

STATEMENT OF POSITION

Extension of Sales Tax to Architectural Services

“...in this world, nothing is certain
but DEATH and TAXES.”

— Benjamin Franklin,
Letter to M. Leroy, 1789



AIA NEBRASKA'S OBJECTIVES:

Given our limited ability
to influence DEATH,
we focus on LIFE

To contribute to the quality of life in Nebraska, striving to continually and positively improve the environment in which we work, live and play. As architects, we have a responsibility to provide exceptional spaces and areas that excite the senses and contribute to our comfort, enjoyment and productivity while at the same time resulting in judicious stewardship of our precious resources.

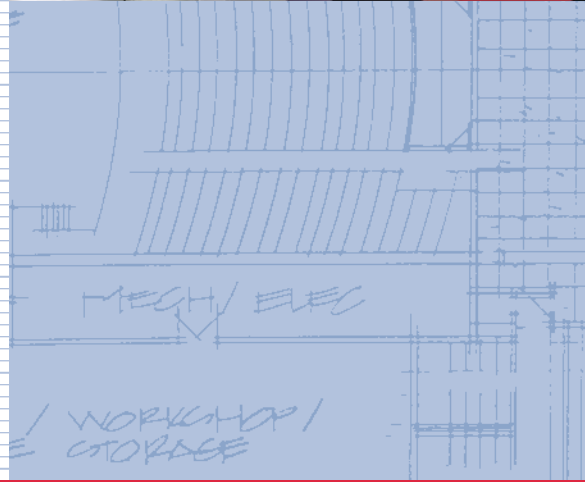
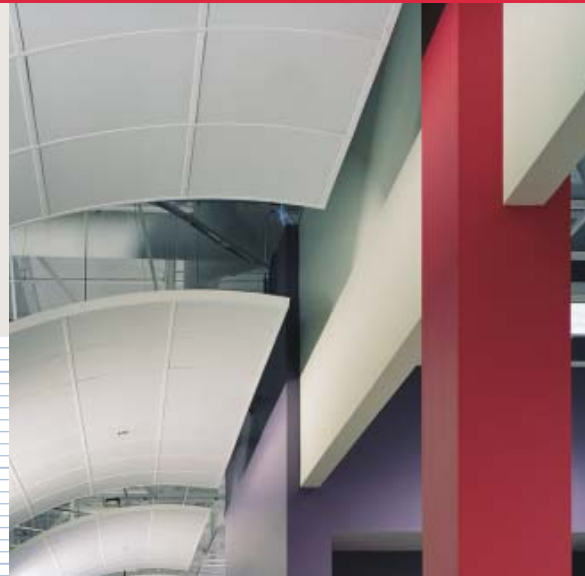
TAXES: Given the changes over the years in the Nebraska and national economies, as Architects we stand ready to assist the unicameral in crafting taxation legislation encourageing Nebraska's growth objectives, increases revenue development, which is fair and equitable to all of Nebraska's enterprises. Resulting in our great state becoming the place where business and individuals locate, grow and prosper.

ISSUES

- Economic
- Potential impact
- Potential loss of revenue
- Potential harm by improper tax extension

NEBRASKA FISCAL ISSUES

- Today's consumers and businesses use far more services than 50, or even 15, years ago
- Extending sales tax to services being considered in many states
- Taxing services (legal services, medical services, engineering and architectural services, computer/data processing, accounting services, advertising, etc.) seen as partial solution to complex fiscal shortfall
- Seven states currently levy tax on architectural services (Florida, Connecticut and Michigan were forced to repeal them due to complications)



INDUSTRY DATA

Nebraska - 2001

- Architectural and related services: 5,920 employees
- Architects: 1,300 (+/-)
- Architects average earnings: \$49,306 (well above Nebraska avg. of \$27,915)
- Payroll: \$269.0 million
- Nebraska architectural firms had more employees and larger payroll than similar firms in Iowa (state with more than 2.9 million people)
- Larger than numbers reported: architects employed in wide variety of industries (e.g., construction, manufacturing, engineering)
- Omaha metro area: 3,578 people employed

Source: United States Bureau of the Census, County Business Patterns, Nebraska, 2001.



Nebraska Exports Architectural Services (higher percentage indicates larger export capacity)

City	Percentage of total population
Omaha	1.26%
Des Moines	1.00%
Denver	1.05%
Kansas City	0.99%
Dallas	0.85%
St. Louis	0.96%
Oklahoma City	0.73%
Wichita	0.69%
Minneapolis	1.47%
Los Angeles	0.45%
San Francisco	0.73%
Seattle	1.05%

SURVEY

Nebraska Architectural Firms – Oct 2003

- 66% of responding firms: four or fewer registered architects
- 75% of responding firms: business was in Nebraska
- 75% of responding firms: also do business outside Nebraska
- Only 25% of responding firms reported doing 100% of their business in Nebraska
- 90% (+) of responding firms indicated some use of consultants
- Typical payment to consultants: 25-30% of billings
- 55% of architectural jobs would be at risk of leaving state
- All larger firms indicated their headquarters would move to branch location outside Nebraska in event of sales tax extension to architectural services
- Some firms noted they currently pay corporate income tax, and if the sales tax were applied to their operations, they believed it constituted double taxation



POTENTIAL ISSUES

If Sales Tax On Architectural Services Is Not Well Planned

Loss of Firms and Weakened Economic Base

- Large firms with branch offices will likely move their headquarters
- Firms of all sizes located near Nebraska's border would find it cost effective to relocate
- Smaller firms harmed due to lack of integrated skills required to comply with new tax
- No firm can absorb sales tax and will be forced to pass it on to clients
- Nebraska total employment could be reduced by 4,000 jobs
- Nebraska total payrolls could be reduced \$158 million
- Assuming 35% of all Positions Relocated Outside Nebraska:
 - 2,000 (+) well-paying jobs lost (payroll loss = \$100 million)
 - Secondary loss of 2,000 jobs (payroll loss = \$58 million)
 - Total job loss = 4,000 jobs
 - Total payroll loss = \$158 million
- Nebraska state and local tax revenue: reduced \$12.5-\$14 million
- Assuming 35% of all Positions Relocated Outside Nebraska
 - Income tax losses as result of job migration = \$6.5-\$7 million
 - Sales tax losses as result of job migration = \$5-\$6 million
 - Losses as result of fewer revenues from fuel, property, and corporate income taxes = \$1 million
 - Total Nebraska tax loss = \$12.5-\$14 million

Sales Tax Penalizes Small Firms

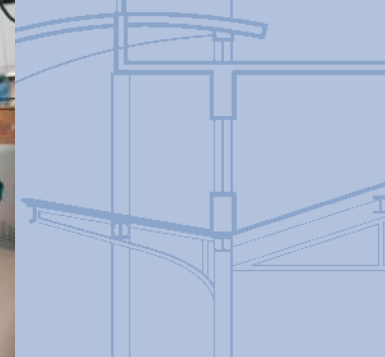
- 50% of Nebraska architectural firms have fewer than four employees
- Small, single-discipline firms may be impacted more than large firms
- Large, integrated firms provide accounting and other services in house, but small firms will have to find outside services to manage administrative aspects of sales tax

Tax Pyramiding

- Tax pyramiding occurs when tax is levied on tax
- Architectural firms typically hire outside consultants for specialty services not found internally. 25-35% of architects' fees subject to tax pyramiding.
- Complicating issues regarding sub consulting
 - Who is the buyer of services?
 - Is the firm hiring a sub consultant or the "prime" consultant responsible for the tax?
 - What happens when sub consultant hires sub consultants?

Nebraska Firms at Competitive Disadvantage to Out-of-State Firms

- Nebraska engaged in competitive struggle to attract and retain businesses
- Nebraska architectural firms engaged in competitive struggle with out-of-state firms
- Sales tax on services would encourage Nebraska firms to relocate out of state in order to remain competitive
- Enforcing sales tax on out-of-state firms is difficult
 - Nebraska would be dependent on out-of-state firms voluntarily registering and paying tax
 - Out-of-state firm might have sufficient incentive not to comply



Public Building Construction and Renovation

- Nebraska requires architectural and other services when public buildings are constructed or renovated
- Since state and local governments do not pay sales taxes, cost of architectural services to all clients would rise to cover added cost incurred by architect
- Architectural fees would have to increase
- Cost of state, municipal, county and school buildings could rise as result of sales tax on architectural services

Administrative Challenges

- New level of bureaucracy needed to implement and enforce tax
 - Florida's brief experiment with tax on services resulted in addition of 240 new full-time enforcement positions. [See Mackinac Center for Public Policy at www.Mackinac.org.]
 - Firms paying tax had to organize education programs and devote employees to training seminars
 - Florida compliance rate expected to be only 65% in first year - even with training
- Nebraska will need to increase number of audit and enforcement staff

Sales Tax Will Become More Regressive

- Tax is regressive when proportion of income paid as tax decreases as income increases
- Tax is progressive when proportion of income paid as tax increases as income increases
- Regressive tax means lower income households pay larger percentage of income in tax
- Progressive tax structure means higher income individuals pay larger percentage of tax
- Several studies indicate that service taxes increase the regressive impact of state's tax system on low-income citizens
 - Bureau of Business Research, University of Nebraska-Lincoln, 2002
 - American Legislative Exchange Council Study, 1987
 - Mackinac Center for Public Policy, July 2003: extension of sales taxes to construction service would "surely price some [lower income taxpayers] out of the housing market"
- Nebraska's tax structure was made more regressive with extension of sales tax to services
- Certain construction services were added to sales tax base in October 2003, a year after University of Nebraska-Lincoln study concluded that Nebraska's sales tax was becoming increasingly regressive
- Some Nebraska families may not be able to afford home ownership due to increased taxes on services

SUGGESTIONS

- 1 Include all professional services (medical, legal, engineering, financial, etc.).
- 2 Apply tax to owner of resulting facility or project. This provides state with best assurance of being able to collect.
- 3 Only apply to services that result in physical structure or environment. Studies, programming, master planning, etc. should not be taxed. Assures collection of tax if service performed by out of state firm.
- 4 Reduce tax rate for owners utilizing in-state firms. Encourages firms to locate and stay in Nebraska.
- 5 Respect and further goals and objectives of other states' initiatives to encourage continued growth within Nebraska.
- 6 Exempt taxation of gross receipts from projects outside Nebraska.
- 7 Exempt taxation of gross receipts from public buildings.

Government Affairs Committee of Nebraska Chapter of AIA hereby extends an offer to further assist the unicameral in its efforts to address the issue of taxation of professional services.

Contact Executive Director Sara Kay via e-mail at skay2@unlnotes.unl.edu or at the address or phone number at right.



AIA Nebraska
A Society of
The American Institute of Architects
102 Architecture Hall
University of Nebraska Lincoln
PO Box 80045
Lincoln, NE 68501-0045

www.AIAne.org
402.472.1456
402.472.1654 fax

AIA Nebraska
Government Affairs Committee
John Sinclair, AIA, Chair
Merle Bachman, AIA
Lowell Berg, AIA
Ron Hughbanks, AIA
Paul Jeffrey, AIA
Lloyd Meyer, AIA
Mike Purdy, AIA
Greg Smith, AIA

Michael James, AIA, President
Sara Kay, Executive Director

Prepared by
Donald E. Pursell, Economist
Retired, University of Nebraska-Lincoln

Design, Editing, & Graphics provided by
HDR Architecture, Inc.

January 2004