Florida TaxWatch
BRIEFING
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Business Rent Tax: Now is the Time to Begin Eliminating a Clear Competitive Disadvantage for Florida Businesses

It would be difficult to find a more clear and widespread competitive disadvantage faced by many Florida businesses than the Business Rent Tax (BRT). Florida subjects commercial lease and license payments to the state and local sales tax and it is the only state in the nation that does so. This creates a government mandated increase of up to 8.0 percent[1] in occupancy costs for all business that rent, a cost they would not incur in any other state (see Appendix for background and history of Florida's sales tax and the BRT). Florida businesses pay more than $1.7 billion a year as a result of this tax.

Additionally, these rents are subject to the applicable local option sales tax, which can be as high as 2.0 percent. Local sales taxes can only apply to the first $5,000 of a sale of tangible property, but this cap does not apply to rents. The full amount of rent is taxable. Local taxes add another estimated $230 million.[2]

If required by the lease, property taxes, as well as payments for services such as utilities, parking, and janitorial services may also be part of the taxable rent.

Florida TaxWatch released a study[3] on the BRT in 2015 that analyzed the potential benefits of reducing/eliminating the tax. This report is an update of that study. In addition to examining who pays the tax, the tax burden, and the potential tax savings, this report assesses the impact of the tax on the competitiveness of Florida businesses and the perception of Florida's business climate. In addition, the myriad of different legislation addressing the BRT for consideration by the 2017 Florida Legislature is examined.

Over the last several years, Governor Rick Scott and the Florida Legislature have shown a commitment to both reducing taxes and improving the state's business climate. A reduction in the BRT has been considered, and despite broad support, it has failed to happen, largely due to concerns over the fiscal impact of a significant reduction and competition for other tax cuts and spending priorities. In 2017, the debate is on again.

FLORIDA'S BUSINESS RENT TAX IS UNIQUE

Florida is the only state to impose a standard, statewide sales tax on commercial real estate leases. Forty-five states only apply the sales tax to tangible personal property or do not have a sales tax, but there are some instances of limited taxation of commercial rents.[4]

New York (City) – There is a sales tax on commercial leases on some properties in a limited area of Manhattan. It only applies to businesses that pay at least

1 Liberty County assesses an 8 percent tax, every other county is less than 8 percent. Statewide, the population-weighted average local sales tax rate (calculated by Florida TaxWatch) is 0.8 percent in 2017.

2 Estimated by Florida TaxWatch using the population-weighted average local sales tax rate of 0.8 percent.

3 Florida TaxWatch, Reducing the Business Rent Tax: Providing Broad-Based Tax Relief to Florida Businesses, October 2015.

4 Florida Office of Program Policy Analysis and Government Accountability, "OPPAGA Review of Sales Tax on the Rental of Real Property", November 24, 2014.

$250,000 in annual rent. The tax is rate is 6 percent, but a 35 percent rent reduction results in an effective tax rate of 3.9 percent.

Arizona – There is no state tax on rents, but in limited instances, municipalities may impose a transaction privilege tax on commercial real estate leases. Five cities impose the tax, at rates ranging from 0.5 percent to 1.65 percent. There is also a broad exemption for leases between affiliated companies.

New Mexico – The state has a gross receipts tax of 5.125 percent. Commercial rents are included in gross receipts but a deduction for those leases is allowed, effectively eliminating the tax.

Hawaii – The state's 4.0 percent excise tax on gross income (4.5 percent on Oahu) applies to commercial rent income.

WHO PAYS THE BUSINESS RENT TAX?

Because the sales tax on business rents is remitted by those who collect the tax (landlords) there is little detail on who actually pays the tax (tenants). It is estimated that as many as 153,000 sales tax accounts remitted the BRT in 2015,[5] but it is not known how many businesses pay the tax. There are two million businesses registered with the state, plus sole proprietorships.[6] A large and increasing percentage of those businesses rent real property. This is supported by the assertion that "leasing has become the dominant way in which most commercial space is occupied and paid for by the space users in the United States, at least for the larger and more valuable properties..."[7]

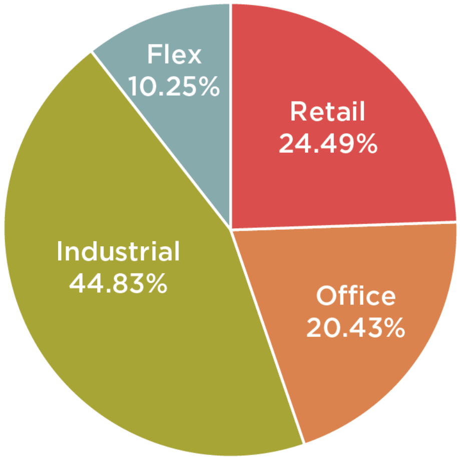
5 Revenue Estimating Conference, Impact Analysis of SB 484, March 2017.

6 Florida Department of State, Division of Corporations, sunbiz.org, Yearly Statistics, updated 1/23/2017.

7 Florida Legislature, Office of Economic and Demographic Research, "Economic Impact: Sales Tax on the Rental of Real Property," November 15, 2014. Quote attributed to Ambrose, B.W., & Lusht, K., "Overview of the commercial real estate industry," National Association of Real Estate Investment Trusts, 2008. 8 International Council of Shopping Centers, 2015 ICSC Florida Retail Report.

It is estimated that the largest category of commercial lease space is industrial, followed by retail and office space (See Chart 1).

Chart 1 – Estimated Inventory Mix of Florida Commercial Leases



Source: Florida Legislature, Office of Economic and Demographic Research

Florida's commercial lease rates vary considerably, both among types of properties and areas of the state. The average statewide lease rate for retail space in Florida is $15.89 per square foot, ranging from $30.44 in Miami-Dade to $11.86 in the Escambia County.[8] Rates for office space are slightly higher ($17.63) and much lower for industrial space ($8.24)[9] (although square footage per lease is likely higher).

Assuming a lease rate of $16 per square foot, each 10,000 square feet of space would cost the renter $9,600 in state sales taxes annually. This does not include any applicable local option taxes, which, at the highest rate, would add $2,400 (25 percent) to the tax bill. The current proposal to reduce the state tax rate from 6 percent to 5 percent would save this hypothetical taxpayer $1,600 per 10,000 square feet of leased space. A report by Florida's legislative economists provided examples of potential savings for various retailers.[10]

8 LoopNet, Florida Market Trends, June 2016 http://www.loopnet.com/markettrends/.

9 Ibid.

10 Florida Legislature, Office of Economic and Demographic Research, "Economic Impact: Sales Tax on the Rental of Real Property," November 15, 2014.

Table 1 – Retailer Savings from Reduction in BRT

			Savings From	
Retailer	Sq. Ft.	Rent	Total Repeal	1% Rate Cut
Drug Store	15,962	306,231	$18,374	$3,062
Supermarket	57,549	1,104,078	$66,245	$11,041
Dept. Store	139,286	2,672,202	$160,332	$26,722
Home Center	53,600	1,028,316	$61,699	$10,283
Spec. Apparel	7,389	141,758	$8,505	$1,418
Big Box Store	88,188	1,691,887	$101,513	$16,919

Source: Florida TaxWatch from Florida Office of Economic and Demographic Research data[11]

The BRT can add significantly to the rental costs of a business, adding $1 per square foot (statewide average). As an extreme example, based on the average retail rent in Miami Beach of $66.51,[12] the state and local BRTs add more than $4 per square foot.

Reducing the BRT would be particularly useful to struggling companies. All businesses that rent commercial real estate pay the sales tax on those rents, regardless of their profitability or financial shape. It would also help new businesses, who may find that other startup costs rule out purchasing real estate as an option. If owning the property is not an option, there are few methods for a business renter to lower rental tax costs, and they are usually less attractive. A business can find a less desirable—but less expensive—location or rent less space than is needed. Landlords have greater options over time. The "essential conclusion" of the legislative report is that "the combination of these economic forces between tenants and property owners makes it probable that the economic burden of the commercial rental tax is pushed in its entirety to the tenants." [13]

EFFECT ON BUSINESS CLIMATE AND ECONOMIC DEVELOPMENT

The impact that taxes have on the perception of a state's business climate and a business decision to locate in a particular state is difficult to measure. Numerous studies have come to different conclusions and surveys of businesses and site selection professionals also provide differing results.[14]

Florida TaxWatch has also examined this issue for many years. Our conclusion is that taxes do play a role in the decision on where to locate or expand a business. Other factors, including labor costs, a skilled workforce, availability to markets, and transportation infrastructure are consistently given greater importance than taxes in location decisions; but taxes are considered, and can often play the role of tie-breaker when other factors even out.

An annual survey of site selection consultants found that 66 percent of clients that were planning to relocate cited high taxes as a primary reason for moving.[15] The survey also found that in 2016, 95.8 percent of respondents said "tax exemptions" were either "very important" or "important" site selection factors, up from 91.0 percent in 2015. It should also be noted that in an annual survey of corporate executives, occupancy costs have ranged between the 4th and 2nd most important site selection factor.[16] This is important when Florida's sales tax can add up to 8 percent to businesses' occupancy costs, especially when other states do not have that cost factor

In 2013, OPPAGA surveyed Florida businesses that had received state economic incentives and interviewed a group of site selection consultants on most important factors that affected companies' decision to locate, remain, or expand in Florida. While economic development incentives, an existing presence in Florida, and skilled workforce were most important,

11 Ibid.
12 LoopNet, Florida Market Trends, June 2016 www.loopnet.com/Miami-Beach_Florida_Market-Trends
13 Florida Legislature, Office of Economic and Demographic Research, "Economic Impact: Sales Tax on the Rental of Real Property," November 15, 2014.

14 A good review of the literature is included in "OPPAGA Review of Sales Tax on the Rental of Real Property", November 24, 2014.
15 Area Development Magazine, 13th Annual Consultants Survey, 2016.
16 Area Development Magazine, 31th Annual Corporate Executives Survey, 2016, and previous editions.

21% of businesses said state tax structure was an important factor. Site selection consultants also cited tax environment as a "primary consideration" when making business location or expansion decisions.

BRT REDUCTION PROPOSALS

Support for cutting the business rent tax has been increasing in recent years but the price tag of a significant reduction has been the biggest obstacle. The House has passed a BRT cut in each of the last sessions, but they did not make the final tax cut package negotiated with the Senate.

Several different bills have been filed for the 2017 Session to reduce the sales tax on commercial rents and there are different approaches. Several of these bills have been approved in committee. All these bills have an effective date of January 1, 2018, halfway through the state fiscal year. This reduces the revenue impact in the upcoming budget year (FY 2017-18), leaving more revenue available for the Legislature to appropriate.

Straight Rate Reduction - Governor Scott included a 1.5 percent reduction in the rate (from 6 percent to 4.5 percent) in his budget recommendations back in January. Senate Bill (SB) 484 would cut the rate by one percent (to 5 percent). A one percent reduction in the rate is also included in SB 378. However, that bill also includes repeal of an insurance premium tax credit, which Florida TaxWatch research shows is unwise.[17] It is estimated a 1 percent reduction in the rate would reduce the tax by $ 127.1 million in the first year (due to the delayed effective date) and by an annual recurring amount of $302.2million.[18] While local option tax rates would not be affected, local governments would lose some revenue sharing. A proposed committee substitute (PCS) for SB 378 would change the sales tax distribution formula to "hold harmless" local governments. This would reduce the local revenue loss by approximately $35 million, with a corresponding increase in the loss of state general revenue.[19]

Variable Rate Reduction - The House has included a BRT cut in the first released draft of its ambitious tax cut package (HB 7109). It would reduce the rate from 6% to 4.5% for two years, beginning January 1, 2018. The rate would then go to 5.5% permanently. The House tax package was approved by the Ways & Means Committee recently. The first-year impact of this approach would be $190.7 million. The 0.5 percent permanent reduction would be worth $152.6 million annually. The 1.5 percent reduction would be worth $454.6 a (calendar) year for two years.[20]

Exempting Property Tax Payments - SB 704 and House Bill (HB) 463 would exempt separately stated property tax payments, that are part of the lease payments, from the BRT. This would reduce taxes by $174.6 million annually[21] (as opposed to $302.2 million annually from reducing the rate to 5 percent). SB 704 has passed the Community Affairs Committee. This approach is attractive because the payment of taxes should not be subject to more taxation. Property taxes, being a business cost of the lessor, are usually reflected in rental prices but renters that do not have separately stated tax charges would not benefit.

Exempting Smaller Renters - SB 820 would exempt property that has total annual rent payments of less than $50,000. All leases between lessee and lessor, including related entities, would be counted towards total rent. As opposed to rate reductions, a license to

17 Florida TaxWatch, Repealing the Salary Credit Would Eliminate an Incentive for Insurance Companies to Create Jobs and Invest in Florida, March 2017. Available at www.floridataxwatch.org
18 Revenue Estimating Conference, Impact Analysis of SB 484, March 2, 2017
19 Revenue Estimating Conference, Impact Analysis of Proposed Committee Substitute - SB 378, March 23, 2017
20 Florida House of Representatives, Staff Analysis (Pre-Meeting) of PCB WMC 17-06, April 4, 2017.
21 Revenue Estimating Conference, Impact Analysis of HB 463, updated March 23, 2017.

use property[22] would not qualify for this exemption. The revenue impact of this bill has not been estimated. This approach would have the benefit of helping many smaller businesses, but it does not reduce the tax rate, which may not help the perception of Florida being the only state to levy the sales tax on business rents. There is also a fairness question when a business with $50,000 in rent would have no tax due, but a business with $51,000 in annual rent would pay the full amount of tax ($3,060 plus any applicable local taxes.)

Phase-out by an increasing exemption – HB 223 and SB 838 would provide an increasing exemption from the BRT, starting at the first $10,000 of payments and increasing by $10,000 a year until the tax is repealed in 2027. The revenue impact of this approach has not been estimated. This is the only bill that would put repeal of the BRT in law. The Legislature is unlikely to do this because it would make all $1.7 billion of BRT revenues non-recurring from a budget standpoint. Non-recurring revenue should not be spent on recurring programs. As was done during the elimination of the intangibles tax, this approach could be done by creating an exemption but leaving it up to future legislators to increase the exemption and ultimately repeal the tax. Of course, there is no assurance that any additional exemptions would be provided. Increasing exemptions has the benefit of helping smaller businesses first, but this can make ultimate repeal politically difficult since every new increased exemption may be perceived as more and more only beneficial to "big business."

22 Licenses to use property differ from a lease in that a license is the granting up permission to use property and does not provide sole possession nor does in create or transfer interest in the property. Licenses are revocable and are not transferrable.

CONCLUSION AND RECOMMENDATIONS

The Business Rent Tax (BRT) stands out as a tax that creates a clear competitive disadvantage for the state's businesses. Florida is the only state that levies a statewide sales tax on commercial rents. This creates a government-mandated increase in occupancy costs of up to 8 percent which does not exist in other states.

The BRT can add significantly to a business's rent costs. Statewide, state and local BRTs add approximately $1 per square foot to the rent of retail space. In high-rent areas, such as Miami Beach, BRTs can add more than $4 per square foot to retailer rents.

A reduction in the BRT would be broad-based, benefiting a large number of businesses. All businesses that rent commercial real estate pay the sales tax on those rents, regardless of their profitability or financial shape. Reducing the sales tax would help be a significant help to struggling companies. It would also help new businesses, who may find that other startup costs rule out purchasing real estate as an option.

Eliminating the BRT tax would be a long-term proposal, due to the large negative revenue impact; however, since both the Governor and legislative leaders want to provide significant tax relief this session, there is an opportunity reduce the BRT.

Florida TaxWatch recommends that the Legislature enact a permanent reduction of at least 1 percent in the 2017 Regular Session, lowering the rate from 6 percent to 5 percent. We also recommend that future legislatures continue to work to eliminate this tax.

Among all the methods for providing tax relief to Florida businesses that will be considered by the 2017 Legislature, reducing the business rent tax is easily the best option.

APPENDIX

FLORIDA'S GENERAL SALES TAX AND THE TAXATION OF BUSINESS PROPERTY RENTS

With a constitutional prohibition on a personal income tax, Florida relies heavily on transaction taxes—particularly the sales tax—to fund its government. Florida levies a state sales and use tax of 6 percent. Generally, the tax applies to the final sale of tangible personal property; however, admissions, transient lodgings, commercial rentals, and a limited number of services (burglar protection, detective, non-residential cleaning, and pest control services) are also subject to the tax. Non-residential electric services (4.35 percent) and coin-operated amusements (4 percent) are taxed at a lower rate.

The sales tax is by far the state's largest tax source; total collections for FY2016-17 are estimated at $25.889 billion.[23] Most of this (currently 89.0 percent) is deposited into the General Revenue Fund and accounts for 77 percent of all GR receipts. The state also shares $2.803 billion (10.8 percent) with local governments. A very small amount goes to state trust funds and qualifying sports facilities.

The Legislature has also authorized a number of local option sales taxes. Sixty-one counties levy a sales tax. Current local rates vary by county, up to 2.0 percent,[24] and raise $2.3 billion annually for Florida's local governments.

There are 268 separate exemptions, exclusions, credits, and deductions from the sales tax in Florida statutes.[25] Some of these uphold the nature of a sales tax and some are required by other law. Most of the larger exemptions are for items that could be considered necessities, such as groceries, prescription drugs, and residential heating and power.

The foundation of Florida's current sales tax structure was established in 1949 and it has been amended extensively since. Florida law defines "sale" as "any transfer of title or possession or both, exchange, barter, license, lease, or rental, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration."[26] This allows for the taxation of the rental of tangible property.

In 1969, the Legislature made the rental of real property a taxable transaction. "It is declared to be the legislative intent that every person is exercising a taxable privilege who engages in the business of renting, leasing, letting, or granting a license for the use of any real property…"[27] However, there are numerous exemptions to this, including one for dwellings. Therefore, the tax is largely levied on the rental of commercial property and short-term (transient) living accommodations. If the tenant makes payments such as mortgage, ad valorem taxes, or insurance on behalf of the property owner, such payments are also classified as rent and are subject to the tax.

If required by the lease, property taxes, as well as payments for services such as utilities, parking, and janitorial services may also be part of the taxable rent. The granting of a license to use real property for placement of ATMs, kiosks, vending, amusement, or newspaper machines is also taxable. In the event of subleasing, the lowest level of sub-leasing is required to pay the tax.

These rents are also subject to the applicable local option sales tax, which can be as high as 2.0 percent. The $5,000 cap on the amount subject to local option taxes on tangible property does not apply to rents.

The business rent tax is a big money-maker for the state (and its local governments). It is estimated that nearly $29 billion in taxable rents produces $1.724 billion annually for the state.[28] There is no official estimate of the local option sales tax on commercial rents, but based on the population-weighted local sales tax rate of 0.8 percent, local taxes could add $230 million more in tax burden. [29]

23 Results of the General Revenue Estimating Conference, March 17, 2017.
24 Florida Department of Revenue, Form DR-15DSS, Discretionary Sales Surtax Information for Calendar Year 2017. Effective January 1, 2017 Liberty County became the first county with a 2.0% local sales tax.
25 Florida Legislature, 2016 Florida Tax Handbook.
26 Section 212.02(15), Florida Statutes
27 Section 212.031(1)(a), Florida Statutes
28 Revenue Estimating Conference, Impact Analysis of SB 484, March 2017.
29 Calculations by Florida TaxWatch.

This TaxWatch *Briefing* written by **Kurt Wenner,** Vice President of Research
Robert Weissert, Executive Vice President & Special Counsel to the CEO
Chris Barry, Director of Publications

Florida TaxWatch Research Institute, Inc.
www.floridataxwatch.org