



The District's Dime

Going Beyond the Budget Book

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Tax Commission Tuesday: Sales Taxes in DC

By Jenny Reed

It's Tuesday, which brings another installment in our series looking at important research generated by DC's Tax Revision Commission. Today's focus is the sales tax and a [paper](#) and presentation by Dr. William Fox of the University of Tennessee. One of the biggest takeaways: DC's sales tax has become a weaker revenue source over the years, because residents are spending more on things that currently are not subject to sales tax, including a number of services and online purchases. Fox recommends DC expand its sales tax to more services and goods to update it to the current times.

DC's general sales tax is 5.75 percent, well below the 6.85 percent average rate across the country when both state and local taxes are combined. (The DC Council voted to lower the sales tax from 6 percent to 5.75 percent beginning October 1.)

At its core, the sales tax is a tax on consumption. But what is taxed varies widely from one state to the other. DC applies the general sales tax to most goods, but has 38 exemptions which Fox notes are largely for purchases by businesses or governments, but also include food and prescription drugs.

DC taxes a number of services -- including 78 of 168 services identified by the Federal of Tax Administrators. That is above the typical state, which taxes 50 services, and above Maryland (taxes 39 services) and Virginia (taxes 18 services).

Nevertheless, DC's sales tax covers a small and shrinking share of purchases made in the city. DC's sales tax base -- what the sales tax covers -- equals 34 percent of the city's economy (defines as total personal income). That is down from 1998, when the sales tax base equaled 47 percent of the economy. Fox calls this "evidence of a shrinking economy that is taxable." And, he says, that is largely due to the growth of internet sales, the low taxation of services, and an increasing number of sales tax exemptions.

Some of the options that Fox says DC should consider to expand the sales tax base include:

- **Taxing internet sales.** With more and more purchases being made online, giving states the ability to collect those taxes from retailers that don't have a physical location in the state is important. The Marketplace Fairness act currently being debated in Congress would do just that.

- **Expanding the sales tax to additional services:** Fox notes that services made up 47 percent of consumption expenditures in 1979 and 66 percent in 2011. That means the sales tax needs to cover as many services as possible. Extending the sales tax to storage, carpet cleaning and construction contractors are some suggestions.

Fox also recommended some changes that may be considered controversial, such as applying the sales tax to groceries and non-prescription drugs. DC and most states do not tax essential items because the sales is regressive. In other words taxing necessities like bread and milk would take a bigger slice out of the incomes of low-income residents than higher-income residents. Yet higher-income families also spend money on food that is exempt from the tax, and so the sales tax break goes beyond just offsetting the impact on low-income families. Fox argues that DC could apply the sales tax to food items and instead consider a sales tax credit for low-income households or monthly debit-like-card to help offset the cost of sales tax. But he also cautions that Maryland doesn't tax food (while Virginia does), and that DC should also weigh the potential impact of leakage across borders.