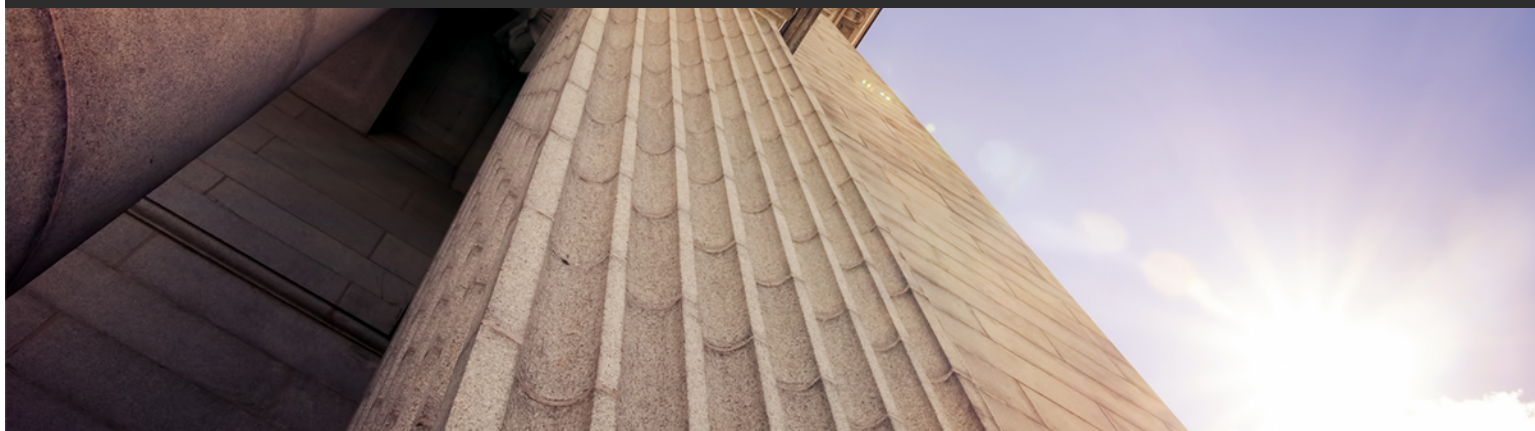


Alert | State & Local Tax



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California Proposes Legislation to Impose Sales and Use Tax on Services

Recently proposed legislation would require sellers to collect sales and use tax on the sales price of certain services to California businesses.

On Feb. 5, 2018, California Senator Robert Hertzberg introduced a bill, which if enacted, would impose sales and use tax on purchases of services by businesses for benefit and use in California, effective Jan. 1, 2019. For services that benefit or are used by the purchaser's California and non-California operations, a share of the services would be apportioned to California. The proposed tax rate has not yet been determined. Notably, the tax would not apply to purchases of services by individuals.

The proposed legislation provides an exemption for healthcare, education, and child care services, and interest and insurance payments subject to the California gross premiums tax. Presumably, non-exempt services would be subject to tax, including legal, accounting, maintenance, real estate brokerage, consulting, IT support, cloud computing, and advertising services. In addition, businesses with less than \$100,000 of gross receipts in the previous four quarters would be exempt. The bill does not provide an explicit resale exemption or exemptions for services purchased in the provision of other services, so it is possible that the current version of the proposed legislation would seek to impose multiple levels of tax where services are purchased for resale. The bill would include a change in California statute that would result in taxpayers paying a higher tax, and therefore, would require approval by two-thirds of each house of the California Legislature in order to pass.

Sellers of services and California business should continue to monitor the progress of this proposed legislation. If history is any guide, this bill might have a rocky road in the event it is enacted into law. Although a few smaller states impose their sales tax on a broad range of services, the last time a major

state tried to do so was in 1987 when Florida expanded its sales tax to encompass most service transactions. Because advertising services were subject to tax under that 1987 law, there was a barrage of editorials from newspapers, television, and radio outlets which helped lead to the repeal of the tax after only six months. Similar proposals have failed in California in the past, but those bills sought to tax services purchased by both individuals and businesses. Given the significance of a tax on businesses purchasing services, such as software services, this bill is likely to be an important issue in this legislative session and may have subsequent amendments if it actually moves towards enactment.

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