

BRIEFINGS



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The FAIR Amendments: Latest Attempt to Sunset Nearly All Sales Tax Exemptions and Tax Services Is Very Dangerous and Ill-Advised

Three proposed amendments to the Florida Constitution which could go before the voters in November 2006 would turn the tables on taxpayers, fundamentally changing the way taxes can be raised and creating opportunities for dangerous unintended consequences.

In 2004, a similar proposed constitutional amendment that would have sunset most sales tax exemptions and started to tax services unless the Legislature enacted new exemptions for each one was removed from the ballot by the Florida Supreme Court, in large part, for violating the single subject requirement and likely misleading voters.

The sponsors of that amendment—Floridians Against Inequities in Rates (FAIR)—are trying again. This time the one amendment is broken up into three separate amendments in an attempt to pass court scrutiny of the single subject requirement.

The three amendments are:

Sales Tax Exemptions - This amendment would require the Legislature to review all sales tax exemptions except those currently provided for food, prescription drugs, health services, and residential rent, electricity and heating fuel by July 1, 2008 and every ten years thereafter. Unless the exemptions are re-enacted by that date, they will all be repealed.

Taxing Services – All services, except for employee salaries and benefits, will also be reviewed and if not exempted, will be automatically taxed in 2009. A vast majority of services are not currently subject to the state sales tax.

Requirements for passing new exemptions - This would require that each law granting an exemption to the sales tax shall contain a legislative determination that such exemption advances or serves a public purpose and shall contain the single subject of a single exemption.

Florida TaxWatch stood in opposition to past attempts to automatically impose the tax on hundreds of exemptions and services not taxed and is doing so again with these new proposed amendments.

“Improving taxpayer value, citizen understanding and government accountability.”

A review of exemptions is healthy, but a system that schedules billions of dollars of exemptions to be automatically repealed is dangerous for the state's economy and UN-FAIR to taxpayers. Add to this the automatic taxation of services and this is unquestionably an economic development disaster because it sends the message that our basic tax system is subject to a radical, dramatic change and uncertainty for business investment, the formation of capital and good paying jobs in Florida. The fact that the process happens anew every ten years only perpetuates and increases the uncertainty.

There is a right way to review exemptions and sunseting almost all of them is not it. The right way to do this is through the Legislature, not through the Constitution. We strongly urge the Governor and Legislature to undertake a responsible, fair and disciplined review, not an automatic sunset of our sales tax system. Florida TaxWatch research provided a very disciplined, thorough, and constructive method of review along with careful public policy, economic, and fiscal analysis in its *Joint Report of the Florida TaxWatch Cost Savings Task Force And The Center for a Competitive Florida Task Force on Tax System Modernization*, March 2003.

Only the Legislature can raise taxes, and it should only do it by voting affirmatively to do so. Under these amendments, the tax exemptions would be allowed to expire automatically, without a required affirmative decision by the Legislature. Similarly, services, which are currently not taxed, would automatically begin to be taxed if the Legislature does not enact a new exemption for each one of them. The Legislature could raise hundreds of millions of dollars of sales taxes, even billions, by simply doing nothing, due to the automatic sunset provision. This would be a fundamental change of the rule of law. Consideration of a tax increase must be conducted with the necessary checks and balances, which require affirmative committee review and accountable votes by each chamber to raise taxes.

The three amendments obtained the required signatures to be reviewed by the Supreme Court. It would appear that the amendments have at least a better chance than last year's to withstand the review. If that happens, and they each get the required 611,009 signatures, they will go before the voters in November 2006.

The Three FAIR Amendments

Initiative requiring legislative determination that sales tax exemptions serve a public purpose

Ballot Summary:

The legislature shall periodically review all sales tax exemptions except those currently provided for: food; prescription drugs; health services; and residential rent, electricity and heating fuel. After such review, the legislature shall reenact and continue only those exemptions that advance or serve a legislatively determined public purpose. Sales tax exemptions not reenacted and continued by the legislature shall be eliminated.

Extending existing sales tax to non-taxed services where exclusion fails to serve public purpose

Ballot Summary:

Except for the payment of employee salaries and benefits, all non-taxed services provided for compensation shall be reviewed by the Legislature to determine whether the exclusion of each service from taxation serves a public purpose. Upon completion of such review, services currently not taxed and which are not exempted from taxation by the Legislature shall be subject to the sales tax on January 1, 2009.

Initiative directing manner by which sales tax exemptions are granted by the legislature

Ballot Summary:

Each law granting an exemption to the sales tax shall contain a legislative determination that such exemption advances or serves a public purpose and shall contain the single subject of a single exemption.

Note: Full text of amendments is in the appendix of this report.

Automatic “Sunsetting Exemptions” Without an Affirmative Vote is a Bad Idea

The major problem with the amendments is the automatic sunseting of nearly all exemptions without an affirmative vote of the Legislature. This means it would eliminate all sales tax exemptions that are under review, unless the Legislature votes to reenact any of them. Similarly, all services would become taxable unless the Legislature votes to specifically exempt them.

Ever since Florida’s service tax debacle in 1987, Florida TaxWatch has been warning of the problems with sunseting exemptions, especially in such a wholesale fashion.

It turns the process of raising taxes around, putting taxpayers in a precarious situation. Instead of the Legislature needing to state its case for tax hikes, this could result in a tax increase of billions of dollars, even if the Legislature does nothing. Taxes should never be raised without an affirmative and accountable vote of the Legislature.

As we have seen in recent legislative history--and a variety of special sessions--it can be very difficult to get the Legislature to come to an agreement about some of the most innocuous and simple issues. If the Legislature were to determine that the majority of sales tax exemptions (and exclusions of services) were worthwhile, hundreds of individual bills would have to be filed, debated and approved by both chambers. If any bill does not survive this often-arduous legislative journey, that good or service will begin to be taxed, despite the legislative determination that the exemption serves a public purpose. This is an unacceptable situation when even one legislator in a position of power can effectively kill a bill. Requiring an affirmative vote of the Legislature to avoid a tax increase sets a very bad precedent.

The amendment also removes the Governor’s normal and important role in this process. Not only could it create non-voted tax increases, but also a veto by the Governor would not be possible either.

The proper course would be for the Legislature to take a careful look at each exemption and only after it is sure that the exemption is not justified, specifically repeal that exemption and statutorily address how that item should be taxed. A wholesale sunseting of exemptions, without the specificity of exactly what should be taxed and how it should be taxed, will surely present far more serious problems than solutions.

Look back at what happened in 1987 with the ill-fated services tax. The taxation of services is a very complex issue as evidenced by the voluminous legislation that was passed and the large number of rules promulgated by the Florida Department of Revenue to implement the law. It resulted in a tax that was not only unpopular, but also extraordinarily complicated and hard to administer. Taxing services raises difficult nexus issues and can result in pyramiding where essentially the same service is taxed multiple times.

Most Exemptions Are Not “Loopholes” and Serve a Sound Public Purpose

One thing that must be remembered is that the contention that there are billions of dollars of sales tax “loopholes” and unjustified exemptions is just not true. Of the nearly \$29 billion often cited as the value of exemptions, \$19.9 billion are services, which are not exemptions at all but are rather not considered part of a sales and use tax. There is almost no sales taxation of services by other states and, remember, Florida tried it once before and it lasted seven months.

Almost two-thirds of the remaining exemptions are made up of six basic necessities of life: groceries, residential rents, residential power and heating fuel, drugs and medical supplies, hospital rooms and meals, and water.

There are also numerous exemptions that are needed to maintain the nature and structure of the sales and use tax as a tax on the final retail purchase of an item. These include exemptions to avoid pyramiding and duplicative taxation, such as materials used for packaging. Their cost is included in the price of the item being packaged and sold and is subject to tax at that time. Another example is separately billed utility charges to a tenant on which the landlord has already paid sales tax. Without that treatment, the tax would be collected twice. Other exemptions guard against the imposition of tax on tax.

Repealing some exemptions would also be in violation of federal or other controlling law. These include exemptions for Internet access fees, the taxation of which is prohibited by federal law. The credit allowed for sales tax paid in other states is required by the Commerce Clause of the United States Constitution. There is also an exemption for sales to governments, which are constitutionally immune from tax.

Economic development exemptions also exist that help Florida businesses and employees compete with those in other states and nations. These exemptions can more than pay for themselves in the long run and repeal would be counterproductive. Economists believe it is critical to employ a tax system that both encourages sustained and healthy economic growth and generates revenue from economic growth. In other words, Florida’s tax structure should encourage productivity—not tax it—while generating revenue from consumption.

In fact, there is a need for additional economic development exemptions to be created, particularly on inputs to manufacturing such as research and development and machinery and equipment. These exemptions would allow Florida to keep pace with other competitor states that offer similar exemptions.

Tax expert David Brunori, writing in the June 2004 edition of *Governing Magazine*, was critical of a proposal in Virginia to eliminate sales tax exemptions for many businesses. He writes:

But sales taxes are not supposed to be imposed on business purchases. When a business pays sales tax, the amount paid becomes part of its cost of goods sold. That cost is passed down the line until it falls on the consumer. The tax is hidden, and that violates all the principles of transparency — citizens do not know they are paying the tax, which is disguised as higher prices.

He goes on to say that if you are reforming a tax system today, you should be trying to expand the sales tax exemptions for business purchases, not eliminate them.

The point is, not all exemptions are bad. In fact, close examination shows that most are there for good public policy reasons.

In 2002 and 2003, Florida TaxWatch established a Task Force on Tax System Modernization. Part of that effort was a close look at sales tax exemptions. The Task Force contracted with Florida State University to use the most sophisticated econometric modeling available to examine the impact of removing various exemptions and imposing the sales and use tax on various service sectors. Florida TaxWatch and Florida State University researchers found that applying the sales tax to services was a questionable economic move and that taxing certain sectors would result in significant losses in jobs, gross state product and personal income.

The Task Force created three categories of exemptions that should be retained: life's necessities, structural (retaining the nature of the sales tax as a tax on final purchase), and economic development. Outside of these categories, the Task Force found that there were over 100 exemptions and exclusions worth over \$1 billion that could be considered for repeal. These should be carefully reviewed and eliminated only by an affirmative vote of the Legislature.

“Single Subject/Single Exemption” Amendment May Be A Good Idea, But Coupled With Other FAIR Amendments Would Create A Problem

The third proposed amendment, on it's own, is actually a good idea. But if one or both of the other amendments were to pass, it would make re-enacting worthy exemptions even more difficult. The amendment would require that each law granting an exemption to the sales tax contain the single subject of a single exemption and contain a legislative determination that such exemption advances or serves a public purpose. Of course, if the Legislature passes a new exemption, we rightly expect that a determination that it serves a public purpose be made.

If the Legislature were going through a comprehensive review of exemptions and facing a deadline to enact them, this amendment would create a logistical burden that would be difficult to overcome. With hundreds of separate bills needed to enact exemptions, it is easy to imagine some falling through the cracks.

Potential Fiscal Impact of Amendments

Earlier this month, the Financial Impact Estimating Conference (FIEC) met to adopt financial impact statements on the FAIR amendments. These are required to accompany any proposed constitutional amendment that is placed on the ballot by initiative petition.

The adopted impact statements for both the sales tax exemptions and services tax amendments, basically say that while the potential revenue is substantial, the actual impact is indeterminate because it depends on the actions of future legislators. These statements, which must be included in the ballot, do not mention any dollar estimates.

The financial information statement summaries—which must be made available at the polling places—state that the potential value of the services subject to review may exceed \$19 billion and that the value of the sales tax exemptions subject to review may exceed \$8 billion. This results in a total estimated potential tax increase of close to \$28 billion.

A coalition of business groups opposed to the amendments provided a memo to the FIEC that claims the total potential impact is \$81 billion. The group is using the same data the FIEC uses but it submits that three additional items be included, which are: items purchased for resale; intangible personal property; and agricultural products purchased for processing or resale. These total almost \$52 billion. These items are generally not considered exemptions because repeal of them would “alter the character of the tax.”

It is probably correct to exclude these items because their statute citation is not an exemption but a clarification of what “retail sale” and “tangible personal property” mean.

It is interesting to note that a similar item—property imported or produced for export (\$4.4 billion)—was added to the FIEC’s list of exemptions subject to review in its adopted statement after being excluded from the draft statement. Although this is generally not considered an exemption, the statutory language pertaining to this is written in a way that could be construed as an exemption.

This highlights the fact that Florida’s tax code is a complicated one and what the Legislature, or perhaps the courts, deems is covered under the amendments is not cut and dried.

It should also be noted that these estimates are only rough approximations, as acknowledged in the *Florida Tax Handbook*. This document is produced annually by staff of the Legislature and the Florida Department of Revenue.

Other interesting notes about the estimated financial impact:

- Although the 2004 FAIR amendment specified it covered the sales *and use* tax, the new amendment only mention the sales tax. The FIEC’s estimates include exemptions from the use tax although it acknowledges that they may not be covered in the review. This raises another issue. If repealed exemptions and newly-taxed services are only subject to the sales tax, this discriminates against in-state sellers in favor of out-of-state sellers.

This proposal then would clearly put Florida's employers and 1.3 million retail employees at a clear competitive disadvantage. This appears to be one of the harmful unintended consequences of these initiatives.

- The estimate only includes (with one minor exception) exemptions contained in Chapter 212, *Florida Statutes*, which is the sales tax code. Since the amendment does not specify the chapter, exemptions from other taxes may be covered by the amendment if they are considered to be "sales taxes." An example would be the Communications Services Tax, which is imposed on the retail sale of communications. There are over \$500 million worth of exemptions from this tax that may be covered under the amendment.
- The estimates for taxing services assume that they would be implemented in the same manner as in the 1987 Services Tax, although the Legislature would not have to follow that model.
- Although the amendment dealing with sales tax exemptions includes health services in its list of exemptions not subject to review, it must be remembered that health services are not exempted from the sales tax. Like other services, they are not subject to sales taxation. The services tax amendment does not mention health services, so it would appear that the taxation of health services is subject to review and (potential) automatic sunset, and thus, taxation.

The financial impact statements, financial information statements and other information can be found on the Internet at:

<http://edr.state.fl.us/conferences/constitutionalimpact/2005/citizensinitiative.htm>.

Florida's Tax Structure Has Served the State and Floridians Well

Proponents of FAIR have tried to perpetuate the myth that Florida's tax structure is too volatile and the sales tax is too vulnerable to downturns in the economy. When the discussion about wholesale review of exemptions got serious in the 2002 Legislature, this was often raised as the reason to broaden the sales tax base. In reality, in terms of stability, Florida's tax structure does very well. During the last recession, Florida's general revenue collections continued to rise, a feat that 31 states cannot claim. Without raising taxes, Florida's collections rose 4.3% from 2001 to 2003. Only eight states fared better, and Florida was the only major state that did not have a decrease in revenue. Again, 31 states saw their collections drop, including 3.2% in Texas, 10.1% in New York, and 15.3% in California.

In recent years, despite no significant tax increases and even some tax cuts, general revenue collections (including the sales tax) have continued to grow significantly.

Sales Tax Exemption Review and Automatic Taxation Do Not Belong in the Constitution

Moreover, this issue does not belong in the Florida Constitution. Florida TaxWatch has a long history of opposing attempts to legislate statutory matters by improperly using the Constitution.

The Constitution should be a fundamental document that contains the root guidelines of government. It should not be used to address statutory issues that the Legislature will not take on. The Florida Constitution does establish taxation as a uniquely legislative function and the Florida Supreme Court has observed:

The constitution is the framework of the government containing the general principles upon which the government must function. It is not designed to provide detailed instructions for the method of its implementation. This must of necessity be left up to the legislature.

Johns v. May, 402 So. 2d 1166 (Fla. 1981).

Instead, the Constitution in Florida is being reduced to the status of statutory code.

Opposition Briefs Assert Amendments Are Unconstitutional

The FAIR amendments are now before the Supreme Court for review. Two briefs filed by a coalition of business, professional, and trade organizations in opposition to the amendments assert that the sales tax exemption initiative and the services tax initiative are invalid because they still violate the single-subject requirement and the ballot summaries are misleading and do not adequately explain to the voters the decision before them.

Some of the issues raised include:

- The exemption repeal amendment gives the false impression that health services are protected from taxation;
- Both amendments fail to disclose that the sales tax would be imposed but not the use tax;
- They fail to disclose that tax increases would arise from legislative inaction;
- They fail to disclose the significant change in the Governor's role in law-making;
- They force the voter who wants to end a certain exemption to acquiesce in ending others;

- They alter the functions of the branches of government; and
- The services tax amendment performs the legislative function of imposing a new tax.

If Amendments Make it to the Ballot, Two Of Them May Require a Supermajority Vote to Pass

Article XI, Section 7 of the *Florida Constitution* states “no new State tax or fee shall be imposed on or after November 8, 1994 by any amendment to this constitution unless the proposed amendment is approved by not fewer than two-thirds of the voters voting in the election in which such proposed amendment is considered.” We believe by their affirmative vote, voters would be expanding the base of the sales tax and imposing a "new" tax. Constitutionally imposing a plethora of additional taxes by removing exemptions that are not re-authorized should then trigger the supermajority requirement. It is clearer that the services tax amendment does create a new tax. In fact, when the Supreme Court struck down the last FAIR attempt in 2004, it said the amendment mandates "the creation of a sales tax on services that currently does not exist." (880 So.2d 630, 634-635 (Fla. 2004)).

Therefore, if the FAIR amendments pass court scrutiny and make it to the ballot, while the applicability of the 2/3 vote provision has not been tested, we believe the directive set forth in the two amendments dealing with taxing services and sunseting exemptions creates new taxes which should require the supermajority vote to be enacted.

Conclusion

The FAIR Amendment must still obtain the required number of signatures and withstand Supreme Court scrutiny before it makes it to the ballot. A thorough review of sales tax exemptions and exclusions is justified, but it must be done without constitutionally sunseting all exemptions and without making it difficult to avoid raising taxes. Exemptions should be repealed and new taxes enacted only by a majority vote of the full Legislature.

The process must would allow for sufficient review and ensure that an exemption is repealed only after the Legislature has determined that it is the right thing to do. The Legislature must carefully consider the long-term economic impact of all exemptions before it makes any decisions. More importantly, these proposed amendments place taxpayers in an unfair and precarious position and remove the essential constitutional checks and balances of taxation and lawmaking. These constitutional checks and balances constitute the bulwark of our freedoms and civil liberties which we as Americans must hold sacred.

Unfortunately, the FAIR amendments do not provide that most important safeguard and a barrage of unintended consequences could be the result.

Voters are facing an attempted shortcut of due process that puts taxpayers at a clear and overwhelming disadvantage.

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About Florida TaxWatch

Florida TaxWatch is a private, non-profit, non-partisan research institute that over its 25 year history has become widely recognized as the watchdog of citizens' hard-earned tax dollars. Its mission is to provide the citizens of Florida and public officials with high quality, independent research and education on government revenues, expenditures, taxation, public policies and programs and to increase the productivity and accountability of Florida Government.

Florida TaxWatch's research recommends productivity enhancements and explains the statewide impact of economic and tax and spend policies and practices on citizens and businesses. Florida TaxWatch has worked diligently and effectively to help state government shape responsible fiscal and public policy that adds value and benefit to taxpayers.

This diligence has yielded impressive results: since 1979, policy makers and government employees have implemented three-fourths of Florida TaxWatch's cost-saving recommendations, saving the taxpayers of Florida more than \$6.2 billion--approximately \$1,067 in added value for every Florida family.

Florida TaxWatch has a historical understanding of state government, public policy issues, and the battles fought in the past necessary to structure effective solutions for today and the future. It is the only statewide organization devoted entirely to Florida taxing and spending issues. Its research and recommendations are reported on regularly by the statewide news media.

Supported by voluntary, tax-deductible memberships and grants, Florida TaxWatch is open to any organization or individual interested in helping to make Florida competitive, healthy and economically prosperous by supporting a credible research effort that promotes constructive taxpayer improvements. Members, through their loyal support, help Florida TaxWatch to bring about a more effective, responsive government that is accountable to the citizens it serves.

Florida TaxWatch is supported by all types of taxpayers -- homeowners, small businesses, large corporations, philanthropic foundations, professionals, associations, labor organizations, retirees--simply stated, the taxpayers of Florida. The officers, Board of Trustees and members of Florida TaxWatch are respected leaders and citizens from across Florida, committed to improving the health and prosperity of Florida.

With your help, Florida TaxWatch will continue its diligence to make certain your tax investments are fair and beneficial to you, the taxpaying customer, who supports Florida's government. Florida TaxWatch is ever present to ensure that taxes are equitable, not excessive, that their public benefits and costs are weighed, and that government agencies are more responsive and productive in the use of your hard-earned tax dollars.

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