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Primer on Florida's Sales Tax on Services

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A PRIMER ON FLORIDA'S SALES TAX ON SERVICES

by Walter Hellerstein

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Introduction

Florida's recently enacted sales and use tax on services has spawned an extraordinary amount of controversy. Much of that controversy is partisan and ultimately will be resolved through the legal and political process. Part of the controversy, however, reflects confusion—confusion over what the law actually says and how it works. My purpose here is to try to clear up some of that confusion. With full acknowledgement that I have been (and will continue to be) associated with one side of the partisan controversy and with no pretense that I have provided a detailed roadmap to the tax, the following is offered as an introductory primer on Florida's sales tax on services.

Overview

During its 1987 session, the Florida Legislature enacted a tax on the sale and use of a broad range of services consumed in the state.[1] The fundamental design of the tax is simple: the sale or use of services whose benefit is enjoyed in the state is taxed; the sale or use of services whose benefit is enjoyed outside the state is exempt. Florida's sales and use tax on services is intended to tax consumption of services in Florida and nothing more.

Florida's recently enacted sales and use tax on services has spawned an extraordinary amount of controversy.

In its essential structure, Florida's sales and use taxation of services follows the traditional pattern of sales and use taxation of tangible personal property that long has been established in Florida and in other states. The sale of the service is taxable if it is sold within the state; the use of the service is taxable if it is sold outside the state but used within the state and if the sale or use of the service has not been subjected to taxation in another state. Under such a taxing regime, potential purchasers of services have no tax-induced incentive to purchase their services outside of Florida, for they will pay the same tax on services used in Florida regardless of where the services are purchased. Nor will purchasers of services outside of

[1]Fla. Laws Ch. 87-6, as amended by Committee Substitute for House Bill 1506. Chapter 87-6 of the Laws of Florida, which enacted a sales and use tax on services, was signed by the Governor on April 23, 1987. During the balance of the 1987 legislative session, the legislature considered various changes to Chapter 87-6, many of which were designed to correct perceived technical errors in the tax as originally enacted. The bill designed to correct these errors—a bill that was modified on a frequent basis as the session progressed—was popularly known as the "glitch bill." The "glitch bill" was enacted in the final hours of the 1987 legislative session on June 6, 1987 as Committee Substitute for House Bill 1506. Although the bill has not been signed into law by the Governor at this writing, this article has been written on the assumption that it will be signed into law in the near future. All references to Florida's sales and use tax on services therefore will be to the Florida statutes as they will appear once Chapter 87-6 as amended by Committee Substitute for House Bill 1506 has been codified. For background on the development of the statute, see Hellerstein, "Extending the Sales Tax to Services," *Tax Notes*, February 23, 1987, p. 823.

Florida for use in Florida be subjected to a risk of multiple taxation of such services not borne by purchasers of local services for use in Florida. Any purchaser of services outside the state who has lawfully paid a sales or use tax on services in another state receives a full credit against his Florida tax for such payment.[2]

[The] purpose [is] to tax only the sale or use of services whose benefit is enjoyed in Florida....

In several respects, however, Florida's sales and use tax on services is more narrowly circumscribed than the typical sales and use tax on tangible personal property. Consistent with its overriding purpose to tax only the sale or use of services whose benefit is enjoyed in Florida, the sales and use tax on services provides an exemption for the sale of services purchased within the state for use outside the state. The sale of tangible personal property under comparable circumstances generally is taxable. Moreover, the sale or use of services whose benefit is enjoyed in part of Florida and in part outside the state often is subject to apportionment. Apportionment generally is not provided for the tax on the sale or use of tangible personal property in Florida that may be enjoyed in part in other states. Furthermore, the tax contains provisions that relieve the purchaser of the service tax burden if he can demonstrate to the satisfaction of the Florida Department of Revenue that the benefit of the service is enjoyed outside Florida. No comparable "relief" provisions are available for the purchaser of tangible personal property.

The Operation of the Statute

The operative provisions of the sales and use tax on services systematically implement the overall taxing scheme described above. A tax is imposed on the retail sale of any service in the state.[3] The sale of the service is in the state if (1) the service is performed wholly in the state or if (2) the service is performed partly within and partly outside the state, but the greater proportion of the service is performed within the state based on costs of performance.[4]

If the sale of the service is outside the state (because the greater proportion of the service is performed outside the state based on costs of performance) and the service is used in the state, a tax is imposed on the use of the service in the state.[5] As noted above, this tracks the traditional structure of sales and use taxes on tangible personal property where the use tax applies to purchases outside the state for use within the state. Following that pattern, the use tax applies only if a sales or use tax on the sale or use of the service has not been lawfully paid to another state.[6]

The taxes on the sale or use of services in the state apply only to services that are consumed in the state. Even though a sale of a service is in the state (because the greater portion of the service is performed in the state based on costs of performance), the sale will not be subject to tax if the service is sold for use outside the state.[7] The use tax by definition applies only to "the use of any service *in this state*."[8] Florida's sales tax on services thus imposes no tax on the sale or use of services that are used or consumed outside the state regardless of where those services are sold.

The sales tax on services establishes a series of rules for determining whether (and, in some cases, the extent to which) a service is used or consumed in Florida and, consequently, whether (and, in some cases, the extent to which) it is taxable there. These rules are equally applicable to the sales tax—for purposes of determining whether the services sold in the state are "for use outside the state,"[9] and to the use tax—for purposes of determining whether the "use of the services is in the state."[10] The central principle governing both the application of the sales tax and the use tax is that services are used or consumed "where the benefit of the service is enjoyed."[11]

The sales and use tax on services provides two sets of rules for determining where the benefit of a service is enjoyed. The first set of rules applies to individual purchasers of services acting in a personal or nonbusiness capacity; the second set of rules applies to business purchasers of services.

The tax...[applies] only to services that are consumed in the state.

If the purchaser is an individual and the purchased service directly relates to real property, the benefit of the service is presumed to be enjoyed where the real property is located.[12] If the purchased service does not directly relate to real property, then the benefit of the service is presumed to be enjoyed where the purchaser receives tangible personal property representing the service.[13] If neither of the two preceding rules is applicable, an individual purchaser is presumed to enjoy the benefit of the service where the greater proportion of the service is performed based on costs of performance.[14] Notwithstanding the presumptions embraced by the three preced-

[2]Fla. Stat. section 212.06(7) provides in pertinent part:

> The provisions of this chapter do not apply in respect to the use or consumption of tangible personal property or services, or distribution or storage of tangible personal property or services for use or consumption in this state, upon which a like tax equal to or greater than the amount imposed by this chapter has been lawfully imposed and paid in another state.

[3]Fla. Stat. section 212.059(1)(a).
[4]Fla. Stat. section 212.059(1)(b).
[5]Fla. Stat. section 212.059(2).
[6]Fla. Stat. section 212.06(7).
[7]Fla. Stat. section 212.0592(1)(a).
[8]Fla. Stat. section 212.059(2) (emphasis supplied).
[9]Fla. Stat. section 212.0592(1)(a).
[10]Fla. Stat. section 212.059(2).
[11]Fla. Stat. sections 212.0592(1)(b) (sales tax), and 212.059(2) (use tax).
[12]Fla. Stat. section 212.0591(9)(a)1.
[13]Fla. Stat. section 212.0591(9)(a)2.
[14]Fla. Stat. section 212.0591(9)(a)3.

ing rules, if the individual purchaser can demonstrate to the satisfaction of the Department of Revenue that the benefit of a service was enjoyed outside of Florida, the service shall be deemed to be used or consumed outside of Florida.[15]

The rules regarding the place of enjoyment of services purchased by businesses are somewhat more detailed than the rules regarding the place of enjoyment of services purchased by individuals. As in the case of purchases by individuals, if the business purchases a service directly related to real property, the benefit of the service is presumed to be enjoyed where the real property is located.[16] If the business purchases a service directly related to tangible personal property, the benefit of the service is presumed to be enjoyed where the property has acquired a business situs, if the property has acquired such situs.[17] If a business purchases a service that is not directly related to either real property or tangible personal property with a business situs, but directly involves sales to a service purchaser's local market, the benefit of the service is presumed to be enjoyed where the purchaser's market exists.[18]

The rule of apportionment . . . applies to . . . services that are not situs-specific . . . .

If none of the three preceding rules for business purchasers is applicable (because the service does not directly relate to real or tangible personal property or to sales to a local market), and if the business purchaser is doing business within and without the state, the service is presumed to be enjoyed in Florida to the extent that the purchaser is doing business in the state.[19] For purposes of determining the extent of the purchaser's business in the state, the corporate income tax apportionment formulas are to be employed. Broadly speaking, the rule of apportionment of services applies to business purchases of services that are not situs-specific. For example, purchases of legal services relating to Federal income tax liability or accounting services relating to the preparation of an annual report generally would fall into this category. The business purchaser would pay a tax on the service equal to five percent of the charge for the service multiplied by the enterprise's Florida income tax apportionment percentage.

If none of the four preceding rules applies (because the service does not relate to real property, to tangible personal property with a business situs, or to services involving sales to a local market, and the purchaser is not a multistate business), the service is presumed to be enjoyed in the state where the purchaser is exclusively doing business.[20] Finally, as in the case of an individual purchaser, if a business purchaser can demonstrate to the satisfaction of the Department of Revenue that the benefit of the service was enjoyed outside the state even though it would have been deemed to have been enjoyed within Florida under one of the preceding five rules, the benefit of the service shall be deemed to be consumed outside of Florida.[21]

Collection of the Tax

When services are sold in Florida (i.e., when the greater proportion of the service is performed in the state based on costs of performance) and when the benefit of the services is enjoyed in the state, the tax on the sale of the services generally is collected by the seller of the services, who adds the tax to the consideration paid for the services.[22] When services are sold outside Florida for use within the state, the tax on the use of the services generally is remitted by the purchaser of the services, if the purchaser has nexus for tax purposes with Florida.[23] This rule assures that the burden of collecting taxes on services performed outside but consumed within the state is placed upon purchasers who enjoy the benefit of services within the state rather than upon sellers of services who perform the services outside the state.[24]

As a practical matter, then, the principal administrative distinction between the sales tax and the use tax on services imposed by Florida concerns which party bears the primary responsibility for collecting the tax. The tax on the sale of services sold and consumed in the state generally is collected by the seller of the services who, by definition, has performed the greater proportion of the services within the state. The tax on the use of services sold outside but used within the state is collected by the purchaser of the services.

There are two exceptions to the preceding generalizations regarding collection of Florida's sales and use tax on services. If the sale of a service is made in Florida to a multistate business with which Florida has nexus for tax purposes, and if the business seeks to avail itself of the exemption for sales of services sold in Florida for use outside the state, the business must present an exempt purchase permit to the seller of the service.[25] Upon the presentation of such a permit to the seller of the service, the seller is absolved of any responsibility for collecting sales tax that may be due on the service.[26] The multistate business must "self-accrue" any taxes that may be due on the service and remit them to the Department of Revenue.[27]

The second exemption to the generalization that the seller collects the sales tax on services and the purchaser remits the use tax on services concerns the use tax on the sale of a service outside the state that directly relates to real or tangible personal property in Florida (other than

[15]Fla. Stat. section 212.0591(9)(a)4.
[16]Fla. Stat. section 212.0591(9)(b)1.
[17]Fla. Stat. section 212.0591(9)(b)2.
[18]Fla. Stat. section 212.0591(9)(b)3.
[19]Fla. Stat. section 212.0591(9)(b)4.
[20]Fla. Stat. section 212.0591(9)(b)5.

[21]Fla. Stat. section 212.0591(9)(b)6.
[22]Fla. Stat. sections 212.059(3)(a), 212.06(2)(k), and 212.12. The same rule obtains with regard to taxes on sales of tangible personal property in the state.
[23]Fla. Stat. section 259.059(3)(b).
[24]The rule differs somewhat from the rule concerning collection of use taxes on tangible personal property which generally requires the out-of-state vendor to collect the tax if the state has jurisdiction over the out-of-state vendor. See *Scripto, Inc. v. Carson*, 105 So.2d 775 (Fla. 1958), *aff'd*, 362 U.S. 207 (1960).
[25]Fla. Stat. section 212.0593(1).
[26]Fla. Stat. section 212.0593(1).
[27]Fla. Stat. section 212.0593(1).

vehicles or vessels used in interstate or foreign commerce) or that is represented by tangible personal property forwarded to a person in Florida.[28] In such cases, if the seller has tax nexus with Florida, the seller rather than the purchaser of the service has the obligation to remit the use tax to the state.

A state may not impose a tax, or the obligation to collect a tax, upon one with whom the state lacks a sufficient nexus....

It is important to reiterate one aspect of the tax payment and collection obligations imposed by Florida's sales and use tax on services, because it has been the source of considerable misunderstanding in the press and elsewhere. The statute does not—and constitutionally could not—require an out-of-state purchaser or vendor with whom Florida has no nexus to collect the tax imposed by the statute. It is a constitutional truism that a state may not impose a tax, or the obligation to collect a tax, upon one with whom the state lacks a sufficient nexus to satisfy Due Process and Commerce Clause strictures. Although language to this effect did not appear in the original statute enacted by the Florida Legislature in mid-April, the "glitch bill"[29] amended the original statute to make it clear that a purchaser of services sold outside the state for use within the state is obligated to remit the use tax only "if the purchaser has nexus for tax purposes with the state."[30] The question whether a particular taxpayer has nexus with Florida for tax purposes will have to be determined on a case-by-case basis under prevailing constitutional standards, just as it has been for years with regard to nexus over out-of-state vendors of tangible personal property.[31] There is nothing on the face of the payment or collection obligations imposed by Florida's sales and use tax on services, however, that exceeds constitutional bounds.

Sale for Resale

The tax imposed on the sale or use of services in Florida, like the pre-existing tax on the sale or use of tangible personal property in the state, is limited to transactions involving *retail* sales.[32] Retails sales are sales for any purpose other than resale.[33] The Legislature prescribed specific guidelines for determining when the sale of a service is to be considered a sale for resale. These guidelines provide that a sale of a service is a sale for resale (and excluded from the scope of the sales and use tax on services) only if all five of the following conditions are met: (1) the purchaser of the service does not consume the service but rather acts as a broker in procuring the service for his customer or client; (2) the purchaser of the service buys the service pursuant to a written contract which identifies the client or customer for whom the purchaser is buying the service; (3) the purchaser of the service separately states the value of the service in his charge for the service on its resale; (4) the service will be taxed on its resale, unless exempt as a service sold in the state for use outside the state; and (5) the service is purchased pursuant to a resale permit by a dealer primarily engaged in the business of selling services.[34]

For example, automobile body work billed to an automobile mechanic by the body shop which repaired the owner's car would not be taxable to the mechanic if the mechanic resold the body work to the customer by separately stating such charges on his invoice. In this case, the mechanic acts as a broker and does not consume the service rendered by the provider of the body work. On the other hand, if a lawyer prepares a memorandum which he sends by courier to his client, the sale for resale exemption would not apply to the charge for courier services, whether or not the lawyer separately bills his client for such services. In this case, the lawyer pays the tax because he consumes the courier service as part of rendering his service to his client—the timely delivery of legal services.

The Legislature recognized that certain service industries required particularized treatment.

Other Exemptions

Beyond the exemptions or exclusions from the sales and use tax on services that are a function of its underlying structure (such as the exemption for services consumed outside the state and the exclusion of sales for resale), the Legislature provided for a variety of exemptions on public policy grounds. The Legislature exempted, among other things, occasional and isolated services by those not engaged in business (e.g., neighborhood babysitters),[35] agricultural services,[36] educational services,[37] governmental services,[38] health services,[39] local and suburban passenger transportation services,[40] sanitary services,[41] social services,[42] and religious services.[43]

Particularized Treatment of Special Industries

In imposing a tax on the sale and use of a broad range of services, the Legislature recognized that certain service

[28]Fla. Stat. section 212.059(3)(b).
[29]See note 1 *supra*.
[30]Fla. Stat. section 212.059(3)(b).
[31]See *Scripto, Inc. v. Carson*, note 24 *supra*.
[32]Fla. Stat. sections 212.059(1)(a) (imposing tax on the "retail" sale of services); 212.059(2) (imposing tax on the use of services when the sale of services is "at retail" outside the state).
[33]Fla. Stat. section 212.02(19).
[34]Fla. Stat. section 212.02(19).
[35]Fla. Stat. section 212.0592(3).
[36]Fla. Stat. section 212.0592(6).
[37]Fla. Stat. section 212.0592(9).
[38]Fla. Stat. section 212.0592(10).
[39]Fla. Stat. section 212.0592(12).
[40]Fla. Stat. section 212.0592(20).
[41]Fla. Stat. section 212.0592(22).
[42]Fla. Stat. section 212.0592(24).
[43]Fla. Stat. section 212.0592(31).

industries required particularized treatment. Advertising services furnished by the media were a case in point. Proceeding under the same general principle that underlies the taxation of the sale or use of other services—that the sale or use of services should be taxed where the benefit of the service is enjoyed—the Legislature determined that the most appropriate measure of enjoyment of the benefit of advertising services furnished by the media is the market coverage of the media. The Legislature therefore provided that the sales price of the sale of advertising services or the cost price of the use of advertising services furnished by the media should be apportioned to the state based on the proportion of the Florida market coverage of the service provider to the total market coverage of the provider.[44]

If...advertising is sold in the state..., the sales tax...is collected...by the advertising media....

For example, if a business paid a nationally-circulated magazine with 10 percent of its circulation in Florida $100,000 to run its advertisement in the magazine, the business would be obligated to remit a tax of $500 to Florida ([$100,000 service tax base] x [10% Florida apportionment percentage] x [5% tax rate]). As in the case of other services that are sold to business purchasers outside the state (based on cost of performance) and used within the state, it is the purchaser of the service, not the seller, who is obligated to remit the tax to the state.[45] And as in the case of other services, no obligation to remit the use tax is imposed if the purchaser of the service (the advertiser) lacks nexus with Florida for tax purposes.[46] Thus, if a New York restaurant sporadically advertises in the national edition of *The New York Times*, the restaurant would have no obligation to remit the Florida service tax. Nor would *The New York Times* have any obligation to collect the tax because the sale of the advertising, based on *The New York Times'* cost of performance, presumably would be deemed to occur outside the state. If the advertising is sold in the state (i.e., if the greater proportion of the advertising service is performed in the state based on cost of performance), the sales tax on the advertising service is collected and remitted by the advertising media provider.[47]

The Legislature also provided specialized treatment for the transportation industry,[48] and the construction industry.[49]

Savings Provisions

The Legislature recognized that the extension of Florida's sales tax to services could create situations, at least in application, that would raise Federal constitutional issues. Therefore, in addition to the "relief" and tax nexus provisions described above,[50] the Legislature therefore enacted a broader savings provision designed to assure that the sales and use tax on services be construed to comply with constitutional restraints.

> If the sales price of the sale of a service or if the cost price of the use of a service cannot be included within the measure of the tax imposed by this part under the Constitution or laws of the United States, there shall be included in the measure of the tax imposed by this part on the sale of services that proportion of the sale price, or on the use of services that proportion of the cost price, that may lawfully be included under the laws and Constitution of the United States.[51]

Hence imaginary horribles that may be conjured up under an extreme application of Florida's sales tax on services to hypothetical fact situations should not arise if the Department of Revenue implements the statutes within its intended constitutional limits.

Conclusion

The preceding description of Florida's sales and use tax on services is skeletal at best. More detailed descriptions soon will be forthcoming from my pen and, no doubt, from the pens of others. My immediate and narrow purpose here is to provide interested observers with a brief and, I hope, comprehensible summary of Florida's sales and use tax on services with the aim of facilitating reasoned discussion of Florida's action.

[44]Fla. Stat. section 212.0595(4)(a).
[45]Fla. Stat. section 212.0595(6).
[46]Fla. Stat. section 212.0595(6).
[47]Fla. Stat. section 212.0595(5).
[48]Fla. Stat. section 212.059(5).
[49]Fla. Stat. section 212.0594.
[50]See text at notes 15, 21, 23, 30, and 46, *supra*.
[51]Fla. Stat. section 212.0591(2).