STATEMENT OF THE TAXATION DIVISION OF
THE DISTRICT OF COLUMBIA BAR
ON THE
PROPOSAL TO EXTEND THE SALES AND
USE TAX TO PROFESSIONAL SERVICES

BEFORE THE COMMITTEE ON FINANCE AND REVENUE
OF THE
COUNCIL OF THE DISTRICT OF COLUMBIA

April 25, 1980

Members of the Committee:

My name is James Boyle. I appear before you today on behalf of The District of Columbia Bar's Taxation Division to offer for your consideration our comments on the proposal to extend the District's 5% sales tax to services of attorneys and other professionals. As Chairperson of the Division's Steering Committee, I can speak only for the members of our Division and not for the Bar as a whole or its Board of Governors. We are the tax specialists in the Bar, however, and as such we believe we can make a useful contribution to the Council's deliberations on the tax proposal.

The Steering Committee of our Division believes that serious legal, practical and policy problems argue against adoption by the District of the proposed tax on services, and we are supported in this belief by the overwhelming majority of

our fellow tax specialists who responded to a Taxation Division poll on this subject.

The tax would be an administrative nightmare for the District as well as for those who would be required to comply with it. The tax would invite litigation challenging its validity, once again putting the District in a precarious position of uncertainty with respect to a significant component of its revenues. The District would stand virtually alone in imposing a separately stated surcharge on its professionals' fees, thus, Washington attorneys and other professionals would stand to lose substantial business to competing firms in other jurisdictions, particularly in nearby Maryland and Virginia where office rentals and overhead costs are already significantly lower than in Washington. We are concerned too that the tax would be counterproductive to the Bar's efforts to deliver necessary legal services to average citizens at a reasonable cost. For these reasons, we conclude that imposing the sales tax on professional services is neither an efficient nor a wise method of meeting the District's revenue needs.

All of us who work in the District, including many of us who both live and work here, are aware of the District's need for revenues. To that end we gladly offer the technical expertise of our members to assist you in evaluating alternate tax proposals that may come before you. But we urge that the

Council not approve an expanded sales tax in the mistaken belief that this will provide a quick and painless cure for the District's revenue shortfall. That is not the case.

Sales and use taxes were designed for transactions involving the purchase at retail of tangible personal property. With the exception of South Dakota, every state which imposes a sales and use tax limits the scope of the tax to tangible property, to entertainment, or to standardized consumer services such as those provided by barbers, dry cleaners, and the like. Transactions traditionally subject to the tax are easily identifiable and, for the most part, occur entirely within the taxing jurisdiction.

A sales tax on the services of attorneys and other professionals, particularly those located in the District, raises much more complicated issues. An attorney does not typically "sell" his services in a single transaction, but may spend days, months, or even years advising his client in a complex matter or representing his client in litigation. Moreover, since the clients of many Washington attorneys are located outside the District, these services may be rendered both in and outside the District.

For example, suppose a Washington attorney mails a legal opinion to a client which is the product of a factual investigation conducted at the client's office outside the District and legal research performed in the District. Is this exempt

from the District sales tax because the destination of the attorney's "product" is the client's office outside the District (as would be the result in the case of a sale of goods)? If not, would the District permit or require an allocation of the "sales price" between services performed within and without the District, and if so, how should such allocation be made? Is the District prepared to incur the significant additional costs of obtaining qualified manpower to audit sales tax returns to prevent evasion and check compliance with the necessarily complex rules that will be involved?

Again, suppose the Washington attorney renders services for a client in litigation or some other protracted matter and does not bill for his time until the matter is completed. Since the District insists on receiving its sales tax as soon as a "sale" is made, regardless of when the vendor actually receives payment, must the attorney remit tax to the District on a monthly basis as his services are performed? Suppose the attorney does not compute his fee on an hourly basis, or has a contingent fee arrangement under which he may receive no payments at all if he is unsuccessful? In addition to the difficulty of determining currently the amount of unbilled fees on which the tax must be computed, the sales tax proposal would also create a terrible cash flow problem for many Washington practitioners, especially those in smaller firms, not only in those situations described above, but also where taxes are imposed on billed but unpaid fees of slow-paying and delinquent clients.

What of the Nebraska attorney who appears before a Federal Court or agency in the District on behalf of his Nebraska client? Will the District require him to collect a tax in such cases? If so, how does the District propose to enforce that tax? If not, can the Council doubt that Washington law firms would face an enormous handicap in competing with out-of-town firms?

Consider also the problems presented by multi-city law, accounting, architectural and consulting firms. What portion of their services would be subject to the tax and how would the District verify the correctness of the determination?

These are not academic questions; the situations described occur every day in Washington. The issues are not simple ones, and no matter how they are answered initially by District tax officials they are bound to produce litigation which will be expensive for the District to defend and could keep the law and its administration in a confused state for many years.

Moreover, legal issues will be raised which go to the very validity of the tax. It is inevitable, for example, that a tax on the legal fees of attorneys who come to the District to represent a non-District resident in federal court or before one of the many federal agencies will be challenged on First Amendment (right to petition the Government; free speech) and Sixth Amendment (right to counsel) grounds. There may also be

objections under the Commerce and Due Process clauses to subjecting citizens outside the District to a District sales tax on what essentially are interstate transactions which touch the District only because it happens to be the seat of our National Government. Finally, the District may even find itself defending its authority to impose this tax under the District's home rule charter.

The Council should also be mindful of the effect this tax will have on the competitive position of Washington professional firms. Under present law, the sales tax is required to be separately stated to the customer, and with the District as virtually the only jurisdiction to impose such a tax, clients will clearly prefer to retain an attorney who is not required to add a 5% surcharge to his fee (or, as a practical matter, who is beyond the reach of the District tax collector). Even when the Washington attorney wishes to absorb the 5% tax out of his own earnings, it may be difficult for him to persuade his client that he has done so when the 5% tax clearly appears as a separate item on the client's bill. We cannot be sure of the extent to which this tax will result in a loss of business for Washington firms, or how much the tax will contribute to the exodus of professional firms from Washington to the Maryland and Virginia suburbs, but both results seem likely and the prospect of either is discouraging to us as it must be to the Council.

Finally, the Council should not overlook the adverse impact of the tax on citizens of the District who need legal advice on estate planning, consumer problems, divorce, and other matters and who are not receiving that advice because they perceive that the cost of legal services is too expensive for them. The Bar has been concerned about delivering legal services to these people at a reasonable cost. Imposition of the 5% sales tax would clearly be a step backward in an area in which we very badly need to make great strides in the opposite direction.

We urge the Council not to be misled into thinking that this is just another sales tax which will produce substantial revenue at minimum administrative expense. The tax will be extremely difficult to administer, difficult to enforce, and is likely to result in a substantial shift in legal and other professional services away from the District. Nor should the Council believe that this tax is a painless way of raising revenues from sources outside the District. The tax will hurt citizens of the District whose ability to pay the cost of necessary legal and other services is already strained.

Thank you.