Accounting is a Business Service and Doesn't Belong in the Sales Tax Base

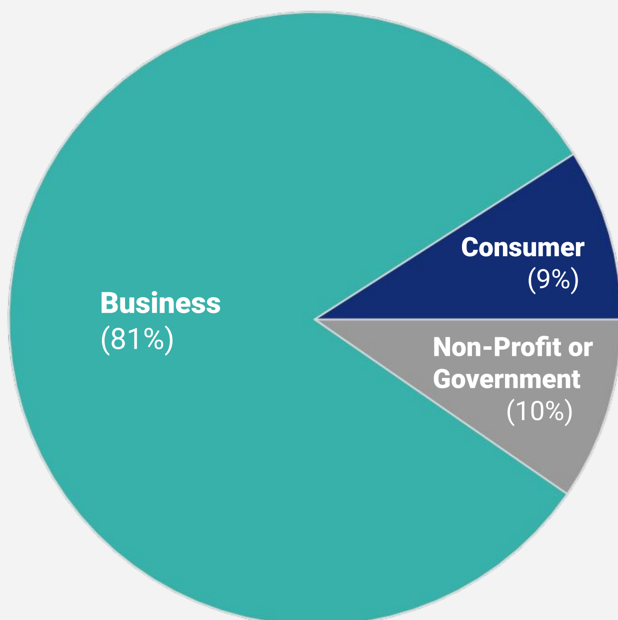
In recent years, many states have considered (and rejected) legislative proposals which would expand the sales tax base to include additional services. "Broad base, low rate" has been the mantra, with advocates arguing that by taxing more types of transactions, tax rates can be decreased, or new revenue can be generated.

Whatever the merits of these proposals, attempts to impose sales tax on accounting services are nonsensical: the data shows that accounting services are by definition business services, and thus do not fit in any rational sales tax base. Public finance economists agree that consumption taxes, like the sales tax, should not include business inputs. More than 90 percent of accounting services are either business inputs, or are sold to governments and nonprofits. Subjecting them to sales tax wouldn't be "tax reform" but rather "tax corruption."

Ninety-One Percent of Accounting Services are Purchased by Businesses, Governments, and Nonprofits

Based on Bureau of Economic Analysis (BEA) data,[1] we estimate that 81 percent of "accounting, tax preparation, bookkeeping, and payroll services" (the most granular BEA category for these services) are purchased by other businesses as an intermediate input.

Who purchases accounting, tax preparation, bookkeeping, and payroll services?



Further, 10 percent of accounting services are purchased by governments and nonprofits (states shouldn't apply sales tax to these purchases either – and usually don't).

Therefore, if traditional economic principles are applied and business inputs, along with government and nonprofit consumption, are excluded from the sales tax base — and only final consumer purchases are taxed — only nine percent of accounting, tax preparation, bookkeeping, and payroll services would be taxable.

There is no justifiable reason to apply sales tax to the entire accounting industry if 91 percent of its output will subsequently be exempt from tax. The administrative cost of including something in the tax base when 91% of the purchases will be exempt based on actual use is prohibitive and wouldn't be justified by the miniscule amount of tax revenue collected.

About That Remaining Nine Percent...

As noted above, the BEA groups accounting with other similar services: tax preparation, bookkeeping, and payroll. By definition, individuals do not need payroll or bookkeeping services (unless for their business). Similarly, very few individuals will purchase accounting services outside of a business context. Which leaves tax preparation services.

Of course individuals purchase tax preparation services. So one could argue from first principles that tax preparation services, when purchased by individuals, should be subject to sales tax. But it would be perverse to impose a new sales tax on the consumption of a service people only purchase because they have to comply with a different tax (i.e., income taxes). It is unreasonable to tax an activity that the government requires individuals to do in the first place — doing so is essentially taxing the act of paying tax itself.

Don't Just Take Our Word For It

Economists and fiscal policy experts on both sides of the political spectrum agree that business inputs shouldn't be taxed under the sales and use tax because they lead to tax pyramiding (in other words, a "tax on tax") and that this should be a major consideration when a state explores expanding the sales tax base to services.

For example, the right-leaning Tax Foundation notes that "there is a scholarly consensus that an ideal sales tax is imposed on all final consumption, both goods and services, but exempts all intermediate transactions (business inputs) to avoid tax pyramiding, where the same tax is embedded multiple times in the final purchase price."[2]

Similarly, the left-leaning Center on Budget and Policy Priorities explains: "Economists generally counsel states to forgo taxing the first category of services, so-called 'business-to-business' sales. They point out that taxing the goods and services businesses buy to use as inputs into the production of other goods and services often leads to 'tax pyramiding'. Tax pyramiding refers to the situation in which an input is taxed when purchased and then effectively taxed again when its cost is passed through into the price of a taxable good or service into which it has been incorporated."[3]

Why is tax pyramiding so undesirable? The Council On State Taxation, the nation's leading business tax policy organization, describes the negative economic effects: "Multiple taxation is an undesirable outcome of sales tax being imposed on business-to-business transactions because it affects business choices of input purchases, location of jobs and investments, and organization of business structures. It favors larger organizations over smaller businesses because they can internalize certain costs without incurring sales tax, putting the smaller businesses at a significant cost disadvantage purely because of a distortive sales tax policy. With such multiple layers of taxation along the production chain, different products and services purchased by households from different sources would be subject to varying effective tax rates. This distorts consumer choices by penalizing the purchase of goods and services subject to higher effective tax rates. [...] While public finance economists may worry about these economic "inefficiencies" more than legislators, the distortions have real economic consequences that the states' policy-makers need to consider."[4]

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[1] U.S. Bureau of Economic Analysis, "Input-Output Accounts Data," Use Tables (2012).
[2] Jared Walczak, "Modernizing Utah's Sales Tax: A Guide for Policymakers," Tax Foundation (June 4, 2019), p. 2.
[3] Michael Mazerov, "Expanding Sales Taxation of Services: Options and Issues," Center on Budget and Policy Priorities" (August 10, 2009). Mazerov further cites rationales in support of taxing business inputs (pp. 28-29), but those rationales either do not support taxing accounting services or are unduly complex and potentially violate equal protection standards in state constitutions (e.g., a suggestion that accounting services purchased by specific businesses be subject to tax if those businesses' own outputs were not subject to tax).
[4] Council On State Taxation, "The impact of imposing sales taxes on business inputs" (May 2019), p. 11.

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