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Legislation Would Help Add Much Needed Certainty to Sales Taxation of Groceries

One of the most confusing aspects of Florida's state tax laws concerns the taxable status of items sold by food and drug retailers. Although groceries and prescription drugs are generally exempt from the sales tax, many of the products these retailers sell are taxable, and there are many gray areas which do not make complying with the sales tax law an easy task.

Examples of tax determination problems that retailers must face every day include: 1) whether granola bars are cereal (non-taxable) or candy (taxable); 2) whether cranberry juice cocktail and lemonade are soft drinks (taxable) or fruit juice (non-taxable); whether a salad mix that is prepared in bulk and shipped to a store and then further prepared by adding a dressing or garnish is considered prepared "off the premises" (non-taxable) or on the premises (taxable); and 4) whether an item is purchased for its sweet taste (taxable) or its nutritional value (non-taxable).

Adding to the confusion is the proliferation of gas stations and convenience stores selling foods prepared or ready for immediate consumption, food sold through grocery store delis, salad bars and bakeries and bookstores selling baked goods, coffee and tea.

To make the situation more difficult for retailers, approximately 1000 to 2000 new products are

introduced in the food and drug industry each month. The taxable status of each of these products must be determined before they are sold, usually within ten days after the retailers order the product.

However, a determination of the taxable status of an item by the Florida Department of Revenue (DOR) is not binding until a rule is promulgated to address the item. In addition to the statutes concerning food and drink taxation, there are over thirty different food and drink categories and conditions of service, preparation or sale in the sales tax exemption regulations. This can take months and retailers have to use their best judgement or depend on an opinion from DOR. And they are just that - an opinion. Until it goes through the rulemaking process, any assistance given by DOR in the determination of taxable status is not binding, and retailers can be liable under audit for incorrect determinations. Some items, such as promotional ones, have such a short shelf-life that they are already out of the stores before a rule can be promulgated.

UPC Technology Can Help Ensure Consistent Application of Sales Taxes

Most retailers work very hard to ensure that they collect all the sales tax due the state. It is costly and time consuming ensuring that the law is

applied correctly, both to business and the Department of Revenue. Both parties want to see that taxable status is determined correctly, in a timely, efficient manner and -- perhaps most important of all -- consistently.

Most large and medium-sized stores have the technology to consistently tax products correctly, once the taxable status is determined. This involves scanners and Universal Product Codes (UPC). Each new product is assigned a unique UPC code by the manufacturer. These are the bar codes on packaging that allow retailers to determine the price of an item by scanning it. Any attribute can be assigned to UPC codes, including taxable status.

What is needed is a central database that contains the taxable status of each item and its corresponding UPC code. The information in the database should be binding and quickly updated.

DOR formed a Performance Improvement Team (or "PIT crew") consisting of department staff, HRS staff (for medicines) and representatives from grocery, drug and convenience stores to address an overhaul of the Florida's sales tax exemption provisions. Legislation arose out of the PIT crew to clear up some of the cloudy areas in the law and help move the state toward a central database and the ability to avail itself of UPC technology.

Contents of the Legislation

Rewrite of the Grocery Exemption Statutes

The first thing House Bill 1395 (Rep. Tedder) and Senate Bill 1142 (McKay) do is rewrite S. 212.08(1), the section which provides the sales tax exemption for general groceries, to clarify the application of the sales tax on food and beverage products. The new language states that "Food

products for human consumption are exempt from the tax..." It goes on to define the term "food products" and lists the items that are included in the definition. It then lists the products and circumstances to which the exemption does not apply such as food products sold for immediate consumption, soft drinks, ice cream sold in small containers, candy and food prepared or sold in restaurants or similar establishments.

The rewrite of this section clears up some problem areas. This includes such changes as providing that all bakery items sold by bakeries or pastry shops without eating facilities would be exempt. Also, for an item to be taxable as candy, it must be regarded as candy, based on its normal use, as indicated on the label or advertising. Two items that are currently considered exempt but would become taxable under the legislation are coffee sold in liquid form and food products prepared off the premises and sold for immediate consumption, unless prepared and sold in the original sealed container.

Miscellaneous Exemptions

The legislation also addresses two sales tax problems experienced by food retailers. Grocers were finding themselves liable for sales tax on complimentary items, such as free samples or coffee or cookies provided for customers to enjoy while shopping. The proposed legislation would exempt any food or drink provided to customers without charge. This also includes items given away as part of a price guarantee plan related to point-of-sale errors -- as in cases where if the customer is charged the wrong price, the item is given to the customer for free.

The legislation would also exempt food or beverage donated by a food retailer to a food bank or charitable organization that is exempted

under s.501(c) of the U.S. Internal Revenue Code governing non-profit organizations.

In addition, the house bill was recently amended to provide an exemption for free samples of prescription medicines. Although these items had not been considered taxable, it was thought that clarifying language was needed due to action in other states.

Taxability Guidelines and A Central Database

Perhaps the most important aspect of the proposed legislation is that it directs DOR to develop guidelines for determining the taxability of specific products. The Department of Revenue has a technical assistance advisory committee comprised of public and private sector members which was established to advise the DOR and the Department of Health and Rehabilitative Services in determining the taxability of foods and medicines. The legislation directs DOR, with the advice of the advisory committee, to develop these guidelines. The advisory committee is to use these guidelines in making recommendations to DOR on the taxability of products. DOR will make the determination on the taxable status. That determination will be public record and will be final upon its publication. This will not be subject to the Administrative Procedures Act, except that the final determination may be challenged. This means that the Department would be able to make a final determination on the taxable status of an item without having to promulgate a rule.

That determination however, is subject to challenge under the APA.

The legislation further directs DOR to develop a central database and to publish the determination of the taxable status of products in a manner that allows retailers to properly tax products based on their universal product codes. Such a central database would even be a great help to smaller retailers who do not have scanners in their stores. DOR would be able to provide these retailers with taxable status by product name. The taxable status of products could also be checked at distribution sites and boxes could be marked as to taxability before they are shipped to the stores.

Conclusions and Recommendations

The proposed legislation would be very helpful in achieving the goal of consistent, correct application of the sales tax to grocery items. It clarifies some troublesome points in the current statutes, allows the Department of Revenue to make a final determination of taxable status more rapidly and sets the stage for the use of UPC technology in determining taxability. There are no deadlines in the legislation for development of the guidelines and the Department is not mandated to develop the central database. DOR is to be commended for working with the industry to address this problem in a truly cooperative manner, and they should be encouraged to ensure that the legislation's potential is realized.

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In recent years, news stories about Florida TaxWatch have run in all Florida newspapers, *The Wall Street Journal*, *The New York Times* and *The Washington Post*. In addition, Florida TaxWatch has been featured on the prestigious *MacNeil/Lehrer Newshour* and several times in *The Wall Street Journal*.

Florida TaxWatch is a private, non-profit, non-partisan research institute supported entirely by voluntary, tax-deductible membership contributions and philanthropic foundation grants. Membership 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, corporations, professional firms, labor unions, associations, individuals and philanthropic foundations – representing a wide spectrum of Florida's citizens.

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