



TAXATION AND BUDGET REFORM COMMISSION

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Staff Analysis and Economic Impact Statement

Measure: CS/CP 2, First Engrossed REFERENCE: ACTION:

Sponsor: Commissioners McKay, 1. GPSC Fav/2 amendments
Rouson, L. Miller, Lacasa, 2. FTC Fav/CS
Levesque, Riley, Corcoran, 3. TBRC Fav/Engrossed
Wilkinson, Kyle, and Martinez 4. Style/Drafting Pre-meeting

Subject: Property taxes and replacement
of required local effort with state
revenues

Date: March 17, 2008

I. Summary:

This measure requires the Legislature to fully replace the ad valorem taxes comprising the required local effort to fund education with:

- Revenues gained from the repeal of sales tax exemptions;
- An increase in the sales tax rate of up to one cent;
- Reductions in state spending;
- Revenues resulting from economic growth attributable to lower property taxes; and
- Other revenues identified or created by the Legislature.

The ad valorem taxes comprising the required local effort must be replaced starting with the 2011 General Appropriations Act for property taxes assessed in 2011 and thereafter.

This measure also:

- Reduces the annual cap on the growth in assessments of non-homestead property to five percent from ten percent for all property tax levies, except for school district levies;
- Reduces the maximum ad valorem millage for school purposes to five mills from ten mills, for which voter approval is not required by the Florida Constitution; and
- Provides that laws creating new sales tax exemptions must address only the single subject-matter of a single exemption and include a finding that the exemption serves a public purpose.

II. Present Situation:

The *2007 Florida Tax Handbook* estimates that Florida's sales tax will raise \$23,581,500,000 for fiscal year 2007-2008. The value of a 1 percent levy on the sales tax base was estimated to be \$3.9303 billion.¹

Sales Tax

Florida law provides that each sale, admission charge, storage, or rental is taxable unless the transaction is specifically exempt. Florida's general sales tax rate is 6 percent. However, there is an established "bracket system" for collecting sales tax on any part of each total taxable sale that is less than a whole dollar amount. Additionally, a discretionary sales surtax is imposed by many Florida counties. To compute the Florida sales tax rate for each county, the county imposed discretionary sales surtax rate is added to the general sales and use tax rate.²

Discretionary Sales Surtax

Under specific conditions, Florida counties are authorized to levy a discretionary sales surtax on most transactions that are subject to sales and use tax. A dealer who sells and delivers taxable merchandise or taxable services is required to collect the surtax at the rate imposed in the county where the merchandise or service is delivered. For motor vehicle and mobile home sales, the surtax rate of the county where the vehicle or mobile home will be registered is used to calculate the appropriate tax.³

Only the first \$5,000 of a single sale of tangible personal property is subject to a discretionary sales surtax if the property is sold as a single item, in bulk, as a working unit, or as part of a working unit. The \$5,000 limit does not apply to commercial rentals, transient rentals, or services.⁴

Use Tax and Consumption

Use tax complements, and is applied in the same manner as, sales tax. The use tax rate and sales tax rate are the same, including discretionary sales surtax, if applicable. Use tax is due on purchases made out of state and brought into Florida within 6 months of the purchase date. Also, if one purchases a product tax-exempt that one plans to sell at retail, but ends up using it at their place of business, the "use" of the product is subject to tax. If one purchases materials that are "consumed" in a manufacturing process to create an end product, but are not part of the end product, those materials are subject to tax.⁵

The "use" component of the sales and use tax provides uniform taxation on items that are purchased outside Florida, but are used or stored in the state. If the item brought into Florida is subject to tax, a credit for lawfully imposed taxes paid to another state, a U.S.

¹ The Florida Senate, *2007 Florida Tax Handbook: Including the Fiscal Impact of Potential Changes* 114 (2007).

² Department of Revenue, *Florida Sales and Use Tax*, http://dor.myflorida.com/dor/taxes/sales_tax.html (last visited Jan. 15, 2008).

³ *Id.*

⁴ *Id.*

⁵ *Id.*

territory, or the District of Columbia is permitted. Credit is not given for taxes paid to another country.⁶

Sales Tax Exemptions

The *2007 Florida Tax Handbook* lists 246 exemptions from the sales tax.⁷ The *Tax Handbook* states that several of the exemptions are fundamental to the structure of the tax. These structural exemptions include:

- Items purchased for subsequent resale;
- Intangible personal property;
- Tangible personal property imported or produced for export; and
- Purchases of agricultural products used in further processing for resale.

The revenue impact of the remaining exemptions is estimated to be \$12.3403 billion. However, the *Tax Handbook* notes that some of the exemptions overlap such that the repeal of all of the exemptions, excepting the structural exemptions, would yield less than \$12.3403 billion. Of non-structural exemptions:

- \$8.15 billion relate to household items;
- \$0.67 billion relate to organizations;
- \$2.16 billion relate to business items; and
- \$1.35 billion relate to miscellaneous items.⁸

Sales Tax on Services

In 1986, the Legislature repealed the sales tax exemptions on services, effective July 1, 1987. In 1987, the Legislature integrated the tax on services with the sales tax on tangible personal property. In a 1987 special session, the Legislature repealed the sales tax on services, effective January 1, 1988. Accordingly, the state's experience with a broad-based sales tax on services lasted six months.

Most services are not [currently] subject to Florida's sales tax. This lack of tax on most services is not due to an exemption from the tax, but from the fact that services are not specified as taxable. There are basically two exceptions to this. First, s. 212.05(1)(k), F.S., specifically states that detective, burglar protection, and other protective services and nonresidential cleaning and pest control services are subject to the sales tax.⁹

Second, the definition of "sales price" in s. 212.02, F.S., states that the amount paid for tangible personal property includes any services which are part of the sale "without any deduction therefrom on account of the cost of property sold, the cost of materials used, labor or service cost, interest charged, losses, or any other expense whatsoever." The

⁶ *Id.*

⁷ The Florida Senate, *2007 Florida Tax Handbook: Including Fiscal Impact of Potential Changes* 115-118 (2007).

⁸ *Id.* at 118.

⁹ The Florida Senate, Fiscal Resource Committee, *Sales Tax Exemptions: A Tool for Lowering the Sales Tax Rate in Florida* 13 (Aug. 2000).

definition also states that sales price includes “the consideration for a transaction which requires both labor and material to alter, remodel, maintain, adjust, or repair tangible personal property.”¹⁰

The third component important in the discussion of sales tax on services is the exemption in s. 212.08(7)(v), F.S., relating to a professional, insurance, or personal service transaction that involves sales of tangible personal property as “inconsequential,” and elements for which no separate charges are made. Thus, even though a lawyer might issue a written opinion in the performance of his or her duties, the written report is considered inconsequential to the main service of rendering the opinion.¹¹

The *Tax Handbook* estimates that the annualized receipts from the application of the state sales and use tax on service transactions for fiscal year 2007-2008 would yield \$23.4144 billion.

Education Funding

Florida Education Finance Program - In 1973, the Florida Legislature enacted the Florida Education Finance Program (FEFP) and established the state policy on equalized funding to guarantee to each student in the Florida public education system the availability of programs and services appropriate to his or her educational needs that are substantially equal to those available to any similar student notwithstanding geographic differences and varying local economic factors. To provide equalization of educational opportunity, the FEFP incorporates a funding formula to recognize: (1) varying local property tax bases; (2) varying education program costs; (3) varying costs of living; and (4) varying costs for equivalent educational programs due to sparsity and dispersion of the student population.¹²

The FEFP is the primary mechanism for funding the operating costs of Florida school districts. School districts in 2005-2006 received 40.71 percent of their financial support from state sources, 49.31 percent from local sources (including the Required Local Effort portion of the FEFP), and 9.98 percent from federal sources.¹³

School districts also receive some funding outside of the FEFP. These funding sources include: 2 mill ad valorem millage for capital outlay and maintenance; discretionary operating millage of .51 mills and .25 mills; voter approved millage for debt service, and other voter approved millage.¹⁴

Required Local Effort - In accordance with s. 1011.62, F.S., the Legislature establishes in the General Appropriations Act the amount of required local effort for school districts. These funds specified by the Legislature must be collected by school districts through ad

¹⁰ *Id.*

¹¹ *Id.* at 13-14.

¹² Florida Department of Education, *2007-2008 Funding for Florida School Districts 1*, <http://www.fldoe.org/fefp/pdf/fefpdist.pdf>.

¹³ *Id.*

¹⁴ *Id.* at 3.

valorem taxes. A school district must levy the required local effort as a condition to receive state funding through the FEFP. The required local effort amount set by the Legislature for fiscal year 2007-2008 was approximately \$7.9 billion, not including discretionary local effort.

Growth of Property Tax Assessments

Article VII, section 4(c) of the Florida Constitution generally limits the annual growth in the assessed value of homesteads to the lesser of inflation or three percent. On January 29, 2008, the voters approved a constitutional amendment to section 4 which generally limits annual increases in the assessed value of non-homestead properties to ten percent, except for school district levies.

Ad Valorem Taxes for School Purposes

Article VII, section 9(b) of the Florida Constitution limits the maximum millage for ad valorem taxes for school purposes to 10 mills. However, the millage limit expressly does not apply to ad valorem taxes “levied for the payment of bonds and taxes levied for periods not longer than two years when authorized by vote of the electors who are the owners of freeholds therein not wholly exempt from taxation.”

III. Effect of Proposed Changes:

This constitutional proposal:

- Requires the Legislature to fully replace the ad valorem taxes comprising the required local effort to fund education with state revenues;
- Reduces the annual cap on the growth in assessments of non-homestead property to five percent from ten percent for all property tax levies, except for school district levies;
- Reduces the maximum ad valorem millage for school purposes to five mills from ten mills, for which voter approval is not required by the Florida Constitution; and
- Provides that laws creating new sales tax exemptions must address only the single subject-matter of a single exemption and include a finding that the exemption serves a public purpose.

Education Funding

Replacement of Required Local Effort - This measure eliminates the property taxes established by the Legislature as required local effort, which funds the operations of school districts. The Legislature must replace the “full revenue impact” of the loss of required local effort with:

- Revenues gained from the repeal of sales tax exemptions;
- An increase in the sales tax rate of up to one cent;
- Reductions in state spending;
- Revenues resulting from economic growth attributable to lower property taxes; and

- Other revenues identified or created by the Legislature.

The ad valorem taxes comprising the required local effort must be replaced starting with the 2010 General Appropriations Act for property taxes assessed in 2010 and thereafter.¹⁵

The measure provides that the appropriation from the “General Appropriations Act in the 2010-2011 fiscal year” shall not be “less than the amount *appropriated* in the 2008-2009 fiscal year . . . as increased by the average historical growth for such amounts during the prior two state fiscal years.”¹⁶ The prior two state fiscal years to be used for this purpose are state fiscal years 2006-2007 and 2007-2008. The Legislature *establishes* the amount of property taxes that must be levied by school districts for eligibility to receive state funding in the General Appropriations Act. However, the Legislature *does not actually appropriate* the required local effort amount as a portion of state funding for school districts.

Cap on Growth of Property Assessments

This measure also reduces the annual cap on the growth in assessments of non-homestead property to five percent from ten percent for all property tax levies, except for school district levies.

New Sales Tax Exemptions

A law creating new sales tax exemptions must address only the single subject-matter of a single exemption and include a finding that the exemption serves a public purpose.

Exempt Exemptions

This measure expressly states that it does not mandate the repeal of exemptions for: food; prescription drugs; health services; charitable and religious institutions; and residential rent, electricity, and heating fuel. These items refer to categories of exemptions, as opposed to specific exemptions identified by statute. These exemptions likely correspond to nearly the full revenue impact of the exemptions categorized as “household items” and some categorized as “organizations” in the *Tax Handbook*. Viewed broadly, the categories of exempt exemptions may refer to the items described as excerpted from the *Tax Handbook* below.

Line No.	Exemption	Revenue Impact (in \$ m)	Type
17	Rent charges paid by certain long term occupants.	4.0	Household
18	Rent charges paid by certain full-time students.	33.1	Household
19	Rent charges paid by active military personnel.	32.0	Household
20	Rent charges paid by permanent residents.	1,259.2	Household
21	Charges for rent in certain mobile home parks.	3.3	Household
22	Rent charges for living accommodations in migrant labor camps	13.1	Household
99	Groceries purchased for human consumption.	2,651.5	Household
100	Food purchased with food stamps.	1.2	Household

¹⁵ Constitutional Proposal 22, 1st Eng., line 222; *but see*, lines 201-202 suggesting that the elimination of the required local effort occurs in 2011.

¹⁶ *Id.* at lines 221-226.

101	Prescription drugs.	896.0	Household
102	Non-prescription drugs.	199.0	Household
103	Eyeglasses and other corrective lenses.	44.3	Household
104	Medical supplies and products such as syringes and prosthetics.	114.8	Household
160	Charges for hospital meals and rooms.	603.2	Household
161	In-facility meals purchased by residents of homes for the aged.	22.2	Household
162	Purchases of power & heating fuels by residential households.	2,178.9	Household
167	Sales or leases to churches.	10.3	Organizations
177	Section 501(c)(3) organizations.	47.8	Organizations
200	Nonprofit cooperative hospital laundries.	0.1	Business
207	Complimentary food items.	0.8	Business
208	Food or beverages donated to nonprofit organizations.	<u>0.3</u>	Organization
		8,115.1	

The maximum amount of revenue that may be gained by the repeal of all non-structural sales tax exemptions is \$12.3403 billion.¹⁷ The most that the Legislature will be able to recover from the non-exempt exemptions to offset the required local effort may be slightly more than \$4 billion.

Elimination of Required Local Effort

The required local effort is a property tax that must be levied by a school district for eligibility to receive state funds under the FEFP. The measure provides that the “legislature shall be prohibited from requiring the levy of an ad valorem property tax as a required local effort for participation by school districts in the Florida Education Finance Program.” The measure does not state that education must be primarily state funded. As a result, the measure may permit the Legislature to compel a school district to levy other taxes.

Statutory Cross-References

This measure contains a number of specific cross-references to the Florida Statutes. The inclusion of cross-references to statutes in state constitutions is rare. The inclusion of the statutory cross-references may incorporate the specific statutes into the constitution. Thus, the Legislature may be unable to modify or repeal them.¹⁸ Alternatively, if the Legislature is not precluded from amending or repealing the cross-referenced statutes, the measure contains provisions that will become obsolete when the Legislature amends the cross-referenced statutes. To avoid the potential problems described above, the Commission may wish to address the issue in terms of principles, rather than statutory cross-references and statutory concepts.

Taxes not Affected by CS/CP 2, 1st Eng.

Property taxes levied by school districts other than required local effort required property taxes are unaffected by this measure.

¹⁷ The *Tax Handbook* states that some exemptions overlap. As a result the repeal of all exemptions would generate less than \$12.3403 billion.

¹⁸ See *Williams v. State*, 100 Fla. 1567, 1569 (Fla. 1930) (stating “[i]t is a general rule that when a statute adopts a part or all of another statute, domestic or foreign, general or local, by a specific and descriptive reference thereto, the adoption takes the statute as it exists at that time”).

Effective/Application Dates

If approved by the voters, this measure will take effect January 6, 2009, by operation of subsection 5(e) of Article XI of the Florida Constitution.

As a result of the default effective date in the Florida Constitution, the cap on the growth of non-homestead assessments may not apply until 2010.¹⁹ Additionally, the reduction in the maximum ad valorem millage for school purposes could also take effect before the replacement of the required local effort. The Commission may wish to amend this measure such that the cap on the growth in non-homestead assessments takes effect January 1, 2009 and that the reduced ad valorem millage for school purposes coincides with the elimination of required local effort.

IV. Constitutional Issues:**A. Constitutional or Legislative Matter:**

The State Constitution currently does not prevent the Legislature from shifting revenue sources to fund schools from local revenues to state revenues.

B. Other Constitutional Issues:

None.

V. Economic Impact and Fiscal Note:**A. Tax/Fee Issues:**

This measure will shift funding for a substantial portion of the public education system from local property taxes to state revenue sources.

B. Private Sector Impact:

This measure will shift funding for a substantial portion of the public education system to state revenue sources. This measure may reduce state government spending on services and items other than education due to possible budget reductions.

The cap on the annual growth of assessments of non-homestead properties may reduce local government revenues and/or lead to an increase in ad valorem millage rates on all properties.

This measure may shift a greater portion of the burden to fund schools from property owners to those who do not own real property. In 2007, the state-wide average ad valorem millage for required local effort was 4.843 mills. The

¹⁹ *Fuchs v. Wilkinson*, 630 So. 2d 1044 (Fla. 1994) (finding that the Save Our Homes amendment which contained no effective date, took effect January 5, 1993 did not apply to assessments until January 1, 1994).

residents of several counties, however, pay substantially less than the state-wide ad valorem millage. Thus, the exchange of required local effort for state revenues for education may be less advantageous for residents of low millage counties. These counties include: Charlotte--3.611 mills, Collier--2.786 mills, Franklin--1.437 mills, Monroe--1.408 mills, Sarasota--3.541 mills and Walton--1.696 mills.²⁰

Property taxes are deductible from the federal income tax. The Federal Income Tax Deduction for state sales taxes has expired and has not been reenacted for 2008.²¹ If the deduction for state sales taxes is not reenacted and property taxes are reduced, Floridians will pay more federal income taxes.

C. Government Sector Impact:

Local school districts may become less relevant and less influential as the state revenues funding education increase relative to local revenues. This measure may reduce state government spending on services and items other than education due to possible budget reductions.

The cap on the annual growth of assessments of non-homestead properties may reduce local government revenues and/or lead to an increase in ad valorem millage rates on all properties.

Under Art. XI, s. 5(d), Fla. Const., the Secretary of State must publish in newspapers throughout the state proposed constitutional amendments and notice of the date of the election at which it will be submitted to the electors. According to the Department of State, the average publishing costs for citizen initiative amendments is \$60,000. However, the cost to publish lengthy amendments will exceed that amount.

VI. Technical Deficiencies:

The Commission may wish to make the following technical changes:

- Delete the word “and” on line 213;
- Provide for the five percent cap on the growth of non-homestead assessments to take effect January 1, 2009;
- Provide for reduction in the maximum millage authorized for school purposes to coincide with the elimination of the required local effort;
- Make the date for the elimination of required local effort on lines 201-202 consistent with the date on line 222; and
- Move the word “not” on line 222 to after the word “shall.”

²⁰ Florida Department of Education, *2007-2008 Funding for Florida School Districts 2*, <http://www.fldoe.org/fefp/pdf/fefpdist.pdf>.

²¹ Kay Bell, *State sales taxes can still cut your IRS bill*, Bankrate.com, <http://www.bankrate.com/brm/itax/20041012b1.asp> (Jan. 14, 2008).

VII. Related Issues:

This measure contains statute-like detail and includes cross-references to specific Florida Statutes. For clarity and to prevent confusion over the effect of cross-references to statutes, the proposal could state that the Legislature may not require a school district to levy a property tax to become eligible for state funds.

The measure directs the Legislature to focus its revenue raising efforts on repealing exemptions that are “determined not to advance or serve a public purpose.” One could argue that nearly all exemptions serve some public purpose.

The measure provides that a bill creating a sales tax exemption must include a “legislative finding that the exemption advances or serves the public purpose of: encouraging economic development and competitiveness; supporting educational, governmental, literary, scientific, religious, or charitable initiatives or institutions; or securing tax fairness.” In contrast, subsection (c) of section 24 of Article I of the Florida Constitution requires the Legislature to “state with specificity the public necessity justifying [a public records] exemption.” In order to more closely follow the intent to justify a public purpose, bills creating a tax exemption should contain the boilerplate statement that the exemption “advances or serves the public purpose of: encouraging economic development and competitiveness; supporting educational, governmental, literary, scientific, religious, or charitable initiatives or institutions; or securing tax fairness.”