



## TAXATION AND BUDGET REFORM COMMISSION

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### Staff Analysis and Economic Impact Statement

Measure:	REFERENCE:	ACTION:
CS/CP 2		
Sponsor: Commissioners McKay, Rouson, and L. Miller	1. GPSC 2. FTC 3. TBRC	Fav/2 amendments Fav/CS Pre-meeting
Subject: Repeal of sales tax exemptions and taxation of services		
Date: March 11, 2008		

#### I. Summary:

Committee Substitute for Constitutional Proposal 2 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; and
- revenues resulting from economic growth attributable to lower property taxes.

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.

A law creating a new sales tax exemption must address only the single subject-matter of a single exemption and 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.<sup>1</sup>

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

***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.<sup>2</sup>

***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.<sup>3</sup>

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.<sup>4</sup>

***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 you purchase a product tax-exempt that you plan to sell at retail, but end up using it at your place of business, the "use" of the product is subject to tax. If you purchase materials that are "consumed" in a manufacturing process to create your end product, but are not part of the end product, those materials are subject to tax.<sup>5</sup>

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

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<sup>2</sup> Department of Revenue, Florida Sales and Use Tax, [http://dor.myflorida.com/dor/taxes/sales\\_tax.html](http://dor.myflorida.com/dor/taxes/sales_tax.html) (last visited Jan. 15, 2008).

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

### ***Sales Tax Exemptions***

The *2007 Florida Tax Handbook* lists 246 exemptions from the sales tax.<sup>7</sup> 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.<sup>8</sup>

### ***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.<sup>9</sup>

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 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."<sup>10</sup>

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<sup>7</sup> The Florida Senate, 2007 Florida Tax Handbook: Including Fiscal Impact of Potential Changes

<sup>8</sup> *Id.* at 118.

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

<sup>10</sup> *Id.*

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.<sup>11</sup>

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.

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

### ***NAICS Codes***

“The North American Industry Classification System (NAICS, pronounced Nakes) was developed as the standard for use by Federal statistical agencies in classifying business establishments for the collection, analysis, and publication of statistical data related to the business economy of the United States. NAICS was developed under the auspices of the Office of Management and Budget (OMB), and adopted in 1997 to replace the old Standard Industrial Classification (SIC) system. It was also developed in cooperation with the statistical agencies of Canada and Mexico to establish a 3-country standard that allows for a high level of comparability in business statistics among the three countries. NAICS is the first economic classification system to be constructed based on a single economic concept.”<sup>12</sup>

### **III. Effect of Proposed Changes:**

Committee Substitute for Constitutional Proposal 2 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; and
- revenues resulting from economic growth attributable to lower property taxes.

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<sup>11</sup> *Id.* at 13-14.

<sup>12</sup> U.S. Census Bureau, Ask Dr. NAICS, What Is NAICS and How Is It Used?, <http://www.census.gov/epcd/www/drnaics.htm#q1> (last visited Jan. 15, 2008).

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.

A law creating a new sales tax exemption must address only the single subject-matter of a single exemption and 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; 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” in the *Tax Handbook*. Viewed broadly, the categories of exempt exemptions may refer to the items described as excerpted from the *Tax Handbook* below.

<b>Line No.</b>	<b>Exemption</b>	<b>Revenue Impact (in \$ m)</b>	<b>Type</b>
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
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
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
		8,057.0	

The maximum amount of revenue that may be gained by the repeal of all non-structural sales tax exemptions is \$12.3403 billion.<sup>13</sup> The most that the Legislature will be able to recover from the non-exempt exemptions to offset the required local effort is slightly more than \$4 billion.

<sup>13</sup> The *Tax Handbook* states that some exemptions overlap. As a result the repeal of all exemptions would generate less than \$12.3403 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. The measure provides that the “legislature shall be preempted from requiring the levy of an ad valorem property tax as a required local funding effort [for] participation by school districts in the Florida Education Finance Program.” As a result, the measure may permit the Legislature to require a school district to levy a tax other than a property tax as a condition for eligibility to receive state funds.

***Creation of Exemptions***

This measure requires sales tax exemptions, including exemptions for sales tax on services, to be created by the Legislature in a bill containing the single subject-matter of a single exemption. The bill must also include a statement that the exemption advances or serves a public purpose.

***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.<sup>14</sup> Alternatively, if the Legislature is not precluded from amending or repealing the cross-referenced statutes, CS/CP 2 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 Effected CS/CP 2***

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

***Effective Date***

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.

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

Nothing in the State Constitution requires the Legislature to condition state funding to school districts on the levy of a property tax by the school district.

**B. Other Constitutional Issues:**

None.

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<sup>14</sup> 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”).

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

This measure will shift funding for a substantial portion of the public education system 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 likely will 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 millage rates on all properties.

**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 likely will 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 millage rates on all properties.

Subsection 5(d) of Article XI, Fla. Const., requires the Department of State to publish proposed constitutional amendments in newspapers throughout the state. The Department of State estimates that the average cost to publish constitutional amendments is \$60,000.

**VI. Technical Deficiencies:**

The word “for” should be inserted on line 203 after the word “effort.”

The ballot summary must be updated to conform to the text of the portions of the amendments adopted by the Finance and Taxation Committee.

The reference to exclusions on line 173 should be deleted as this measure no longer provides for the application of the sales tax to exclusions or services.

**VII. Related Issues:**

This measure contains a lot of statute-like detail and also includes cross-references to specific Florida Statutes. For clarity and to prevent confusion over the effect of cross-

references to statutes, the Commission may wish to amend this measure to discuss the principles embodied in the statutes. For example, the principle at issue in the provisions relating to required local effort, may be whether the Legislature may require a school district to levy a property tax (or any tax) to become eligible for state education funds. As such, CS/CP 2 could be amended to eliminate the discussion of required local effort and the Florida Education Finance Program. Instead, the measure could state that the Legislature may not require a school district to levy a property tax to become eligible for state funds.

For ease of compliance by the Legislature, the Commission may wish to more precisely identify the sales tax exemptions that may not be used to reduce the required local effort based on their names or statutory reference, rather than broad categories of exemptions. There are other measurement scales, such as the one used by the Federation of Tax Administrators, which could be considered.

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” and the “taxation of services whose exclusion from sales taxation is determined not to advance or serve a public purpose.” One could argue that nearly all exemptions serve some public purpose. Perhaps, the measure should be revised to direct the Legislature to focus on exemptions and services that fail to serve a public purpose *sufficient to justify an exemption*.

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.” Perhaps, the Commission may wish to revise the measure to more closely follow the statement requirements for the creation of a public records exemption. Otherwise, bills creating a tax exemption may 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.”