysis

House Bill 441 would likely have increased the retail sales tax burden on low- and middle-income families. However, a robust progressivity analysis requires us to examine how that revenue is spent and the overall tax burden and base.¹⁸² The expanded personal and dependency exemptions, redistributive tax credits, and lower income tax would have at least partially offset the hike, mitigating (though not entirely resolving) concerns about vertical equity.

176. See *supra* text accompanying notes 6–10, 69–77.

177. See *supra* Section I.B.2.

178. I.R.C. § 151(d)(5) (suspending the personal and dependent exemptions for taxable years 2018–25). During floor debate of S.B. 2019 in December 2019, lawmakers pointed out that the expanded state personal and dependency exemption, first introduced in H.B. 441, was designed to counteract the penalty Utah families sustained when the federal personal and dependency exemption was suspended by the TCJA. See, e.g., S.B. 2001 Senate Debate, *supra* note 60, at 2:11:10 (statement of Sen. Lincoln Fillmore).

179. H.B. 441 ll. 885–91.

180. *Id.* ll. 1275–94. The refundable EITC would have permitted a qualifying taxpayer who claimed the federal EITC in the previous taxable year to claim a state EITC equal to 10% of the previous year's federal credit. *Id.* Under existing Utah law, "[i]ntergenerational poverty" means poverty in which two or more successive generations of a family continue in the cycle of poverty and government dependence [sic], but excludes "situational poverty." UTAH CODE ANN. § 35A-9-102 (West 2020).

181. H.B. 441 ll. 1222–63.

182. See *supra* Section I.B.2.

On the other hand, had the Legislature carefully considered the essential services exemption discussed above in Section I.B.3, it likely would not have imposed a 1% tax on health insurance premiums. But the primary flaw in House Bill 441 was its failure to exempt business inputs. As discussed above in Section I.B.1, all business-to-business transactions should be exempt from sales tax to avoid cascading. Otherwise, intermediate tax costs paid by businesses are simply shifted down the chain of production to the ultimate consumer, raising the effective rate of tax paid.¹⁸³ Although House Bill 441 exempted some B2B services, like manufacturing,¹⁸⁴ wholesale trade,¹⁸⁵ and most financial services,¹⁸⁶ it would have subjected other key business services—including legal, architectural, accounting, and engineering—to sales tax.¹⁸⁷ While lawmakers claimed they had “gone out of their way to avoid [the cascading] effect by excluding certain services from the sales tax,”¹⁸⁸ the list of exemptions was woefully incomplete. Professional services providers mobilized against the bill, protesting that higher post-tax service prices would make Utah businesses less competitive¹⁸⁹ and that two weeks’ consideration

183. See *supra* Section I.B.1.

184. H.B. 441 I. 4339.

185. *Id.* I. 4340.

186. *Id.* II. 4350–58.

187. See, e.g., Tim Vandenack, *Ogden Chamber Head Lauds Move to Pull Utah Tax Reform Bill, Wants More Debate*, STANDARD-EXAMINER (Ogden) (Mar. 7, 2019), https://www.standard.net/news/business/ogden-chamber-head-lauds-move-to-pull-utah-tax-reform/article_45babdff-72ce-5139-80bb-bf24478908a7.html; Bethany Rodgers, *Tax Reform or “Misery Tax”? Attorneys, Homebuilders, Barbers, and a Slew of Others Begin to Digest Big Tax Overhaul Plan That Is Hard to Swallow for Some*, SALT LAKE TRIB. (Feb. 28, 2019), <https://www.sltrib.com/news/politics/2019/02/28/highly-anticipated-tax/>.

188. Rodgers, *supra* note 187.

189. See, e.g., Brown, *supra* note 128; Roche, *supra* note 17; Press Release, Utah Association of Certified Public Accountants, *Urgent: We Need Your Help with HB441* (Mar. 2, 2019), <https://www.uacpa.org/news/440375/Urgent-We-Need-Your-Help-With-HB441.htm> [hereinafter UACPA Press Release] (“With a tax on professional services we could potentially invite an out-migration of business and uninvite businesses that are currently looking to relocate to Utah.”); Douglas Foxley, Frank Pignanelli & Steve Foxley, *Legislative Update*, UTAH BAR J., May–June 2019, at 28, 30 (“Many local attorneys support policymakers who prize the competitiveness of Utah with other states . . .”).

Pushback from well-organized professional services providers, like attorneys and accountants, is unsurprising. Duey, *supra* note 89, at 670 (describing the “resistance and political pressure” legislatures risk when they try to tax industries like accounting and legal services).

was inadequate for such a dramatic shift in the state's tax regime.¹⁹⁰ The Legislature pulled the bill,¹⁹¹ and it instead created the Tax Restructuring and Equalization Task Force to take a deeper dive into the issue ahead of a special legislative session dedicated to tax reform later in the year.¹⁹²

B. 2019 Second Special Session: Senate Bill 2001, "Tax Restructuring Revisions"

1. Structure

The Task Force produced a bill for the Legislature to consider,¹⁹³ which it took up during a special legislative session on Dec. 12, 2019.¹⁹⁴ Unlike House Bill 441, Senate Bill 2001 kept Utah in the majority of states that only tax enumerated services.¹⁹⁵ The bill did expand that list to capture more retail services, including pet boarding and grooming,¹⁹⁶ ridesharing services like Uber and Lyft,¹⁹⁷ media streaming services like Spotify and Netflix,¹⁹⁸ "identity theft protection,"¹⁹⁹ and "dating referral services."²⁰⁰ Professional services fell out of the bill, probably thanks to industry group lobbying.²⁰¹ The enumerated services added by Senate Bill 2001 look generally like the elective consumer spending an RST should target.²⁰² Unlike House Bill 441, the bill did not capture all

190. See, e.g., UACPA Press Release, *supra* note 189.

191. @utahsenate, TWITTER (Mar. 7, 2019, 3:48 PM), <https://twitter.com/utahsenate/status/1103789573103017984>.

192. H.B. 495, 63d Leg., Gen. Sess. (Utah 2019).

193. *Draft Minutes*, *supra* note 22.

194. S.B. 2001, 63d Leg., 2d Spec. Sess. (Utah 2019).

195. TAX RESTRUCTURING AND EQUALIZATION TASK FORCE, 63D LEG., TASK FORCE TAX RESTRUCTURING POLICY PROPOSAL (4TH SUBSTITUTE), (Utah 2019), <https://le.utah.gov/interim/2019/pdf/2019s2SB2001sub4.pdf>.

196. S.B. 2001 ll. 4304–05.

197. *Id.* l. 4298 (subjecting "personal transportation that originates in the state and terminates in the state" to state sales tax).

198. *Id.* ll. 4282–92 (taxing "amounts paid or charged for access to digital audio-visual works, digital audio works, digital books, or gaming services, including the streaming of or subscription for access to digital audio-visual works, digital audio works, digital books, or gaming services").

199. *Id.* l. 4307.

200. *Id.* l. 4306.

201. See *supra* notes 189–190.

202. See text accompanying *supra* note 119.

services by default and would therefore need to be revisited by future legislatures to include as-yet unknown services.²⁰³ Still, Senate Bill 2001 was a reasonable start toward a broader services RST.

The bill also expanded the general sales tax base by repealing essentially the same exemptions House Bill 441 did, including off-campus textbook purchases and electricity for ski lifts, though Senate Bill 2001 left coin-op laundry and carwashes untaxed.²⁰⁴ It also repealed the motor fuel exemption and levied a new excise tax on diesel.²⁰⁵ Most surprisingly, however, Senate Bill 2001 proposed to raise the “grocery” tax on unprepared foods from a preferential 1.75%²⁰⁶ to the general sales tax rate of 4.85%.²⁰⁷ The rate increase actually *undid* two earlier rate cuts: for most of its history, Utah taxed groceries at the general sales tax rate, but the Legislature cut the rate to 2.75% in 2007 and then again to 1.75% in 2008.²⁰⁸

Unlike House Bill 441, however, Senate Bill 2001’s broader base was not paired with a reduced RST rate. Instead, the Legislature used the revenues raised by expanding the base and eliminating exemptions to reduce the state’s flat-rate corporate and individual *income* tax rate from 4.95% to 4.66%.²⁰⁹ It also retained the targeted deductions and credits from House Bill 441: the expanded state personal and dependency exemption,²¹⁰ the new refundable state

203. Cf. text accompanying *supra* note 167.

204. TAX RESTRUCTURING AND EQUALIZATION TASK FORCE, 63D LEG., TASK FORCE TAX RESTRUCTURING POLICY PROPOSAL (4TH SUBSTITUTE), (Utah 2019), <https://le.utah.gov/interim/2019/pdf/2019s2SB2001sub4.pdf>.

205. *Id.*

206. Note that the state tax rate on groceries is 1.75%, but unprepared foods are also subject to other local taxes, UTAH CODE ANN. § 59-12-103(2)(c), so consumers actually pay 3% at the till, UTAH STATE TAX COMM’N, GROCERY FOOD SALES & USE TAX, <https://tax.utah.gov/sales/food-rate#flow> (last visited Sept. 28, 2020).

207. S.B. 2001, 63d Leg., 2d Spec. Sess. (Utah 2019), ll. 4331–32.

208. OLRGC Report, *supra* note 10, at 2.

209. S.B. 2001 ll. 1272, 1280, 1515–18.

210. *Id.* ll. 1757–61, 1823–24.

EITC for Utahns in intergenerational poverty,²¹¹ and the new nonrefundable tax credit for federal social security benefits.²¹²

Realizing that simultaneously reducing the income tax rate while also raising the grocery tax rate looked like giving the wealthy an income tax break at the expense of the poor,²¹³ the Legislature also crafted a refundable grocery tax credit for low- and middle-income households.²¹⁴ And since that credit would not be available until 2021, when Utahns would file their 2020 tax returns, lawmakers also created an additional “pre-bate”²¹⁵ grocery tax credit that would be available to taxpayers in mid-2020.²¹⁶

In sum, while the December 2019 tax package was billed as merely “revising” the March 2019 tax restructuring plan, House Bill 441’s initial plan for taxing services was actually significantly watered down. Instead, Senate Bill 2001 took aim at a tax exemption with an extremely broad and apparently loyal constituency—people who eat food—which resulted in its ultimate undoing.²¹⁷

2. Policy analysis

a. The services tax. Although Senate Bill 2001 was less ambitious than its predecessor, it largely got the services tax “right” by the normative standards outlined above in Section I.B. The law primarily captured *elective consumer* spending like streaming, ridesharing, pet grooming, and dating services that are, for the most part, (1) not business inputs, (2) probably consumed by individuals and households with disposable income, and

211. *Id.* ll. 2431–48. However, Senate Bill 2001 narrowed the state’s existing definition of “intergenerational poverty,” restricting eligibility to the following: “(a) the individual received public assistance during the previous calendar year; (b) the individual received public assistance for 12 months or more since the individual reached 18 years of age; and (c) the individual or the individual’s family received public assistance for 12 months or more before the individual reached 18 years of age.” *Id.* ll. 572–78.

212. *Id.* ll. 2253–95.

213. A tax on groceries, like all consumption taxes, disproportionately affects low-income households. *See supra* Section I.B.2 and *infra* Section III.B.2.

214. S.B. 2001 ll. 2347–99. The grocery tax credit was scheduled to phase out beginning at 175% of the federal poverty level. *Id.* ll. 2358–59, 2389–92.

215. S.B. 2001 Senate Debate, *supra* note 60, at 1:21:16 (statement of Sen. Jacob L. Anderegg) (describing the 2019 credit amount as a “pre-bate”).

216. S.B. 2001 ll. 2401–29.

217. H.B. 185, 63d Leg., Gen. Sess. (Utah 2020), <https://le.utah.gov/~2020/bills/static/HB0185.html>. The repeal bill passed the House 70-1-4 and the Senate 27-0-2, and it was signed into law the next day by Governor Gary Herbert. *Id.* (bill status report).

(3) non-essential. While there are certainly many other forms of elective consumer spending on services that Senate Bill 2001 did not include in the tax base—my manicures would have remained tax-free—it corrected the major tax cascading problems of House Bill 441.

b. The grocery tax and accompanying tax credits. However, the bill was derailed by the grocery tax. This Note therefore takes a detour at this point, too. Before diving into an analysis of the public debate over the grocery tax, a few notes on the tax's policy grounding are in order. As mentioned above, the rate increase in Senate Bill 2001 actually reversed two earlier rate drops from the general sales tax rate to a preferential 1.75%, passed by the Legislature and signed into law by Governor Jon Huntsman, Jr.²¹⁸ Not only was the preferential rate an enduring source of political appeal for Huntsman,²¹⁹ but there were in fact arguably sound policy reasons for it, which echo the policy considerations discussed above in Sections I.B.2 and I.B.3: groceries are a necessity, and like all consumption taxes, a grocery tax may disproportionately hurt low-income households who have to spend a larger percentage of their already limited resources on food.

Although a grocery tax on unprepared foods applies the same flat rate—whether 4.85% or 1.75%—the flat rate could produce an internally *progressive* effect, because those with more money pay more tax in pure dollars, given that wealthy shoppers likely buy more expensive foods than poor ones: think organic kale, grass-fed beef, and camembert, rather than cabbage and beans. Nevertheless, failing to tax such “gourmet groceries” means those wealthy shoppers get a tax break on what looks more like elective consumption than a necessity.²²⁰ And that tax break is an “upside-

218. H.B. 109, 56th Leg., Gen. Sess. (Utah 2006) (reducing rate on “food and food ingredients” to 2.75% effective January 1, 2007); S.B. 223, 57th Leg., Gen. Sess. (Utah 2007) (1.75%).

219. See, e.g., Bob Bernick Jr., *Huntsman Signs Tax-Cut Package*, DESERET NEWS (Mar. 15, 2007, 12:22 AM), <https://www.deseret.com/2007/3/15/20007401/huntsman-signs-tax-cut-package> (“[T]he political results [of the tax cut] are remarkable.”). In his recent campaign for governor, Huntsman reminded voters of the 2006–07 grocery tax cuts and promised to “completely remove” the grocery tax if elected. Brian Mullahy, *Huntsman Would Gut Food Tax, Other GOP Candidates May Repeal Parts of Tax Reform*, 2NEWS (Dec. 11, 2019), <https://kutv.com/news/local/gop-gubernatorial-candidates-oppose-parts-of-new-tax-plan-but-would-they-look-to-repeal>.

220. Viswanathan, *supra* note 89, at 23 & n.83.

down subsidy,” in that wealthy taxpayers, who spend the most on food, get the biggest tax break by virtue of the exemption.²²¹

One normative justification for excluding groceries from the tax base – as most states do²²² – is that people have to eat to live.²²³ But presumably, a successful CEO would survive if she were forced to switch from wagyu beef to frozen chicken. Progressive tax theory would suggest that while her secretary perhaps shouldn’t pay taxes on the chicken and rice he had for lunch, the CEO’s purchase of imported balsamic vinegar at Whole Foods is probably consumption that could plausibly be taxed.

Without a mitigating income tax credit, a flat-rate grocery tax probably produces an overall regressive effect because poor shoppers spend a greater percentage of their income buying food than wealthy ones, a trend even more pronounced for groceries than for dining out.²²⁴ Poor and middle-class households therefore feel that flat tax more acutely than wealthier ones.

Consider, for example, two hypothetical 4-person households²²⁵:

221. Cf. generally Zelenak, *supra* note 104 (describing “upside-down” tax subsidies).

222. As of December 2019, 34 states and the District of Columbia do not tax groceries. HELLERSTEIN & HELLERSTEIN, *supra* note 48, ¶ 12.02, T. 12-14. Of the 16 states that do tax groceries, Missouri, Utah, and Virginia do so at a reduced rate. *Id.*; see also UTAH CODE ANN. § 59-12-103(2)(c)(i) (1.75% state sales tax on groceries).

223. HELLERSTEIN & HELLERSTEIN, *supra* note 48, ¶ 13.10; Stark, *supra* note 42, at 440–41.

224. BUREAU OF LAB. STAT., CONSUMER EXPENDITURE TABLES, TABLE 1101: QUINTILES OF INCOME BEFORE TAXES (2018), <https://www.bls.gov/cex/tables.htm#annual>. While consumers in the top 20% spend an average of 11.2% of their annual budget on food generally, compared with 15.6% for the bottom 20%, the top 20% spend only 5.7% of their annual budget on food consumed *at home*, while the bottom 20% spend 10.3%. *Id.*

225. A few notes are in order here. First, I choose these two hypothetical families’ incomes by looking at the most current Bureau of Labor Statistics Consumer Expenditure Tables (BLS CETs), see *supra* note 224, which show data for 2018. I chose to place Family A in the second quintile, where the median pre-tax income is \$31,237, and Family B’s in the top fifth, where the mean pre-tax income is \$204,975. While Family A is lower-middle class, it sits above the federal poverty line for a family of 4, which in 2018 was \$25,100. 83 Fed. Reg. 2642, 2643 (Jan. 18, 2018). The data on total annual expenditures comes directly from the BLS CETs, though here I have rounded to the nearest \$100 for income and total expenditures.

Second, the estimated food budgets for each family come from the USDA Food Plans, published each month, adjusted for inflation, and intended to “represent a nutritious diet at four different cost levels.” U.S. DEP’T OF AGRIC., FOOD & NUTRITION SERV., *USDA Food Plans: Cost of Food Reports (Monthly Reports)*, <https://www.fns.usda.gov/cnpp/usda-food-plans-cost-food-reports-monthly-reports> (last visited Sept. 28, 2020) [hereinafter *USDA Food Plans*]. This data is obviously national, not state specific. Both hypothetical families’ estimated budgets follow the December 2019 Food Plans for a family of 4 with two elementary

	Family A	Family B
Annual pre-tax income	\$31,200	\$205,000
Total annual expenditures	\$40,000	\$118,800
Estimated grocery budget (pre-tax)	\$8,267	\$13,474
Groceries as a percent of annual expenditures	20.67%	11.34%
Percent of pre-tax income spent on groceries	26.5%	6.57%
Grocery tax liability (4.85%)	\$400.95	\$653.48
Grocery tax liability as percent of pre-tax income	1.29%	0.32%

In this example, the grocery tax is a *flat* rate of 4.85%. Measured in pure dollars, Family B pays an additional \$250+ in grocery taxes than Family A does, which might initially appear to make the

school-aged children. *Id.* Family A follows the “thrifty” plan, and Family B follows the “moderate-cost” plan. *Id.*

Third, Family A might also qualify for food assistance programs like the Supplemental Nutrition Assistance Program (SNAP). *See* DEP’T OF AGRIC., *SNAP Eligibility*, <https://www.fns.usda.gov/snap/recipient/eligibility> (last visited Sept. 28, 2020) [hereinafter *SNAP Eligibility*]. The data assembled here does not account for such benefits.

Fourth, it might strike some readers as odd is that Family A’s total annual expenditures are \$40,000, nearly \$9,000 more than the family’s annual income, but this is the financial reality of many households, especially in the bottom half of the income distribution. *See, e.g.,* Anna Bahney, *Half of Americans Are Spending Their Entire Paycheck (or More)*, CNN MONEY (June 27, 2017), <https://money.cnn.com/2017/06/27/pf/expenses/index.html>. Family B, on the other hand, has significant saving and investing power: it only spends 58% of its annual pre-tax income on consumption. That said, Family B’s federal, state, and local tax burdens will almost certainly be significantly higher than Family A’s, which means it won’t be able to save or invest the full remaining 42% of its pre-tax income.

Fifth, the data above might be imperfect because the current preferential rate of 1.75% applies to *unprepared* foods like milk, eggs, fruits, vegetables, beans, and meat. UTAH STATE TAX COMM’N, *Grocery Food Sales & Use Tax*, <https://tax.utah.gov/sales/food-rate#flow> (last visited Sept. 28, 2020). The USDA Food Plans assume “all meals and snacks are prepared at home.” *USDA Food Plans*, *supra*. I have used the USDA Food Plan estimates as a proxy for “unprepared food,” but this may not map perfectly onto Utah’s statutory and regulatory definition.

Finally, note that under State Bill 2001, Family A would have qualified for the full refundable grocery tax credit, since the credit was only scheduled to phase out beginning at 175% of the federal poverty line. S.B. 2001, 63d Leg., 2d Spec. Sess. (Utah 2019), ll. 2389–92. Family A’s income is comfortably within that margin.

tax *progressive*. But Family B does not feel that sting so acutely: it pays about a quarter in grocery taxes of what Family A does when measured as a percentage of pre-tax income, which makes the grocery tax *regressive* in its effect.²²⁶ Further, when food costs rise—as they might when consumers rush the pasta aisle in a global pandemic—a grocery tax multiplies the effect, again disproportionately hurting families that are already vulnerable.

The Utah Legislature realized the rate increase would probably have harmful regressive effects. Lawmakers tried to counteract the tax's effect on low- and lower-middle-income families by creating a new refundable grocery tax credit.²²⁷ The credit was structured to give qualifying households \$125 for each of the first four family members and \$50 for each additional family member, and it was scheduled to fully phase out at just below \$75,000 of adjusted gross income for a typical family of four.²²⁸

226. Cf. Viswanathan, *supra* note 89, at 14–15, 16 (“A tax provision described as progressive is often, though not always, defined with reference to a taxpayer’s income, even if a taxpayer’s income has no direct relationship to the amount of tax owed. . . . For example, sales taxes are often described as regressive though nominally levied at a constant rate.”).

227. S.B. 2001 ll. 2347–99.

228. *Id.* ll. 2372–75.

AGI	Available Credit
\$ 30,000.00	\$ 500.00
\$ 35,000.00	\$ 500.00
\$ 40,000.00	\$ 500.00
\$ 45,000.00	\$ 500.00
\$ 50,000.00	\$ 427.38
\$ 55,000.00	\$ 339.88
\$ 60,000.00	\$ 252.38
\$ 65,000.00	\$ 164.88
\$ 70,000.00	\$ 77.38
\$ 74,421.43	\$ -
\$ 75,000.00	\$ -

SENATE BILL 2001'S GROCERY TAX CREDIT: INCOME PHASEOUT
FOR FAMILY OF FOUR²²⁹

For our hypothetical Family A, this means a \$500 annual credit, which—at least according to the grocery budget estimates calculated above—would more than cover the family's new state grocery tax liability of \$400.95. In fact, Family A would have to spend more than \$10,300 per year on groceries before the credit would not fully cover its state grocery tax liability.²³⁰ And since Family A would have spent \$144.67 in grocery taxes under the old regime (\$8,267 multiplied by the 1.75% preferential rate), it is actually in a better financial position than it was before Senate Bill 2001. As a bonus, the Legislature added a "pre-bate" that would have given Utah taxpayers a refundable tax credit for 25% of the amount they could have claimed on their 2019 taxes under the full

229. The phaseout was scheduled to begin at \$45,850 for a family of four, since 175% of the federal poverty level for a family of four in 2020 is \$26,200. *See* 85 Fed. Reg. 3060 (Jan. 17, 2020) (\$26,200 × 175% = \$45,850). Senate Bill 2001 provided for a .0035% phaseout for every dollar of additional income that exceeds the phaseout threshold. S.B. 2001 ll. 2358–59, 2389–92.

230. \$500 / 4.85% = \$10,309.28.

grocery tax credit if had it been in effect then. This meant taxpayers would get an early grocery tax credit in July 2020.²³¹

Between the full tax credit and the pre-bate, most low-income families in Utah would probably have been better off under the new tax regime. Wealthier households—those buying the kinds of gourmet groceries that may look like consumption rather than necessities—would probably not qualify for the tax credit, but that is perhaps an acceptable normative result. Even though food is a necessity for all households, the wealthy are better able to either cut their consumption to accommodate higher prices or eat (pun intended) the extra tax costs.

Further, the grocery tax credit would have meant that the families that can comfortably afford to pay the full 4.85% and don't cut consumption to offset higher prices end up "paying" not only the grocery taxes of the families who cannot, but also for general state spending programs that help the poor.²³² In other words, the credit would have "convert[ed] a flat, or even regressive, tax provision into a measure that reduces inequality" and, at least by some measures, a "progressive provision."²³³ What is more, regardless of state tax reform, some of the poorest shoppers at Utah grocery stores may also be eligible for tax-exempt benefits like WIC and SNAP,²³⁴ and food pantry distributions are free. That means the poor who qualified for both the grocery tax credit and food assistance would have gotten a double benefit.

The primary drawback of the tax-and-credit regime the Utah Legislature designed was its impact on the poorest households and transient populations. A refundable tax credit is an administratively practical and effective way to reallocate money from the wealthy to the working poor. Consider, for example, the federal EITC, which "is an efficient and well-designed anti-poverty

231. S.B. 2001 Senate Debate, *supra* note 60, at 53:00 (statement of Sen. Lyle Hillyard). Without the "pre-bate," taxpayers could not have claimed the grocery tax credit until they filed their 2020 taxes in 2021. *Id.*

232. *Cf.* Viswanathan, *supra* note 89, at 45 ("Because money is fungible, any spending allocation from the general fund could be considered as funded pro rata from all taxes supporting the general fund."). Recall that tax revenues raised by the grocery tax credit would have been allocated to Utah's General Fund. *See* UTAH LEG., *Not Enough*, *supra* note 7.

233. Viswanathan, *supra* note 89, at 42.

234. U.S. DEP'T OF AGRIC., FOOD & NUTRITION SERV., *WIC Frequently Asked Questions*, <https://www.fns.usda.gov/wic/frequently-asked-questions-about-wic> (last visited Sept. 28, 2020); *SNAP Eligibility*, *supra* note 225.

tool, justifiably supported by many thinkers and policy-makers on both sides of the political spectrum.”²³⁵ Since almost everyone who earns income must file a federal tax return,²³⁶ it’s relatively easy to ask the IRS to administer a federal spending program for the working poor.²³⁷ However, the federal EITC does not help those who do not earn income—the unemployed, the disabled, the retired, etc.—and so the federal government has designed other direct spending measures to help those populations.²³⁸

Likewise, the proposed Utah grocery tax credit system was a reasonably well-designed measure for Utah households that are required to file an income tax return.²³⁹ But the tax credit would have been administratively complex—perhaps to the point of infeasibility—for the most vulnerable populations, like retirees living on a small fixed income and the homeless, who may not file state tax returns and for whom food assistance is unavailable or insufficient.²⁴⁰ While those populations were probably eligible for the grocery tax credit, they would have had to apply for the credit through the Department of Workforce Services,²⁴¹ which may be burdensome for the poorest Utahns. And of course, nonresidents—including many in Utah’s sizable homeless population—would never have been eligible for a state tax credit. The Legislature gathered no data on how the grocery tax increase would affect these

235. Clausen, *supra* note 111, at 37.

236. I.R.C. § 6012(a). With certain exceptions, “[e]very individual having for the taxable year gross income which equals or exceeds the exemption amount” must file a federal income tax return. *Id.*

237. See Brian Galle, *The Kindness of Strangers: Taxing (and Regulating) Mass Fundraising 4* (Mar. 6, 2020) (unpublished manuscript) (on file with author) (“[O]nce we have incurred the cost of building a vast apparatus of information collection and resource transfer, it may make sense to use that system to achieve a variety of policy ends.”).

238. See, e.g., U.S. DEP’T OF LABOR, *How Do I File for Unemployment Insurance?* <https://www.dol.gov/general/topic/unemployment-insurance> (last visited Sept. 28, 2020) (describing the federal-state unemployment insurance program); SOC. SEC. ADMIN., *Benefits for People with Disabilities*, <https://www.ssa.gov/disability/> (last visited Sept. 28, 2020); SOC. SEC. ADMIN., *Retirement Benefits*, <https://www.ssa.gov/benefits/retirement/> (last visited Sept. 28, 2020).

239. Governor’s FAQ, *supra* note 5 (“If you currently file a tax return, you don’t have to take any extra steps to receive the benefit of the grocery tax credit.”).

240. Cf., e.g., THE TAX MAVEN, *Can You Hear Me Now?: Why It’s So Hard to Deliver Help to Those Who Need It* (Apr. 24, 2020), <https://taxmavenpodcast.com/episodes/tatiana-homonoff/transcript> (explaining that SNAP beneficiaries are often removed from the rolls for minor compliance violations).

241. *Id.*

populations, the compliance costs for non-filers, or whether non-filers would be functionally able to take advantage of the grocery tax credit, regardless of eligibility.

The tax-and-credit approach poses the same cash flow problem described above in the discussion of the services RST income tax credit: many low- and middle-income households operate on tight budgets, and the grocery tax is due at the till on every transaction. The benefit of the credit, however, isn't available until after taxpayers file their state income tax returns months later. The grocery "pre-bate" only partially solved this problem by providing a one-time mid-year credit.

Finally, to the extent that middle-income families would have faced a larger grocery tax bill, the tax was still somewhat regressive relative to income. As the table above indicates, for a typical family of four, the credit began to phase out just above \$45,000 of income and fully phased out at around \$75,000.²⁴² Following the USDA Food Plan guidelines, a "moderate-cost" annual budget for that family would still be \$12,857, and Senate Bill 2001 would have saddled the family with a \$624 state grocery tax bill—\$399 more than it would have paid under the preferential rate of 1.75%²⁴³—and the family would not qualify for the grocery tax credit. While the poorest households would likely have been better off under the grocery tax-and-credit regime (administrability concerns aside), middle income taxpayers would have faced a higher tax liability on essential grocery spending.

3. *Public debate*

The merits of the proposed grocery tax-and-credit system *and* the expanded tax on consumer services, however, were largely lost in the public debate surrounding Senate Bill 2001. This Section compares the policy *rhetoric* deployed by the bill's (mostly male, mostly Republican) supporters and its (mostly female, mostly Democratic) opponents.

The debate largely passed over the new services captured in the RST base. Lawmakers almost entirely ignored the new service taxes during floor debate. In fact, the only legislators who mentioned

242. See table accompanying *supra* note 229.

243. The family's grocery tax liability would have been \$225 under the preferential 1.75% rate.

services taxation were Senator Lyle Hillyard, the bill's sponsor, who was "disappointed" not to move the state toward the minority taxable presumption, and Senator Jacob Anderegg, who opposed the bill in part because it was a weak "stop-gap measure," not the comprehensive tax reform targeting services he believed the state needed over "the next five generations."²⁴⁴ Likewise, although Governor Herbert's defense of the bill mentioned the macro shift toward a service economy and the resulting problems for the state budget,²⁴⁵ there ultimately wasn't much for policymakers to say about the services tax because Senate Bill 2001 was so much less ambitious than House Bill 441.²⁴⁶

Instead, most of the legislative debate centered around the grocery tax rate increase and, to a lesser extent, the end of the fuel tax exemption. I present the broad arguments side-by-side below to make it easier to see the competing rationales.

244. S.B. 2001 Senate Debate, *supra* note 60, at 1:17:35 (statement of Sen. Jacob L. Anderegg).

245. Herbert OpEd, *supra* note 69 ("Today, in our ever-changing economy, [goods] make up 31 percent of consumer spending, with nearly 70 percent going to largely untaxed services. . . . The new system begins the work of fixing this by broadening the sales tax to a variety of services that have historically been exempted.").

246. See text accompanying *supra* note 182-191.

Issue	Support	Oppose
Regressivity	(1) “Cost of government” should be “broadly shared” ²⁴⁷ : Everyone in the state benefits from many of the services state government provides, so everyone should pay into the General Fund. (2) “Safety net” spending ²⁴⁸ : The revenues raised by the grocery tax fund programs that help the poor, counteracting regressive effects.	“Harms the poor” ²⁴⁹ : The grocery tax is regressive because it places a disproportionate burden on “working families that must make important decisions with limited budgets.” ²⁵⁰
Necessity	(1) “Gail Miller’s filet mignon” ²⁵¹ : The wealthy don’t <i>need</i> a tax break on groceries, and the preferential rate is effectively an upside-down subsidy because the wealthy spend more on groceries than the poor. (2) SNAP, WIC, and food pantries ²⁵² : The poor already benefit	“Essentials of life” ²⁵³ should be tax-exempt: Everyone has to eat, and low-income families don’t have the option to consume less food.

247. Herbert OpEd, *supra* note 69.

248. *Id.*; S.B. 2001 Senate Debate, *supra* note 60 at 1:26:39 (statement of Sen. Todd Weiler).

249. S.B. 2001 House Debate, *supra* note 5, at 1:19:34 (statement of Rep. Marie Poulson at 1:19:34).

250. *Id.*

251. *Id.* at 2:08:05 (statement of Sen. Lincoln Fillmore).

252. Herbert OpEd, *supra* note 69.

253. S.B. 2001 Senate Debate, *supra* note 60 at 2:20:50 (statement of Sen. Karen Mayne).

	from food assistance programs, so a reduced grocery tax rate is duplicative.	
Grocery tax credit	The grocery tax credit fully counteracts the regressive effect of the higher grocery tax rate, and the poor will actually “come out ahead” thanks to the tax credit. ²⁵⁴	Administrability: The costs of compliance for those who don’t file an income tax return are high because “filling out a form, having to do one extra thing, is just too much for them.” ²⁵⁵ The tax credit also does not help transient populations. ²⁵⁶
Gas tax	“User fee” ²⁵⁷ : Because gas taxes are earmarked for the Transportation Fund, it is fair to make those who use more pay more. The historic exemption creates perverse incentives because “the more you drive, the bigger subsidy you get.”	Unfair to poor and rural Utahns: Eliminating the fuel exemption disproportionately hurts both rural residents and the poor, who often live far from work, medical care, and other services, so cannot choose to consume less fuel. ²⁵⁸
Income tax reduction	“Tax on productivity” ²⁵⁹ : Income taxes incentivize people	Regressivity: The grocery tax funds, in part, a reduced income

254. *Id.* at 1:26:40 (statement of Sen. Todd Weiler).

255. S.B. 2001 House Debate, *supra* note 5, at 1:31:30 (statement of Rep. Andrew Stoddard).

256. *Id.* at 1:00:23 (statement of Rep. Patrice Arent).

257. *Id.* at 1:29:57 (statement of Rep. Melissa Ballard); S.B. 2001 Senate Debate, at 2:09:03 (statement of Sen. Lincoln Fillmore).

258. S.B. 2001 Senate Debate, *supra* note 60 at 2:18:55, 2:23:28 (statements of Sen. Jani Iwamoto & Sen. Kathleen Riebe).

259. *Id.* at 2:09:04 (statement of Sen. Lincoln Fillmore).

	to earn less because it makes increased productivity less rewarding. Lower state income taxes mean a stronger, more productive economy for all.	tax that primarily benefits middle- and upper-class households. ²⁶⁰ The overall effect of the shift from income to consumption taxes is regressive.
Spending & state budget	(1) “Stability over the long term” ²⁶¹ : Taxing food reduces state budget volatility precisely because it is a necessity: people buy groceries in good times and bad. (2) “Nine-figure budget surpluses” ²⁶² : The state has consistently run large budget surpluses in the earmarked Education Fund so needs to collect less revenue overall and shift some of that revenue to the General Fund.	“Keep the money” ²⁶³ : Polls show that Utahns would prefer to use those Education Fund surpluses to increase education spending rather than get it back in tax breaks.
Procedural concerns	“62 hours of public hearings” ²⁶⁴ : Although the March 2019 consideration of H.B. 441 might have been	“Rushed” ²⁶⁵ : The proposal is a major overhaul of Utah’s tax regime, and the Legislature has not had

260. *Id.* at 2:06:00 (statement of Sen. Luz Escamilla); S.B. 2001 House Debate, *supra* note 5 at 1:19:34 (statement of Rep. Marie Poulson).

261. Herbert OpEd, *supra* note 69.

262. S.B. 2001 Senate Debate, *supra* note 60, at 2:11:57 (statement of Sen. Lincoln Fillmore).

263. *Id.* at 2:17:16 (statement of Sen. Jani Iwamoto).

264. S.B. 2001 House Debate, *supra* note 5 at 30:16 (statement of Rep. Francis D. Gibson).

265. *Id.* at 1:15:40 (statement of Rep. Marie Poulson).

	rushed, S.B. 2001 was thoroughly considered by the Tax Task Force, and the members of the public were given ample opportunity to share their views.	enough time to reach an informed decision about how best to proceed.
Overall impact	“86% . . . will pay less” ²⁶⁶ : Thanks to the income tax rate reduction, a majority of Utahns will pay less tax under the new system.	“On the backs of those who have the least” ²⁶⁷ : The Legislature is funding a tax break that benefits most Utahns by imposing a heavier burden on the state’s poor.

Lawmakers who opposed the bill repeatedly dismissed it as “regressive” without meaningfully engaging with the grocery tax credit. The two that did discuss the credit, Rep. Patrice Arendt and Rep. Andrew Stoddard, criticized the bill on administrability grounds but did not provide a robust response to supporters’ food assistance critique. On the other hand, Senate Bill 2001’s supporters argued the grocery tax was appropriate for people who “buy steaks every night” but didn’t sufficiently discuss or defend the effect on middle-class taxpayers who have less room in their budgets to adjust consumption when RST rates rise.

Utah legislators ultimately realized that whatever the relative merits of the tax reform package might have been, constituents were unhappy, and the law would likely face – and be taken down by – a citizen referendum in Fall 2020,²⁶⁸ so legislators repealed the law.²⁶⁹ While they did attempt to make some headway on tax reform during the 2020 General Session, the only relevant measure

266. Herbert OpEd, *supra* note 69.

267. S.B. 2001 House Debate, *supra* note 5 at 1:32:15, 1:39:22 (statements of Rep. Andrew Stoddard & Rep. Jen Dailey-Provost).

268. See, e.g., Lisa Riley Roche & Katie McKellar, *As Session Opens, Lawmakers Address “Elephant” in the Room: Tax Reform Backlash*, KSL NEWS (Jan. 27, 2020), <https://www.ksl.com/article/46709713/as-session-opens-lawmakers-address-elephant-in-the-room-tax-reform-backlash>.

269. H.B. 185, 63d Leg., Gen. Sess. (Utah 2020).

they managed to pass was a constitutional referendum proposal that was included on the November 2020 ballot.²⁷⁰ The proposal, which early results show voters approved by a comfortable margin,²⁷¹ will expand the constitutional education earmark to permit state income tax revenue to be spent “to support children and to support individuals with a disability.”²⁷² The ten-word addition will give the state budget added flexibility but may prove to be just another stop-gap measure on the road to the sales taxation of services in Utah.

IV. CONCLUSION

If Utah ultimately elects to expand its sales tax base to include services, I propose that it reconsider and ultimately adopt the “minority” approach discussed in Section II.B: tax all services by default, and then grant exemptions as appropriate. The exemptions should be designed with the normative considerations discussed in Section I.B in mind. Business-to-business services should be per se exempt to prevent tax cascading. To avoid taxing essential services that individuals use more or less consistently over time—like transportation, housing, and utilities—the Legislature could create a fixed-dollar refundable tax income credit to offset the tax liability on baseline-level services for low- and middle-income households. For the types of services that tend to cluster in particular years—like legal and education—it should consider creating a fixed-percentage credit that would offset tax costs for low- and middle-income households in years when they need it. In addition, the RST should simply *exempt* all medically necessary healthcare services, for which it may be exceptionally difficult to craft an appropriate and administrable credit, since healthcare needs vary significantly from taxpayer to taxpayer and over the course of time.

Above all, if the Legislature wants to avoid kicking the hornet’s nest twice, it should leave the grocery tax alone.

270. S.J.R. 9, 63d Leg., Gen. Sess. (Utah 2020).

271. UTAH.GOV, *Utah Election Preliminary Results: UT Ballot Propositions*, <https://electionresults.utah.gov/elections/ballotprops> (last visited Nov. 6, 2020) (reporting a preliminary seven-point margin of approval for Constitutional Amendment G); see also Courtney Tanner, *All 7 of Utah’s Constitutional Amendments Passing – Including One to Change How Education Is Funded*, SALT LAKE TRIB. (Nov. 3, 2020), <https://www.sltrib.com/news/politics/2020/11/03/early-results-utahs/>.

272. S.J.R. 9.

