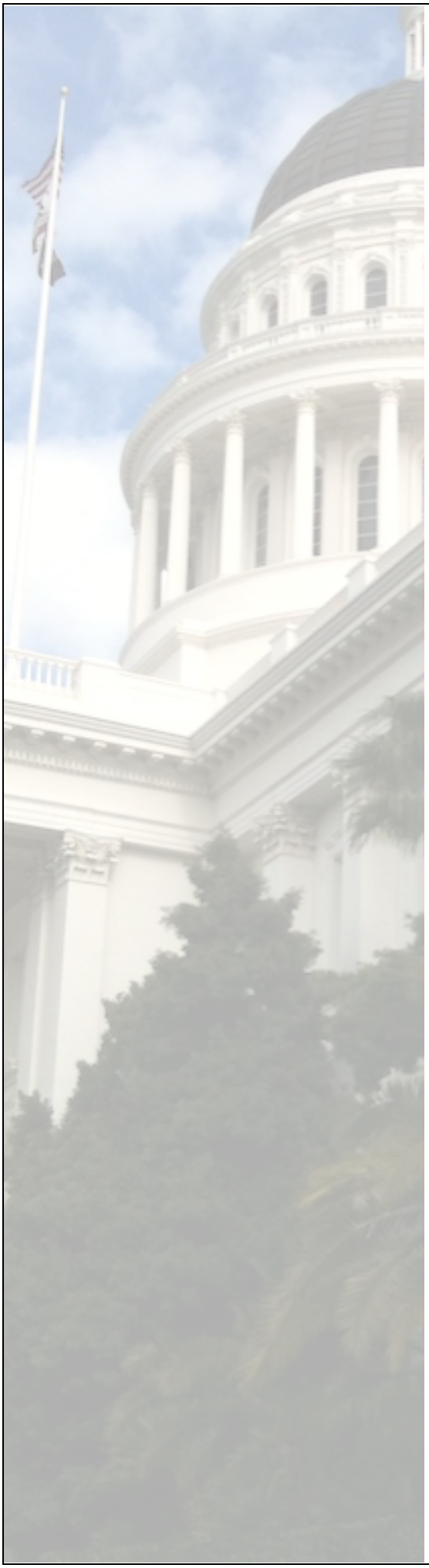

Sales Taxes on Services & Budget Volatility in California

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Prepared for

CFCE
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EXECUTIVE SUMMARY – SALES TAXES ON SERVICES & BUDGET VOLATILITY

The State of California celebrated a record budget surplus in 2022; however in 2024 it finds itself in the midst of a severe fiscal situation. The Governor's Office announced in the May Revise that the State faces a $27.6 billion deficit in the 2024-25 fiscal year (excluding $17.3 billion of early budget actions) as well as a $28.4 billion deficit in 2025-26.

Some have called for the State to solve its ongoing boom-and-bust budget cycles by enacting a sales and use tax on services. A broader sales tax that includes services, the argument goes, should generate a large and stable source of revenue that would eliminate California's budget volatility.

In 2019 when Sen. Robert Hertzberg introduced Senate Bill (SB) 522, which would have imposed a sales tax on a range of "business services" in California, Encina Advisors analyzed the ramifications of such a services tax and issued a comprehensive report. This white paper, the first in a series, revisits our 2019 report and updates the analysis on sales taxes on services and budget volatility. Its purpose is to answer for the current generation of policymakers: Will taxing services actually solve California's budget volatility problems?

California's Budget Volatility

It is commonly accepted that the main causes of California's budget volatility are its increasing reliance on personal income tax (PIT) revenue coupled with its large tax burden on high-income residents, who derive a disproportionate amount of their income from capital gains. In 2019-20, personal income taxes were responsible for 71 percent of General Fund revenue in the state budget while in 1979-80 personal income taxes were responsible for only 38 percent. Additionally, Proposition 63 increased the burden on high-income residents by imposing a 1 percent tax on individual incomes above $1 million to fund mental health services. Propositions 30 and 55 followed by imposing a 12.3 percent tax rate on taxable income between $500,000 and $1,000,000 and a 13.3 percent tax rate on taxable income over $1,000,000; the 13.3 percent rate is now the highest state income tax rate in the nation.

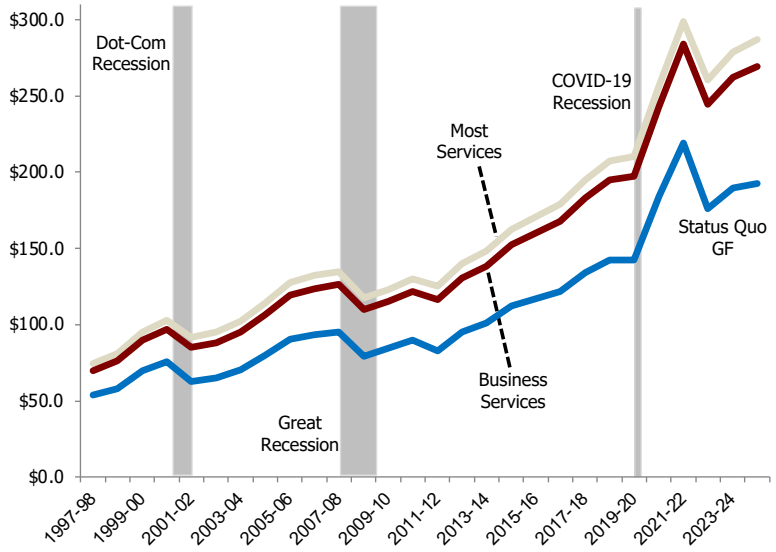
Revenues are just one piece of California's boom-and-bust budgeting, however, since government spending interacts with revenue generation to create the budget volatility problem. Historically, California routinely spends almost all of the revenue it has every year. This tendency is partly driven by structural factors related to the Special Fund for Economic Uncertainties (SFEU) and the Budget Stabilization Account (BSA). The SFEU is the state's discretionary reserve. However, large SFEU balances can trigger tax reductions by law. The BSA is the state's "rainy day fund" that sets aside up to 10 percent of General Fund revenue to

respond to fiscal budget emergencies or natural or man-made disasters, but the BSA is capped once its maximum size is reached. This means that adding more revenue would do little to mitigate volatility if this additional revenue is simply expended on more government programs.

Sales Tax on Services

To explore the potential impact of taxing services on budget volatility, we developed two scenarios of a possible sales tax on services. The first involved a 5 percent tax on *most services*, which included all services other than healthcare and education. The second involved a 5 percent tax on *business services*, comprising all services other than those typically consumed by households. We analyzed the 1997-98 to 2023-24 time period to illustrate how a sales tax on services—had one been in effect during this time period—would have affected General Fund volatility. Figure ES-1 shows the results compared to actual General Fund revenue (Status Quo GF).

Figure ES-1: General Fund Revenues with Estimated Sales Taxes on Services Included, 1997-98 to 2023-24 (in Billions)



Sources: California DoF, S&P Global, Encina Advisors

What is notable is that neither of the services-tax scenarios eliminated General Fund volatility; a typical year could see General Fund revenue with a sales tax on services averaging nearly 9 percent above or below the prior year's revenue. The primary reason for this is that even with the additional sales tax revenue, the General Fund still would rely heavily on the highly volatile PIT. Any meaningful reduction in volatility would require either a significant reduction in the PIT such that other, less volatile revenue sources become relatively more important in the General Fund, or a significant increase in other, less volatile revenue sources to dilute the impact of PIT volatility. Consequently, our analysis demonstrates that the revenue generated from a sales tax on services would not eliminate California's budget volatility—it would just generate more tax revenue from California taxpayers.

INTRODUCTION

The State of California celebrated a record budget surplus in 2022; however in 2024 it finds itself in the midst of a severe fiscal situation. The Governor's Office announced in the May Revise that the State faces a $27.6 billion deficit in the 2024-25 fiscal year (excluding $17.3 billion of early budget actions) and a $28.4 billion deficit in 2025-26. [1] The California Legislative Analyst's Office (LAO) suggests that the budget shortfall could be even larger, given that they recently forecasted state revenues to come in $19 billion below the Governor's Budget across the 2022-23 to 2024-25 budget window.[2]

According to the California Department of Finance, the causes of the budgetary difficulties are straightforward: "The budget shortfall facing lawmakers in 2024… is rooted in two separate but related developments during the past two years—the substantial decline in the stock market that drove down revenues in 2022 and the unprecedented delay in critical income tax collections."[3] To elaborate, capital gains from high-income earners suffered when the stock market declined, and the State's reliance on personal income taxes and a highly progressive tax structure resulted in a drop in revenues. Additionally, a series of storm-related disasters affecting millions of taxpayers in early 2023 pushed the U.S. government to move income tax filing deadlines from April to November (and California conformed with this change), and the delay meant that the State could not see that revenues had fallen in time to make necessary adjustments to the previous budget.

Despite this confluence of factors, some have called for the State to solve its ongoing boom-and-bust budget cycles by enacting a sales and use tax on services.[4] The general argument here is that the role of sales and use taxes (hereafter "sales taxes" for simplicity) in funding the State's budget has diminished over time as the California economy evolved from being primarily goods-producing to being primarily services-oriented. A broader sales tax that includes services

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[1] Governor's Office, "Governor Newsom's Revised 2024-35 State Budget," Fact Sheet, May 10, 2024. Online at https://www.gov.ca.gov/wp-content/uploads/2024/05/FACT-SHEET_-May-Revise-2024_05.10.2024.pdf

[2] LAO, "Updated 'Big Three' Revenue Outlook," May 2, 2024. Online at https://www.lao.ca.gov/LAOEconTax/Article/Detail/777

[3] Department of Finance, *Governor's Budget Summary, 2024-25*, p. 1, January 10, 2024. Online at https://ebudget.ca.gov/2024-25/pdf/BudgetSummary/FullBudgetSummary.pdf

[4] As an example, see Skelton, George, "California's budget relies on the richest taxpayers, and we're paying the price," *Los Angeles Times*, April 22, 2024. Online at https://www.latimes.com/california/story/2024-04-22/column-californias-budget-relies-on-the-richest-taxpayers-and-were-paying-the-price

should then generate a large and stable source of revenue that would eliminate California's budget volatility.

In 2019 when Sen. Robert Hertzberg introduced Senate Bill (SB) 522, which would have imposed a sales tax on a range of "business services" in California, Encina Advisors analyzed the ramifications of such a services tax and issued a comprehensive report.[5] The report specifically addressed three claims being made at the time: that taxing business services would promote overall tax fairness, that a sales tax on business services would stabilize California's government revenue, and that taxing business services would not harm California's economic environment.

This white paper, the first in a series, revisits our 2019 report and updates the analysis on sales taxes on services and budget volatility. Its purpose is to answer for the current generation of policymakers: Will taxing services actually solve California's budget volatility problems?

BACKGROUND ON SALES TAXES ON SERVICES

In the early 1930s, California established a sales and use tax on retailers conducting business in the state. Retailers have been required to remit *sales taxes* on all sales of physical goods and merchandise (tangible personal property) except for those sales specifically exempted by law (e.g., groceries and certain medical devices). Additionally, Californians who buy physical goods and merchandise from a business located outside of the state have been required to remit *use taxes* on these purchases if the out-of-state retailer did not collect California sales tax from the buyer. The current statewide sales and use tax rate is 7.25 percent, although most local jurisdictions in the state have added district taxes of up to 3 percent on top of this amount.

California's sales and use tax does not apply to services except in certain circumstances. Services are defined as transactions where no transfer of physical goods or merchandise takes place—landscaping, accounting, legal advice, hairstyling, consulting, child care and contracting are just a few examples. The limited exceptions where the sales and use tax might apply include when a service is part of a bundled or mixed transaction. Exceptions might also occur when a service is inseparable from a physical good, such as the taxable sale of machinery that the seller must calibrate as a condition of the sale.

Policymakers and other stakeholders in California have explored at various

[5] Encina Advisors, LLC, *An Analysis of Sales Taxes on Business Services in California*, May 2019. Online at https://cfce.calchamber.com/wp-content/uploads/2019/05/Encina-Advisors-Business-Services-Tax-Report-CFCE-May-2019.pdf

times over the past twenty years expanding the sales and use tax to cover services. With respect to studies, the California Commission on Tax Policy in the New Economy in 2003 recommended that the state broaden the sales tax base to include selected services while lowering the tax rate to retain revenue neutrality, and that the state eliminate selected sales and use tax exemptions or exclusions.[6] In 2009, the Commission on the 21st Century Economy contemplated sales taxes on services as a potential option for overhauling California's tax system but ultimately decided against recommending a sales tax on services.[7] In 2011, the Think Long Committee recommended that a new sales tax on services be created and applied to all business and consumer services other than health care and educational services.[8] And in 2016, State Controller Betty Yee's Council of Economic Advisors on Tax Reform examined a sales tax on services among other ideas without making recommendations.[9]

With respect to legislative efforts to impose the sales and use tax on services, Assembly Member Joe Coto introduced Assembly Bill (AB) 9 in the 2005-06 session that would have extended the state sales tax to specified services such as accounting, legal and engineering services. Assembly Member Alyson Huber introduced AB 1963 in February 2012 which would have required the Legislative Analyst's Office to analyze how a sales tax on services would impact the state's revenue volatility. And Senator Hertzberg introduced SB 8 in December 2014, SB 1445 in February 2016, SB 993 in February 2018, and SB 522 in 2019 that would have imposed sales taxes on a broad range of services in the state. All of these efforts failed in their respective houses.

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[6] California Commission on Tax Policy in the New Economy, *Final Report of the California Commission on Tax Policy in the New Economy*, December 2003. Online at http://www.californiacityfinance.com/CaComTaxPolicyNewEcon2003.pdf

[7] Commission on the 21st Century Economy (COTCE), *Report of the Commission on the 21st Century Economy*, September 2009. Online at http://www.cotce.ca.gov/documents/reports/documents/Commission_on_the_21st_Century_Economy-Final_Report.pdf

[8] Nicolas Berggruen Institute, *A Blueprint to Renew California: Report and Recommendations Presented by the Think Long Committee for California*, November 2011. Online at https://36z59wriv543qd814533ma8z-wpengine.netdna-ssl.com/wp-content/uploads/2018/10/Blueprint_to_Renew_ca.pdf

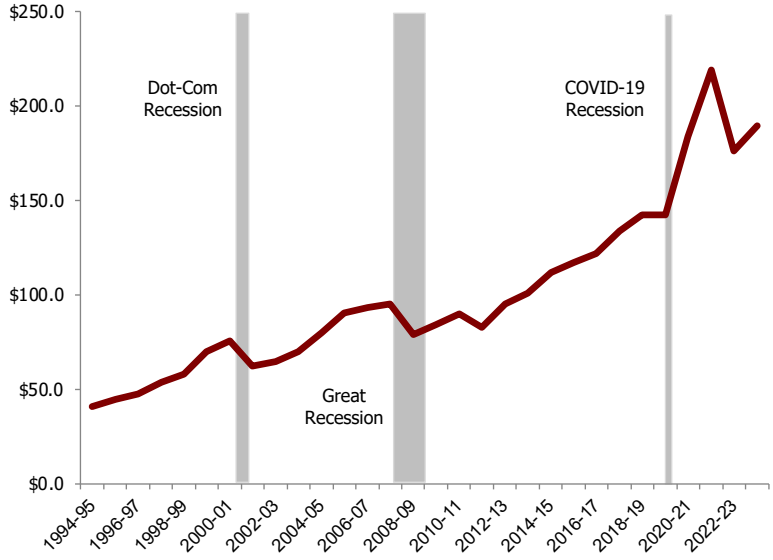
[9] California State Controller Betty T. Yee and the Controller's Council of Economic Advisors on Tax Reform, *Comprehensive Tax Reform in California: A Contextual Framework*, June 2016. Online at https://www.sco.ca.gov/Files-EO/Comprehensive_Tax_Reform_in_California_A_Contextual_Framework_06_16.pdf

California is in fact like most other states when it comes to having no general tax on services. Only four states apply sales taxes to most services: Hawaii, South Dakota, New Mexico, and West Virginia. The vast majority of states apply sales taxes only selectively to services.[10]

CALIFORNIA'S BUDGET VOLATILITY

The magnitude of California's budget volatility problem can be seen in Figure 1 below, which shows General Fund revenues from fiscal year 1994-95 to 2023-24. The chart shows increasing revenue from about $41 billion to nearly $190 billion over the 30-year time period (in current dollars), punctuated by sharp spikes and drops. The volatility is noticeable during the dot-com recession, the Great Recession and the COVID-19 related recession that are highlighted in gray on the chart, although it is not confined to these periods of economic downturn. Over the past 30 years, year-over-year increases or decreases in revenue exceeded 5 percent 23 times, and exceeded 10 percent 11 times.

Figure 1: General Fund Revenues from 1994-95 to 2023-24 (in Billions)



Source: California Department of Finance, January 2024

It is commonly accepted that the main causes of California's budget volatility are its increasing reliance on personal income tax (PIT) revenue coupled with its large tax burden on high-income residents. With respect to the state's increasing reliance on the PIT, personal income taxes in 2019-20 were responsible for 71 percent of General Fund revenue in the state budget. By

[10] It should also be noted that three states that enacted a broad sales tax on services in the past—Florida in 1986, Massachusetts in 1990 and Michigan in 2007—repealed them shortly after they went into effect because of widespread opposition from residents. In both Massachusetts and Michigan, the tax lasted less than two days.

comparison, in 1979-80 personal income taxes were responsible for only 38 percent of General Fund revenue.

This outsized impact of personal income taxes on California government revenue arose for multiple reasons. Included in these reasons certainly is the shift from a goods-based economy to a services-based economy. But they also include significant choices made by policymakers in Sacramento and the electorate. Notably, voters passed Proposition 63 in November 2004 to impose a 1 percent tax on individual incomes above $1 million to fund mental health services. They then passed Proposition 30 in November 2012 which, among other things, raised personal income taxes for seven years on those making more than $250,000 a year. Voters passed Proposition 55 in November 2016 to extend these temporary tax increases for another 12 years. Additionally, the Legislature enacted a major "realignment" of state program responsibilities and revenues to local governments for various criminal justice, mental health, and social services programs as part of the 2011–12 budget.

In addition to California's increased reliance on the PIT is the fact that the burden for much of this revenue has fallen on high-income residents. Propositions 30 and 55 were notable because they imposed a 12.3 percent tax rate on taxable income between $500,000 and $1,000,000 and a 13.3 percent tax rate on taxable income over $1,000,000. These represented 32 percent and 29 percent increases over the previous tax rates of 9.3 percent and 10.3 percent, respectively. The 13.3 percent rate is now the highest state income tax rate in the nation.[11]

Importantly, high-income taxpayers derive a disproportionate amount of their income from capital gains. The LAO describes capital gains as being by far the most volatile part of the California PIT tax base.[12] From 1990 to 2014, capital gains exhibited average deviations (AD) from its growth rate of 35.3 percent, meaning that in any given year capital gains could be on average 35.3 percentage points higher or lower than what the growth trend would predict. That makes capital gains more than ten times as volatile as the part of salaries and wages in the PIT tax base.

Overall, the LAO estimates that approximately 40 percent of the PIT volatility results from California's progressive rate structure that taxes higher incomes at higher rates. Another 40 percent of PIT volatility results from choices made about the types of income to tax, such as

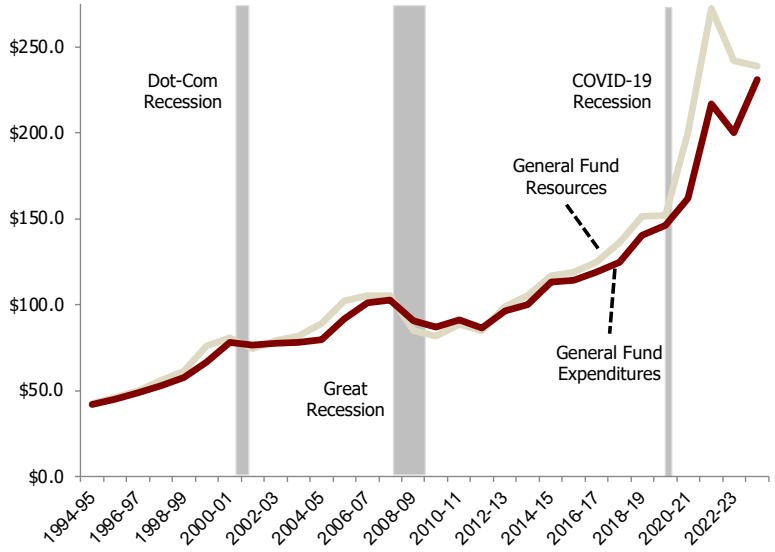
[11] See https://taxfoundation.org/data/all/state/state-income-tax-rates-2024/

[12] LAO, *Volatility of the Personal Income Tax Base*, February 8, 2017. Online at https://lao.ca.gov/reports/2017/3548/Volatility-of-PIT-030817.pdf

capital gains. The remaining 20 percent is attributable to deductions and credits, which primarily reduce the tax liabilities of low-income and middle-income taxpayers.[13]

Revenues are just one piece of California's boom-and-bust budgeting, however, since government spending interacts with revenue generation to create the budget volatility problem. Historically, California routinely spends almost all of the revenue it has every year. Figure 2 below presents General Fund resources and expenditures from FY 1994-95 to FY 2023-24, where resources include revenue, transfers and prior savings. Over this time period, spanning recessions as well as periods of substantial economic growth, General Fund expenditures averaged 95.2 percent of General Fund resources.

Figure 2: General Fund Resources vs Expenditures from 1994-95 to 2023-24 (in Billions)



Source: California Department of Finance, January 2024

This tendency to spend almost all available resources continues to the present, partly driven by structural factors. As the LAO points out, California currently has two mechanisms to maintain state budget reserves, the Special Fund for Economic Uncertainties (SFEU) and the Budget Stabilization Account (BSA). The SFEU is the state's discretionary reserve that essentially represents the differences in spending and available resources in a given fiscal year, while the BSA is the state's "rainy day fund" that sets aside up to 10 percent of General Fund revenue to respond to fiscal budget emergencies or natural or man-made disasters. However, large SFEU balances can trigger tax reductions by law. Additionally, the BSA is capped once its maximum

[13] LAO, *Volatility of California's Personal Income Tax Structure*, September 28, 2017. Online at https://lao.ca.gov/reports/2017/3703/volatility-Cal-PIT-structure-092817.pdf

size is reached, requiring any excess funding to be spent on infrastructure.[14] This means that adding more revenue would do little to mitigate volatility if this additional revenue is simply expended on more government programs.

THE BUDGETARY IMPACT OF A SALES TAX ON SERVICES

To understand how a sales tax on services might impact California's General Fund volatility, we used the State Board of Equalization's (BOE's) estimates of the taxable base of services in the state as the starting point. The BOE developed their estimate industry-by industry using 5-digit and 6-digit North American Industry Classification System (NAICS) codes. We made minor adjustments to their base[15] and then applied S&P Global historical and forecasted growth rates at the 2-digit NAICS level to extrapolate the taxable base of services over the years 1997-98 to 2023-24. We calculated the taxable base of services to be $2.189 trillion in 2023-24. A more detailed methodology is provided in the Methodology section at the end of this report

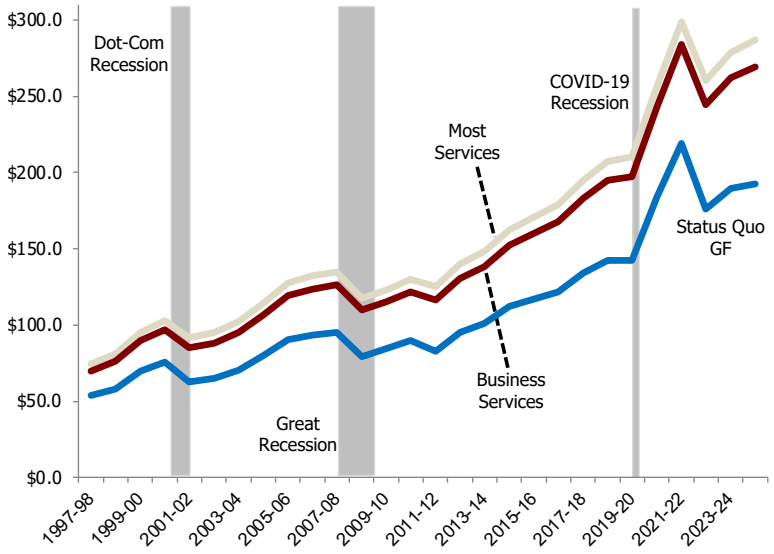
We then developed two scenarios of a possible sales tax on services. The first involved a 5 percent tax on *most services*. These included all services other than healthcare and education, similar to the list of taxable services that would have been taxed under SB 8. The second involved a 5 percent tax on *business services*. These included all services other than those that would have been exempted under SB 993: education; health care and assisted living services; child care; residential building construction; wholesale trade; automotive parts, accessories, and tire stores; the Postal Service; arts, entertainment, and recreation services; food services and drinking places; all other traveler accommodation services; other services except public administration; and selected financial and rental areas.

We applied the services tax for each scenario across the 1997-98 to 2023-24 time period to illustrate how a sales tax on services—had one been in effect during this time period—would have affected General Fund volatility. Figure 3 below shows the results of our hypothetical scenarios over the time period compared to actual General Fund revenue (Status Quo General Fund).

[14] California LAO, *Building Reserves to Prepare for a Recession*, March 7, 2018. Online at https://lao.ca.gov/reports/2018/3769/prepare-for-recession-030718.pdf

[15] We subtracted services receipts for non-employer firms from the BOE's total. This is consistent with legislation like SB993, which exempted services provided by very small businesses, specifically those making less than $100,000.

Figure 3: General Fund Revenues with Estimated Sales Taxes on Services Included, 1997-98 to 2023-24 (in Billions)



Sources: California DoF, S&P Global, Encina Advisors

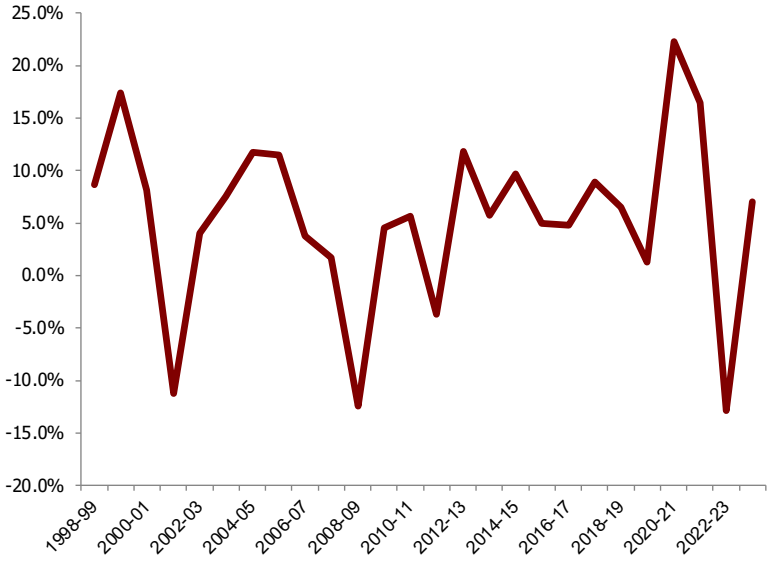
Under the best of circumstances, General Fund revenue growth would have been slightly faster under each scenario relative to Status Quo General Fund revenue growth. Over the twenty-seven years, General Fund revenue under the status quo grew at a compound annual growth rate (CAGR) of 5.0 percent, compared to 5.2 percent under the two services tax scenarios. Consequently, the General Fund by 2023-24 would have been $89.2 billion larger under the Most Services scenario relative to the Status Quo scenario (i.e., $278.9 billion vs. $189.7 billion) and $72.4 billion larger under the Business Services scenario relative to the Status Quo scenario (i.e., $262.1 billion vs. $189.7 billion).

We refer to these results occurring under the best of circumstances because the estimates do not account for the fact that a services tax (like any tax) could be expected to depress economic activity, meaning the taxes actually raised would end up being somewhat less. The estimates also do not account for pyramiding—a compounding of the tax that is common with services taxes—that would further depress economic activity and revenues raised.[16] Thus, the revenue raised under the Most Services and Business Services scenarios shown in Figure 3 represent the best case with respect to the amounts that could be raised.

What also is notable about Figure 3 is that neither of the services-tax scenarios eliminated General Fund volatility. We present the year-to-year growth rates for the Most Services scenario, the services-tax scenario that raises the most additional revenue, below in Figure 4.

[16] Consider the case of a legal firm that purchases (taxed) accounting, (taxed) HR and (taxed) janitorial services in the course of its day-to-day business. The price of the legal firm's services would increase to reflect the higher cost of these inputs, and then the legal services themselves would be taxed.

Figure 4: Year-over-year Growth Rates for the Most Services Scenario



Sources: California DoF, S&P Global, Encina Advisors

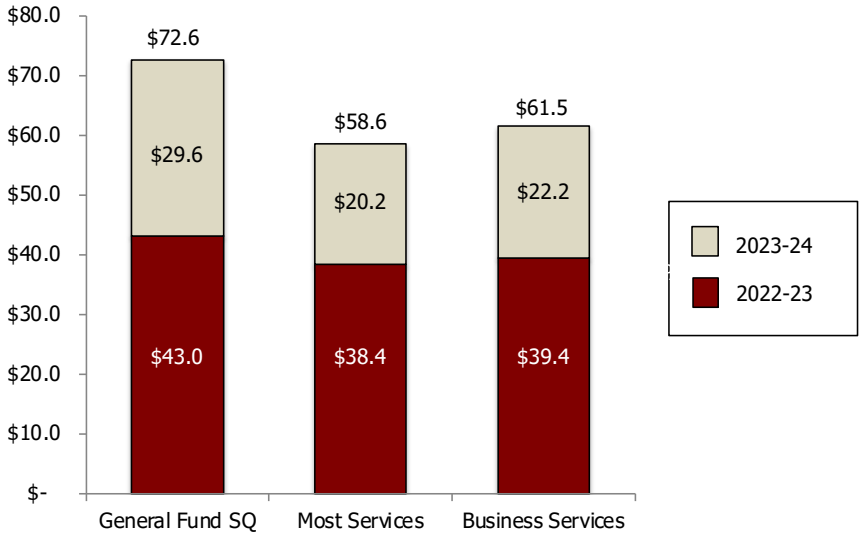
(The graph for the Business Scenario looks similar.) Figure 4 shows sharp swings in projected General Fund revenue even with a services tax. Over this timeframe, year-over-year increases or decreases in revenue would have exceeded 5 percent 18 times, and exceeded 10 percent 9 times. In fact, a typical year could see General Fund revenue with a sales tax on services averaging nearly 9 percent above or below the prior year's revenue.

The primary reason that a sales tax on services would not significantly reduce General Fund volatility is that even with the additional revenue, the General Fund still would rely heavily on the highly volatile PIT. Currently, the PIT is responsible for about 71 percent of General Fund revenue, so any meaningful reduction in General Fund volatility would require either (1) a sufficiently large reduction in the PIT such that other, less volatile revenue sources become relatively more important in the General Fund, or (2) a sufficiently large increase in other, less volatile revenue sources to dilute the impact of PIT volatility.

This leads to the question of whether having a sales tax on services in place would have avoided California's current severe fiscal situation. In other words, would a sales tax on services have provided the state the financial stability that would prevent the need for large budget cuts. The short answer is 'no'.

Under the General Fund Status Quo scenario, the General Fund measured $176.2 billion in 2022-23 and $189.7 billion (estimated) in 2023-24. Relative to the $219.3 billion General Fund in 2021-22, these amounts represent losses of $43.0 billion and $29.6 billion, respectively, for a total loss of $72.6 billion in revenue. We calculated the corresponding amounts for the Most Services scenario and the Business Services scenario and displayed the results in Figure 5 below. Figure 5 shows that both scenarios result in sizeable total losses of roughly $60 billion.

Figure 5: General Fund Revenue Losses Relative to 2021-22



Sources: California DoF, S&P Global, Encina Advisors

It should be reiterated that the revenue losses under the Most Services and Business Services scenarios shown in Figure 5 represent the best case with respect to the amounts of revenue that could be generated. Should a services tax depress economic activity, which is highly likely, then the revenue losses under the Most Services and Business Services scenarios would be greater.

CONCLUSION

Our analysis demonstrates that the revenue generated from a sales tax on services would not eliminate California's budget volatility. While a sales tax on services could generate a significant amount of revenue, this revenue would itself be volatile. A typical year could see revenue from a sales tax on services averaging nearly 9 percent above or below the prior year's revenue.

If a sales tax on services would not reduce California's budget volatility in a meaningful way, what alternatives could the state pursue? One option is to revisit the structure of the state's personal income tax. Recall that the LAO (September 28, 2017) found that approximately 40 percent of the PIT volatility results from California's progressive rate structure that taxes

higher incomes at higher rates and another 40 percent of PIT volatility results from choices made about the types of income to tax. Consequently, reducing the progressivity of the tax would help with budget volatility, although there are competing policy and political reasons for not doing so. Additionally, the LAO (February 8, 2017) highlighted that transfer payments and employer-paid benefits currently are not included in California's PIT tax base, and it estimated that these two categories totaled $521 billion in 2016.

A second option is to create the budgetary mechanisms that provide the State additional flexibility to address its existing volatility. This could entail, for example, increasing the size of the rainy-day fund to better handle large revenue swings without impacting core programs. It could also involve a greater reliance on one-time budgeting to prevent large inflows of revenues resulting in ongoing program commitments that cannot reliably be met.

METHODOLOGY

We calculated California's taxable services base using the following four steps:

First, we used the BOE's estimates of California's taxable services for the 2015-16 fiscal year as a starting point. The BOE developed its estimates in 2015 due to a request by Senator Bob Hertzberg to calculate the value of existing untaxed services for legislation under consideration at the time (SB 8). In developing the estimates, BOE followed the methodology prescribed by the Center on Budget and Policy Priorities[17] which involved: listing the California service industries by 5-digit or 6-digit North American Industry Classification System (NAICS) codes[18]; obtaining sales receipt data for these industries from the U.S. Census Bureau's 2012 Economic Census, which was the most recent data available; subtracting out any taxable expenses for 2012 from these industries by North American Product Classification System (NAPCS) code; and applying growth factors to the net receipts to extrapolate these figures to 2015-16. Because this analysis required expert judgment regarding the tax treatment of individual categories of receipts and expenses, and because the U.S. Census Bureau's 2017 Economic Census data is the most current at the state level, the BOE estimates for 2015-16 are the most credible data currently available.

Second, we subtracted services receipts for non-employer firms from the BOE's total. This is consistent with legislation like SB993, which exempted services provided by very small businesses, specifically those making less than $100,000.

Third, we applied growth factors to each industry. The previous steps effectively calculated a modified taxable services base for California for 2015-16, and we needed to extrapolate this amount historically and to the present day for analysis. We did so by aggregating the net receipts for the 5-digit/6-digit NAICS industries into their 2-digit sectors and then applied S&P Global historical and forecasted growth rates at the 2-digit NAICS level to the corresponding net receipts for services to estimate how the taxable services base changed over this period.

Finally, we developed the two sales taxes on services scenarios. For the *Most Services* scenario, we subtracted from BOE's estimates of California's taxable services the net sales receipts for industries that were explicitly exempted in SB 8, namely educational services (NAICS Sector 61) and healthcare and social assistance (Sector 62). For the *Business Services* scenario, we instead subtracted the net sales receipts for industries that were explicitly exempted in SB 993. These exemptions pertained to educational services (NAICS Subsector 611); health care and assisted living services (Subsectors 621 to 623, inclusive); child care services (Subsector 624410); residential building construction (Subsector 2361); wholesale trade (Sector 42); automotive parts, accessories, and tire stores (Subsector 4413); the Postal Service (Subsector 491); arts, entertainment, and recreation services (Sector 71); food services and drinking places

[17] Mazerov, Michael, *Using Economic Census Data to Estimate the Revenue Impact of Taxing Services*, Washington, DC: Center on Budget and Policy Priorities, February 15, 2012. Online at https://www.cbpp.org/sites/default/files/atoms/files/2-15-12sfp.pdf

[18] The BOE excluded those service industries that were specifically protected from taxation in the California Constitution such as utilities and insurance.

(Subsector 722); all other traveler accommodation services (Subsector 721199); and other services except public administration (Sector 81). SB 993 also exempted services involving interest and rent, so we removed individual industries within the financial services area (Sector 52) and the real estate and leasing area (Sector 53), respectively, as appropriate.