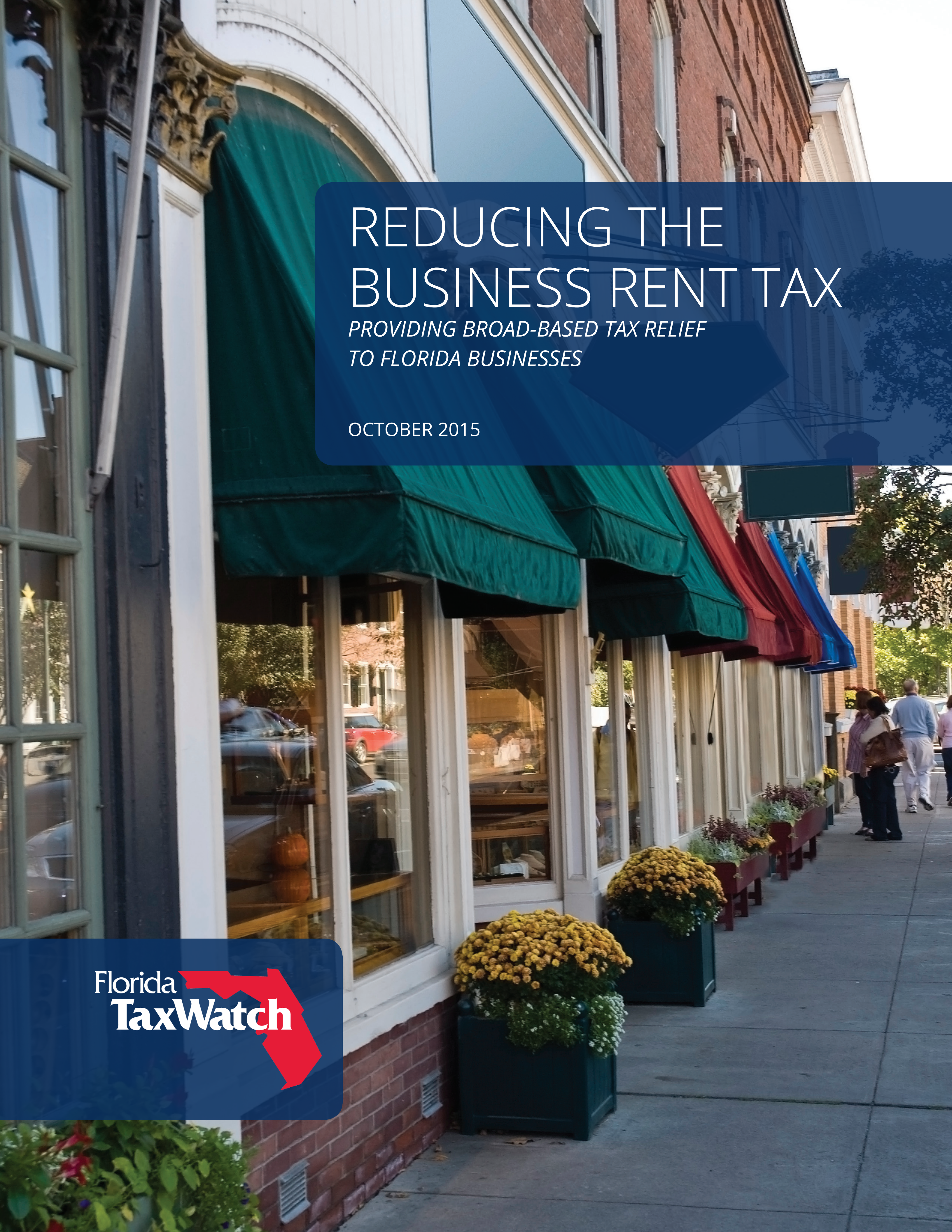

REDUCING THE BUSINESS RENT TAX

PROVIDING BROAD-BASED TAX RELIEF TO FLORIDA BUSINESSES

OCTOBER 2015

Florida TaxWatch

Florida TaxWatch

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Dear Fellow Taxpayer,

Governor Rick Scott and the Florida Legislature have shown a commitment to reducing the taxes paid by Floridians and Florida businesses. Economic development and the state's business climate have also been priorities, especially of the Governor. The last two sessions have seen tax cut packages passed that each total between $400 million and $500 million, and the Governor and legislative leadership have indicated they will pursue additional tax cuts during the 2016 session.

This Florida TaxWatch report looks at the Business Rent Tax, a tax on commercial leases that only Florida charges to its businesses. This unique tax can add tens of thousands of dollars to the operating costs of a business each month, and even a single percentage point reduction could have a significant impact on Florida's businesses and economic development.

It is our hope that the information in this report will be helpful to legislators as they determine the best path forward in terms of tax cuts for Floridians.

Sincerely,

Dominic M. Calabro

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President & CEO

Introduction

Governor Rick Scott and the Florida Legislature have shown a commitment to reducing the taxes paid by Floridians and Florida business. Economic development and the state's business climate have also been priorities, especially of the Governor. The last two sessions have seen tax cut packages passed that each total between $400 million and $500 million, and the Governor and legislative leadership have indicated they will pursue additional tax cuts due the 2016 session.

The last two sessions have shown a high level of competition between various tax proposals, as the Legislature has limited dollars available for tax cuts. This session, the Legislature is not expected have a budget surplus as large as last year's, so competition could even be more intense.

A tax that will be certainly be considered for reduction is the Business Rent Tax (BRT), which is the sales tax levied on all rental of commercial real estate. Legislation has been considered in each of the last two sessions, and Senate Finance and Tax Committee Chair Dorothy Hukill has filed a bill for the 2016 Session.

Florida TaxWatch undertook this research project to examine the potential benefits of reducing/ eliminating the tax. This report:

- examines the background of the tax and compares it to other states;
- examines who pays the tax, what the burden is and what potential tax savings might be;
- assesses the impact of the tax on the competitiveness of Florida businesses and the perception of Florida's business climate;

Sales Tax on the Rental of Business Property

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 FY2015-16 are estimated at $24.674 billion.[1] Most of this (currently 89.0 percent) is deposited into the General Revenue Fund

1 Results of the General Revenue Estimating Conference, August 14, 2015.

and it accounts for 77 percent of all GR receipts. The state also shares $2.693 billion (10.9 percent) with local governments. A very small amount goes to state trust funds and qualifying sports facilities.

There are 255 separate exemptions, exclusions, credits, and deductions from the sales tax in Florida statutes. 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 Legislature has also authorized a number of local option sales taxes. Current local rates vary by county, ranging from 0 percent to 1.5 percent. These taxes raise slightly more than $2 billion for Florida local governments.

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."[2] 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…"[3] 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, 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 sub-leasing, the lowest level of sub-leasing is required to pay the tax.

These rents are also subject to the applicable local option sales tax, ranging from 0.5 percent to 1.5 percent. The $5,000 cap on the amount subject to local option taxes on tangible property does not apply to rents.

2 212.02(15), Florida Statutes

3 212.031(1)(a), Florida Statutes

It is estimated that the state BRT amounts to $1.6 billion annually.[4] There is no official estimate of the local option sales tax on commercial rents, but based on the amount of total local sales tax collections relative to state collections, local taxes could add $130 million more in tax burden.

Florida's Business Rent Tax is Unique

Florida's BRT is unique. It 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.[5]

- ***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 $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 146,000 sales tax accounts remitted the BRT in 2013,[6] but it is not known how many businesses pay the tax. There are two million businesses registered with the state, plus sole proprietorships. 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]

4 Revenue Estimating Conference, Impact Analysis of SB 140, March 2015.

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

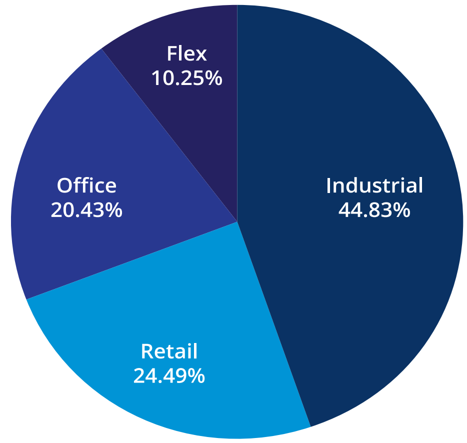
6 Revenue Estimating Conference, Impact Analysis of SB 140, March 2015.

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

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

Florida 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 approximately $16.25 per square foot, ranging from $25.76 in Miami to $12.33 in the Panhandle.[8] Rates for office space are slightly higher ($17.07) and much lower for industrial space ($7.06)[9] (although square footage per lease is likely higher).

Chart 1 – Estimated Inventory Mix of Florida Commercial Lease Space



Source: Florida TaxWatch from Florida Office of Economic and Demographic Research data[19]

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[10] provided some example potential savings for various retailers, which are detailed in Table 1.

Table 1 – Potential Savings for Certain Retailers

Retailer	Square Feet	Rent	Savings From	
			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
Department Store	139,286	$2,672,202	$160,332	$26,722
Home Center	53,600	$1,028,316	$61,699	$10,283
Specialty 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]

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.

9 LoopNet, Florida Market Trends, June 2015 http://www.loopnet.com/markettrends/.

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

11 Ibid.

Another observation about who pays the BRT: All businesses that rent commercial real estate pay the sales tax on those rents, regardless of their profitability or financial shape. This is in contrast to a corporate income tax, which is generally only paid by those companies that turn a profit.[12]

Reducing the BRT would be particularly useful to struggling companies. 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[13] 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."

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 52 percent of clients that were planning to relocate cited high taxes as a primary reason for moving.[15] It should also be noted that an annual survey of corporate executives found that occupancy costs were the second most important site selection factor in 2014, up from fourth in 2013.[16] This is important when Florida's sales tax can add up to 7.5 percent to businesses' occupancy costs, especially when other states do not have that cost factor.

12 Tax planning strategies can allow corporations to legitimately lower or defer tax liability.

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, 11th Annual Consultants Survey, 2014.

16 Area Development Magazine, 29th Annual Corporate Executives Survey, 2014.

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, 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

Legislation has been filed for the 2016 Session to reduce the sales tax on commercial rents. Senate Bill 116 has been filed to reduce the state tax rate on commercial rents from 6 percent to 5 percent. The bill does not affect local option sales taxes. It is estimated this would save businesses $290.1[17] million annually. The law would take effect January 1, 2017, which would cut the revenue loss to the state by more than half in the first year (FY2016-17).

Governor Scott recommended this tax cut in 2014 but he did not include it in his tax recommendation in 2015. Similar legislation was filed in each of the last two sessions. Last year, a small reduction in the tax (0.2 percentage points) was part of the tax package (HB 7141) approved by the full House during the Regular Session. However, that was taken out of the final tax package that passed during the Special Session. Legislation was also filed last year to lower the tax on commercial rents through another method: the first $10,000 of lease payments would be exempted in FY2105-16, and the exemption would increase by $10,000 annually, until it reached $90,000 in FY2023-24. This legislation did not pass.

17 Revenue Estimating Conference, Impact Analysis of SB 140, March 2015.

Conclusion and Recommendations

When examining Florida's tax landscape, 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 7.5 percent, which does not exist in other states. Occupancy costs are one of the top factors cited by executives and site selection consultants in making location decisions.

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 revenue loss. Florida relies very heavily on transaction taxes—especially the sales and use tax—to fund government. The sales tax provides 77 percent of all GR. Eliminating the BRT would take some major restructuring of the state's revenues and expenditures. However, under the current budget outlook, and with the stated intention of both the Governor and Legislature to provide significant tax relief this upcoming session, there is an opportunity to at least reduce the BRT.

Florida TaxWatch recommends that the Legislature enact a reduction of at least 1 percent in the 2016 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 options for tax reductions that will be considered by the 2016 Legislature, reducing the business rent tax, along with making the sales tax exemption for manufacturing machinery and equipment permanent,[18] are the best options.

18 For more information on this exemption, see the Florida TaxWatch report "Economic Impact Analysis of Florida's Manufacturing Sector," March 2009.

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ABOUT FLORIDA TAXWATCH

As an independent, nonpartisan, nonprofit taxpayer research institute and government watchdog, it is the mission of Florida TaxWatch to provide the citizens of Florida and public officials with high quality, independent research and analysis of issues related to state and local government taxation, expenditures, policies, and programs. Florida TaxWatch works to improve the productivity and accountability of Florida government. Its research recommends productivity enhancements and explains the statewide impact of fiscal and economic policies and practices on citizens and businesses.

Florida TaxWatch is supported by voluntary, tax-deductible donations and private grants, and does not accept government funding. Donations provide a solid, lasting foundation that has enabled Florida TaxWatch to bring about a more effective, responsive government that is accountable to the citizens it serves since 1979.

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The findings in this *Report* are based on the data and sources referenced. Florida TaxWatch research is conducted with every reasonable attempt to verify the accuracy and reliability of the data, and the calculations and assumptions made herein. Please feel free to contact us if you feel that this paper is factually inaccurate.

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