

Report to the Florida Legislature

**Legal, Administrative and
Revenue Implications
of**

**Chapter 86-166, Laws of Florida:
Repeal of Sales Tax Exemptions for
Services and Selected Transactions**



**Florida Department of Revenue
March, 1987**



STATE OF FLORIDA
DEPARTMENT OF REVENUE

TALLAHASSEE, FLORIDA 32301-8002

RANDY MILLER
EXECUTIVE DIRECTOR

March 2, 1987

Honorable John W. Vogt
President, Florida Senate
Suite 409, The Capitol
Tallahassee, Florida 32399

Honorable Jon Mills
Speaker, Florida House
of Representatives
420 Capitol
Tallahassee, Florida 32399

Gentlemen:

Herewith is presented our Report to the Legislature: Legal, Administrative and Revenue Implications of Chapter 86-166. This report is submitted pursuant to Section 1, line 1588A, 1986 General Appropriations Act, Chapter 86-167, Laws of Florida. It examines the legal and administrative considerations associated with the repealed sales tax exemptions and provides revenue estimates.

This report represents a significant effort by the Department and its consultants in dealing with the issues raised by Chapter 86-166. We stand ready to further assist as this issue evolves throughout the 1987 session.

Sincerely,

Randy Miller
Executive Director

RM/fam

Table of Contents

	<u>Page</u>	
Overview	0-1	(Tab 1)
Executive Summary	0-7	
<u>Chapter One - Legal Issues</u>		(Tab 2)
Overview of the Legal Study	L-3	
Department's Response to Questions Raised by Chapter 86-166	L-6	
Does Chapter 86-166 Levy A "New Tax"?	L-23	
Consultant's Report: Legal Study of Florida's Sales Tax on Services	L-28	(Tab 3)
Department of Revenue Adjustments to the Hellerstein Draft Statute	L-269	(Tab 4)
The Rulemaking Process and Initial Draft	L-321	(Tab 5)
<u>Chapter Two - Administrative Issues</u>		(Tab 6)
Administrative Activities and Costs	C-3	
PERT Chart for July 1, 1987 Start-Up	C-9	
Training for New Positions (Memo)	C-10	
<u>Chapter Three - First and Second Year Revenue Effects and Related Issues</u>		(Tab 7)
Methodology for Estimating and Projecting Sales Tax Revenues from Services in Florida	R-3	
Estimation of Aberrations in Initial Revenue Flows: Rationale and Technique	R-18	
Financial Institutions as Service Providers: The Brokerage of Pooled Savings for Investors	R-25	
Structure and Administrative Characteristics of A Value-Added Tax: A Solution to the Problems of Pyramiding and In-House Services	R-31	
Effects of State and Local Taxes on Business Location Decisions (Memo)	R-40	

	<u>Page</u>	
<u>Appendix I - Initial Documents</u>		(Tab 8)
Preliminary Department of Revenue Report	A-3	
Chapter 86-166, Laws of Florida	A-45	
<u>Appendix II - Service Taxation in Other States</u>		(Tab 9)
State of Washington Proposed Legislation	A-58	
Hawaii's General Excise Tax on Services	A-70	
New Mexico's Gross Receipts Tax on Services	A-75	
Iowa's Sales/Receipts Tax on Services	A-80	
South Dakota's Retail Sales and Services Tax	A-83	
<u>Appendix III - Recent Literature</u>		(Tab 10)
Hellerstein Article	A-88	
Jacobs Article	A-97	
Pierce and Peacock Article	A-109	
Vickers Article	A-137	
<u>Appendix IV - Coopers & Lybrand Pricing Study</u>		(Tab 11)
Contract and Instructions	A-143	
Consultant's Report	A-158	
<u>Appendix V - Non-Service Exemptions</u>		(Tab 12)
Master List: Other Non-Service Exemptions	A-309	
Fiscal Impact of Chapter 86-166: Taxation of Selected Non-Service Transactions	A-310	
Discussion of Methodology Underlying Each Non-Service Exemption Estimate	A-311	
<u>Appendix VI - Survey of Service Industries</u>		(Tab 13)
Contract and Instructions to Consultant	A-375	
Survey Questionnaires	A-384	

List of Tables

	Page
Table C-1: Administrative Costs 1986-87	C-6
Table C-2: Administrative Costs 1987-88	C-7
Table C-3: PERT Chart for July 1, 1986 Effective Date	C-9
Table R-1: Master List - Service Industries	R-9
Table R-2: Survey of Service Industries: General Data	R-15
Table R-3: Fiscal Impact of Chapter 86-166 (First and Second Year Revenue Effects)	R-17
Table R-4: Sixth Cent Sales Tax Collection Experience	R-20
Table R-5: Laundry and Dry Cleaning Establishments: Tax Collection History and Estimates	R-22
Table R-6: Sales Tax Exemption Collection Factors	R-24
Table R-7: Composite Statement of Income: Florida National and State Bank and Trust Companies	R-30
Table V-1: Master List: Other (Non-Service) Exemptions	A-309
Table V-2: Fiscal Impact: Taxation of Selected Non-Service Transactions	A-310

OVERVIEW

In broadening the state sales tax base in Chapter 86-166, Laws of Florida, the Legislature repealed numerous exemptions from the sales tax including a considerable number of services effective July 1, 1987 and, it levied a tax at the rate of 5% of the consideration for performing or providing any service, effective July 1, 1987.

Realizing the impact of this action was far reaching, the Legislature directed that two studies of its action be undertaken to set a foundation for the possibility of further legislative action during the 1987 legislative session, prior to the effective date of the repeal and levy July 1, 1987. One, to be undertaken by the Department of Revenue in consultation with the Consensus Revenue Estimating Conference (see Section 216.136(3), F.S.) was to study the first and second year revenue effects and the legal and administrative problems associated with the repeal and levy. (See Gen. Approp. Act. Ch, 86-167, Section 1, line 1588A). The other, to be undertaken by the Sales Tax Exemption Study Commission, was to study the public policy and fiscal impact of exemptions (see Section 9, Chapter 86-166, Laws of Florida). This report contains the results of the Department's study.

The Department's Study

In consultation with the Consensus Revenue Estimating Conference, the Department of Revenue engaged the expert services of consultants to undertake a legal study to identify and analyze the legal problems associated with the repeal and a pricing study to develop contributory data toward production of revenue estimates. Since Chapter 86-166 affects much of the service sector of the State's economy, including its interstate and international components, the decision was made to hire consultants for

their expertise. In the face of what was considered and has proven to be an overwhelming task, the consultants also helped to overcome staffing and time limitations within the Department.

The study process began with the Department gathering as much preliminary data as it could get, including information from states that presently tax services. This, together with a preliminary analysis of the Chapter 86-166 and the tax law of Florida and other states, produced an initial preliminary report in the fall of 1986 which was used to communicate what the Department understood at that time and what the consultants were faced with.

The first task was to find and engage a legal expert with outstanding credentials in the area of state and local taxation who was associated with a major law firm so as to provide organizational and manpower resources to undertake the legal study. The Department chose Professors Walter Hellerstein and Prentiss Willson with their law firm Morrison and Foerster, of San Francisco and Washington, D.C.

In negotiating the legal consulting contract, it was determined that the most useful product would be a report which not only identified and analyzed the legal problems associated with Chapter 86-166, but which also provided proposed solutions to them in model annotated statutory form in anticipation of the possibility of further legislation contemplated by Chapter 86-166.

In addition to a legal study, Chapter 86-167, line item 1588A, also required the Department to conduct a study of the first and second year revenue affects of the repeal of the sales tax exemptions, and the administrative consequences thereof.

Initial research indicated that extension of the sales tax to service transactions would add at least 100,000 new dealers to the Department's rolls. In addition to a significant increase in recurring general workload, such a program would specially require identification, registration and education of the new dealers, as well as education of existing dealers whose responsibilities would be broadened.

To determine and prioritize the efforts necessary to successfully implement the tax, and to estimate resource requirements, key departmental personnel in each phase of tax administration, processing and enforcement were consulted. The combined results of these efforts are presented in Chapter Two.

Crucial to the orderly initiation of a relatively new or broadened tax, is the ability to register and educate taxpayers in advance of the effective date of imposition. As a result, it was determined at the outset to delineate all resource requirements by the three months preceding the start-up date and the twelve months following.

In estimating the first and second year revenue efforts of the bill, two consultants were employed to complement the Department's internal efforts. Building upon research which led to the service industry estimates published in Florida Tax Sources: Fiscal Impact of Potential Changes 1986-1987, March 1986, the public accounting firm of Coopers and Lybrand was contracted to evaluate approximately sixty categories of service industries on a case study basis. MGT of America, Inc. was employed to mail and process a survey of approximately 20,000 service providers in Florida. The revenue estimates which appear in Chapter Three are a synthesis of the initial research, the two consultants' work products, and a substantial

amount of additional research by the Department's staff. It should be noted that this report does not attempt to evaluate on a qualitative or quantitative basis the general economic effects of taxing service transactions. The revenue estimates in Chapter Three contemplate no consequential adverse effects of such taxes on the level or composition of economic activity in general.

The Department's Report

This report is organized in four parts; a legal chapter, an administrative chapter, a revenue chapter, and several appendices. The appendices were organized to contain information and articles referenced in the three chapters.

Chapter One, the legal chapter contains six sections:

- (a) A more detailed overview of the legal chapter;
- (b) Numerous questions spawned by Chapter 86-166 and responses to them;
- (c) The question of whether or not Chapter 86-166 is a new tax and a response;
- (d) The Hellerstein report including his draft annotated statute;
- (e) The Department's adaption of the Hellerstein statute with an explanation and an index to the substantive modifications to the Hellerstein draft; and
- (f) The Department's 86-166 draft rules with an explanation of the rulemaking process.

Chapter Two consists primarily of tabular presentations of budget requirements and new positions necessary under the law. This chapter is essentially independent of other portions of the report. However, if by

court action, administrative determination or subsequent legislation the number of new dealers ultimately differs significantly from 100,000, estimates in Chapter Two would require revision.

Chapter Three contains a number of elements related to revenue estimates and economic issues of taxation. These include:

- (a) A more detail overview of the chapter;
- (b) Tables containing final revenue estimates for each service industry;
- (c) A discussion of the methodological approaches employed for service industries (Appendix IV contains the complete Coopers and Lybrand report; Appendix V contains a description of the estimation methodology for each repealed non-service exemption; and Appendix VI contains a copy of the thirteen questionnaires used in the survey phase of the study).
- (d) A discussion of factors causing aberrations in revenue flows during the initial months of new taxes;
- (e) A discussion of the degree to which banks and similar institutions are service providers;
- (f) A discussion of policy and administrative aspects of the value-added approach to transactions taxation (Part 5 of the Hellerstein report in Chapter 1 also discusses value-added taxes, in addition to gross receipts and payroll taxes); and
- (g) A discussion of the degree to which taxes affect business location decisions.

The report concludes with an appendices containing the Department's original report, several recent law review articles on Chapter 86-166, information on other states taxing services, the Coopers and Lybrand pricing study, detail on non-service repealed exemptions and survey forms. The appendix was designed to provide a convenient reference from the report with back-up data and points of view from other authors and jurisdictions.

EXECUTIVE SUMMARY

The following summarizes the conclusions of this study and report:

Legal Conclusions

The following are some broad legal conclusions reached as a result of the legal study and report:

1. The Department's study represents its present understanding of the numerous questions raised by Chapter 86-166.
2. The Department agrees with the conclusion of the Hellerstein report that Chapter 86-166 presents uncertainty but only as to a limited portion of Chapter 86-166.
3. The Department agrees with the conclusion of the Hellerstein report that further legislation will serve to minimize the uncertainty.
4. The Department believes that while a Court could hold the Chapter 86-166 tax to be a prohibited income tax, it is clearly distinguishable from one.
5. The Department believes that while certain provisions of Chapter 86-166 present delegation problems, they are limited and surmountable.
6. The Department believes that Chapter 86-166 is a broad extension of an existing tax for the most part historically dormant due to specific exemptions which have been repealed. In only a limited sense can Chapter 86-166 be characterized as a new tax.

7. The Department believes that should portions of Chapter 86-166 be stricken on constitutional grounds, many, if not most service industries and transactions should remain subject to the sales tax under provisions of the act which which present no significant constitutional questions.

Administrative Cost Conclusions

In the three months preceding the start-up of the tax, \$537,860 and 8 positions above the levels currently authorized for the Department will be necessary for taxpayer registration and notification.

For the twelve months concurrent with the start-up of the tax, the Department will require \$2,184,086 and 86 positions in excess of its 1987-88 Legislative Budget request. The above estimates do not include amounts requested in the Department's 1987-88 Legislative Budget request for computer and RDS hardware, processing costs, systems development and audit resources. However, the requested amounts are necessary for successful administration of Chapter 86-166.

The above estimates also presume that existing sales tax forms and processing procedures will suffice for the tax on services.

Revenue Estimate Conclusions

The following estimates conform with the present reading of Chapter 86-166, and are consistent with the amended legislation and regulations contained in Chapter One.

	<u>Services</u>	<u>Non-Service</u>	<u>Total</u>
<u>1987-88</u>			
General Revenue Fund Cash Receipts	\$2,032.1m	\$ 90.5m	\$2,122.7m
Total Cash Receipts	2,250.4	100.3	2,350.6
Annualized Receipts	3,131.3	134.4	3,265.7
<u>1988-89</u>			
General Revenue Fund Cash Receipts	\$3,062.5m	\$130.5m	\$3,193.0m
Total Cash Receipts	3,391.4	144.5	3,535.9
Annualized Receipts	3,394.6	144.5	3,539.1

These exemptions presume the dealer registration effort begins on or before April 15, 1987.