SALES TAX EXEMPTION FOR TRAVEL AGENCY SERVICES

Presented to
Florida Sales Tax Exemption Study Commission

By
Joseph W. Jacobs

February 24, 1987
MEMORANDUM

1. A Thumbnail Sketch of the Travel Agency Industry.

Travel agencies, as the name implies, act as agents: Agents for suppliers of travel services such as airlines, cruise lines, hotels and motels, bus and rail operators, and automobile rental companies. Agencies enter into contracts with the various suppliers, whereby the supplier will pay a commission based upon the volume of sales generated by the agency. On the average, this commission comes to approximately 10 percent.¹

Our State ranks third nationally in the total number of travel agencies, with some 2,191 travel agencies approved by the Airline Reporting Corporation ("ARC").² Any agency selling airline tickets must be approved by ARC, for ARC is the sole source of the universal ticket stock upon which tickets of any ARC-member airline may be written.³ As described later in this

¹ The commission varies from 5% on rental cars to 11.4% on international air travel. The commission on domestic air travel, the largest single source of agency revenue, is 9.95%. These numbers are based on 1986 figures supplied by industry representatives.

² A non-ARC agency generally acts only as a tour operator, that is, an organization which assembles retail purchasers of particular travel services, and then purchases the services on a wholesale basis from suppliers (airlines, hotels, etc.), retaining part of the savings as its commission.

This memorandum addresses only the legal implications and equities of imposing the new services tax on full service, ARC-appointed travel agencies.

³ ARC covers only domestic air travel. A separate agency, International Air Transportation Association ("IATA"), covers international travel. IATA, like ARC, appoints agencies qualified to issue international air travel tickets. In theory, an agency could be appointed by IATA and not ARC, but this is extremely rare in practice.
memorandum, ARC is a non-profit corporation organized to channel the flow of funds from travel agencies to the airline industry (through the mechanism of the Area Settlement Plan) and to act as a clearinghouse for claims the air carriers have against one another.

Public perception of the industry is probably inaccurate in that clients (members of the public purchasing travel services) often believe that the agency works for the client, not the supplier. In this way the industry resembles real estate brokers, where the public seems to hold the belief that the realtor is the agent of the buyer, not the seller. For purposes of analyzing the effect of the new services tax, however, it is important that this distinction be made. Travel agencies work for, and are compensated by means of commissions paid by, suppliers of travel services.

As might be expected from the large number of agencies located in Florida, the industry consists of many small businesses. More than two-thirds of the agencies in Florida generate gross commissions of less than $100,000. The average agency looks like this: It has gross sales of $1,380,000 per year, meaning that the total dollar value of travel services sold is $1,380,000. The gross sales figure, however, is misleading in terms of either the real revenues of the firm or the proposed services tax because the travel agency's real income is based only upon the commissions it is paid by the carriers on whose behalf the agency acts. This is the "consideration [received by the agency] for performing of any service." Fla. Stat. §212.05(1)(j) (1986). Accordingly, the typical agency's gross income is only 10% of the $1,380,000 total value of the services provided, or some $138,000. Out of this $138,000 the agency must pay its rent, computer system costs, telephone and other utility charges, salaries to employees, and other expenses.

Typically the $138,000 average commission income is generated from the following sources:

4 The figures are as of 1986 and were supplied by on information supplied nationally to the American Society of Travel Agents ("ASTA"), the principal industry wide-trade association. These figures, however, are based on national averages. Incomplete Florida data indicates that they are probably overstated with respect to Florida-based travel suppliers.

5 The figures are computed by basing the analysis on the total number of agencies in the State, as opposed to the gross dollar revenues of those agencies. There are a number of very large agencies whose unmodified inclusion in the computations would skew the numbers and present an unrepresentative picture of the industry.
Airline Commissions 80%-85%
Cruise Ships 5-15%
Hotels, Auto rentals, etc. 5-10%

In the first instance the agency typically collects the full purchase price of the service from the client. Each and every Tuesday the agency must deposit into the Area Settlement Plan (set up by ARC) the total amount collected for air travel less the commission earned by the agency. This means that the agency receives almost no "float" on the funds collected from customers, for the demands of the Area Settlement Plan are merciless. Failure to make the requisite Tuesday deposit means, ultimately, loss of ARC-appointed status.

Finally, to complete the thumbnail sketch of the industry, the typical agency has between three and six employees. The owners almost invariably work on-premises. It should be noted that more than 54.7% of all ARC-appointed agencies are owned and operated by women.

2. Legal Impediments to Extending the Proposed Services Tax to the Travel Agency Industry.

Whether or not the imposition of the services tax on travel agencies is a good idea from a policy or revenue standpoint, there are at least two significant legal impediments that must be considered.

AIRLINE TICKET SALES/COMMISSIONS

As indicated earlier in this memorandum, airline ticket sales make up an overwhelming percentage of the potentially

---

6 Because of the overwhelming preponderance of airline business, most examples in this memorandum use air carriers as exemplar suppliers.

7 Some 79.6% of all managers--owners and non-owners alike--are women. This statistic is also based on information supplied to the ASTA trade association. No data is available for the ownership breakdown in Florida alone, although there is reason to believe that ownership by women is even more common in Florida than nationally.
taxable commissions of the typical travel agency. These sales also represent the great percentage of the projected revenue for the State should they be taxed. Yet, it is these precise sales that create the greatest legal difficulty.

The problem stems from a federal statute. In 1970 Congress enacted the Airport and Airway Revenue Act of 1970. This law, codified at 26 U.S.C. §§4261 and 4271, imposes a federal tax on domestic airline tickets and a head tax on international flights outside of the United States. At the time that this legislation was passed, a number of states were also imposing various types of taxes on airlines and air travelers. As a result, there was an immediate legal controversy over whether such state taxes were still enforceable in light of the new federal law.

The legal battle over dual taxation reached the United States Supreme Court in 1972. The Court ruled, in the context of a state head tax, that state taxes related to air transportation were not preempted by the 1970 federal statute. States were thus given a free rein to impose such taxes as they saw fit.

There was an immediate uproar in Congress. Many in Congress saw the combination of state and federal taxes as both "double taxation" and an overlap which unduly interfered with interstate commerce. Some of the comments made during the legislative hearings clearly illustrate the Congressional mood and intent:

"Finally, Mr. President, S.38 prohibits a new, inequitable, and potentially chaotic burden of taxation on the nearly 200 million persons who used air transportation each year. The bill prohibits the levying of State and local head taxes, fees, gross receipts taxes, or such other charges either on passengers or on the carriage of such passengers in interstate commerce. (emphasis supplied)

In 1970, Congress...intended...that the Federal tax be the

---

8 At least 80% or $110,400 of the average $138,000 total commission revenues of the typical travel agency comes from this source.

9 The maximum possible revenue from a proposed service tax on this industry, assuming all legal challenges failed, would approximate $27,000,000, $10,000,000 of which would be potentially exacted from the very smallest of agencies.

Airline tickets would account for approximately $23,000,000 of this projected total.

only tax on airline passengers...

By prohibiting State taxation on passengers or an air transportation, the committee has accepted greater responsibility for U.S. assistance. With the increased federal assistance, we can see no valid reasons for the continuance of local passenger taxation. 11

***********

"Finally, Mr. President, the committee bill prohibits the state and local taxation of air fares. The Congress intended in 1970 to preempt the States and localities from levying such taxes as taxation on air fares is one of the predominant sources of revenue for the trust fund. Recent Supreme Court decisions necessitate the clarification of this congressional policy determination.

If more than 500 localities—or even a significant proportion of this number—were unilaterally to levy taxes on airline passenger fares, there would result an unconscionable and unacceptable burden on interstate commerce. The national system of air service upon which 180 million airline passengers depend annually would become a hodgepodge of Balkanized assessments and levies against non-resident travelers whose business or leisure takes them across State lines. The committee bill prohibits State and local taxation of air fares, but this Federal preemption is carefully balanced by substantial increases in trust fund assistance for airport development and modernization. 12

This Congressional attitude led to the enactment of §7(a) the Airport Development Acceleration Act of 1973 which, as amended, is currently codified at 49 U.S.C. §1513. That statute provides in pertinent part as follows:

Prohibition...

"(a) No State...shall levy or collect a tax, fee, head charge, or other charge, directly or indirectly, on persons travelling in air commerce or on the carriage of persons traveling in air commerce or on the sale of transportation or on the gross receipts derived therefrom....

12 Remarks of Senator Pearson, Id. (emphasis supplied).
Permissible State taxes and fees

(b) Except as provided in subsection (d) of this section, nothing in this section shall prohibit a State...from the levy or collection of taxes other than those enumerated in subsection (a) of this section, including property taxes, net income taxes, franchise taxes, and sales and use taxes on the sale of goods or services;... (emphasis supplied).

The statute defines both acceptable and unacceptable taxes. In the context of the Florida proposal, the statute facially permits a sales or use tax on the sales of goods or services but prohibits a tax either on the sale of air transportation or on the related gross receipts.

Both of these sections have been judicially interpreted. An analysis of the key cases strongly suggests that the application of Florida's proposed services tax to the travel industry would create significant statutory preemption problems.

The reach of subsection (b) was most recently considered in 1986 by the United States Supreme Court in a case which involved a revenue measure imposed by the State of Florida.\textsuperscript{13} Wardair involved a determination of whether Fla. Stat. §212.08(4)(a)(2) was preempted by federal law or whether it violated the Commerce Clause.

The factual basis of the case was as follows. Wardair Canada, Inc. ("Wardair") was a Canadian carrier which purchased fuel within the State of Florida. The fuel was then used by Wardair to fly outside of the State of Florida and in foreign commerce. As a result, very little of the fuel was actually consumed within the State. Florida's imposition of a 5% tax on that fuel at the time of sale substantially increased Wardair's cost of operation. However, the tax was not imposed on the price of air travel, but on the airline in its role as a consumer; the tax was only levied on fuel which the airline purchased for its own use. Wardair claimed, among other things, that the Florida tax was preempted by the Federal statute (49 U.S.C. §1513) and was thus uncollectible.

The United States Supreme Court rejected that argument, reasoning that the tax was permissible under the express terms of

\textsuperscript{13} Wardair Canada, Inc. v. Florida Dept. of Revenue, 106 S.Ct. 2369 (1986).
the statute. Subsection (b) permits a sales tax on the sale of goods or services; subsection (a) prohibits a tax on the sale of air transportation or the gross receipts derived therefrom. The purchase of fuel oil fell within the ambit of the permissible tax and not within the scope of the prohibition. It was therefore valid.

Other cases have reached the same conclusion when the underlying event was something other than the air transportation of passengers. Thus a tax on the transportation of freight was upheld by the Arizona Supreme Court¹⁴ and a tax on packaged meals purchased by the airlines to serve to their customers during flight was upheld by Florida's Third District Court of Appeals.¹⁵

The distinguishing feature marking all of the cases which upheld the challenged tax was that the tax was levied on a product or service which did not involve the air transportation of passengers. It is notable that all of the cases make this distinction in reaching their respective holdings.

The thrust and scope of this distinction was examined by the United States Supreme Court in 1983. The case, arising out of a tax imposed by the State of Hawaii, raised the precise question of whether a State could impose a tax measured by the gross receipts of an airline.¹⁶ The Hawaii statute¹⁷ challenged by this litigation differed markedly from those which had been judicially upheld in other cases. It specifically provided as follows:

"There shall be levied and assessed upon each airline a tax of four per cent of its gross income each year from the airline business..."

This was not a tax on goods and services purchased by an airline for its own consumption; this was not a tax on portions of the airline's business that related to matters other than the air transportation of passengers. This tax went directly to the heart of the airline's revenue--its gross income from the passenger business.

The Hawaii Supreme Court upheld the tax, holding that there

¹⁴ State, etc. v. Cochise Airlines, 626 P.2d 596 (Az, 1980)
¹⁵ Air Jamaica, Ltd. v. State Department of Revenue, 374 So.2d 575 (Fla. 3rd DCA 1979)
was no federal pre-emption. The State Court reasoned that the tax was valid because it was imposed upon the carrier rather than upon the passengers.

The United States Supreme Court rejected this analysis and decided that the Hawaii tax was indeed preempted. The high Court's reasoning was based upon the following conclusions:

a. The statute unambiguously prohibits a tax on the gross receipts of the airline industry, and the Court does not have to go beyond the plain meaning of the statute to reach its determination;  

b. Even though Congress's primary intent in 1973 was to void head taxes, there is nothing in the statute or legislative history that indicates that the statutory prescription was restricted to that particular kind of tax. 

The statute was thus of no force or effect. In reaching its decision, the Supreme Court cited with approval other cases which invalidated state taxes on gross receipts "derived from air transportation or the carriage of persons in air commerce."  

A analysis of the Aloha case and of those cases cited by the Supreme Court makes the scope of the statutory prohibition even clearer. A tax, regardless of title or description, which is

18 In re Aloha Airlines, Inc., 647 P.2d 263 (Hawaii, 1982).
19 104 S.Ct. at 294.
20 104 S.Ct. at 295.
22 Hawaii argued that the tax should be upheld because it was labelled a property tax measured by gross receipts rather than a straight gross receipts tax. The Supreme Court rejected that argument out of hand and stated that "a property tax that is measured by gross receipts constitutes at least an 'indirect' tax on the gross receipts of airlines. A state statute that imposes such a tax is therefore preempted." 104 S.Ct. at 295. It is fair to infer that the substance of the tax rather than its form will be the controlling factor.
imposed on air transportation, the carriage of passengers, or the gross receipts therefrom will not withstand preemption scrutiny.

For all of these reasons, any attempt to tax the sale of airline tickets would be vulnerable to a substantial legal challenge based on the preemption doctrine. There is every reason to believe that the State would lose that challenge. This risk, when coupled with the other legal and policy arguments presented in this memo, is a strong rationale for specifically exempting these activities from the proposed services tax.23

In addition to the preemption argument, there is another legal challenge which would probably be raised with respect to the taxation of airline tickets. This challenge would be based on the Commerce clause of the constitution and on treaties which the United States has entered into with other countries. These arguments will be discussed in the next section of this memorandum which discusses the cruise segment of the travel agency business. These arguments present additional reasons to question the validity of the proposed tax on the airline-related commissions of the travel industry.24

The inescapable conclusion of this judicial/statutory analysis is that there is a significant risk that the direct or indirect imposition of a services tax on the airline services provided by the travel industry would be illegal.

CRUISE SERVICES

Cruise services amount to 5-10% of the total sales volume of the typical travel agency.25 While there is no federal statute

23 It is extremely important to note that Florida would not be the only state to exempt the travel agencies from a services tax. Of the four states identified by the Commission as imposing similar services taxes, three elected not to tax the travel industry. The validity of the tax imposed by the fourth state, Hawaii, is in serious doubt following the United States Supreme Court decision in Aloha Airlines. See the discussion accompanying Notes 36-41, infra, for a detailed description of the actions taken by other states.

24 If the State were unable to tax the airline-related revenue, the maximum revenue potential of the travel industry drops to approximately $4,000,000. Cf. supra notes 7-9. Even this amount may be a substantial overstatement if some of the other legal problems outlined in this memorandum prevent the collection of taxes levied on other segments of the travel industry.

25 The revenue potential is thus $1,400,000 to $2,800,000. Cf. Notes 7-9, supra.
comparable to 49 U.S.C. §1513 that applies to maritime travel and therefore no similar statutory preemption argument, there is support for an attack on a services tax based on either the Commerce Clause or foreign treaties. This support is found in a series of United States Supreme Court cases that date from the 19th Century.

The first case of note was decided in 1885 and involved an attempt by the State of Pennsylvania to impose a tax based on the capital stock of a New Jersey corporation which operated a steamboat ferry across the Delaware River between New Jersey and Philadelphia.26 The Supreme Court held that the ferry company was engaged in the transportation of passengers and freight in interstate commerce and could not be constitutionally taxed.

The second case dates from 1887 and involves another attempt by the State of Pennsylvania to tax transportation companies.27 In this case, Pennsylvania taxed the gross receipts of a steamship company incorporated in Pennsylvania which transported persons and property between different states and in foreign commerce. The Court held that such taxation was in the exclusive power of Congress. Accordingly, the tax was an impermissible burden upon commerce and could not stand.

The third case involved a California tax upon a ticket agent who did not sell tickets but who tried to influence people to travel by a particular freight line. The tax was in the form of a quarterly license tax.28 Once again, the Court held that the tax was an impermissible burden upon interstate commerce and was thus unconstitutional.

The fourth case is factually quite close to the problem analyzed by this memorandum. Louisiana attempted to impose a license tax on a corporation which was employed as an agent by owners of vessels engaged in interstate and foreign commerce to solicit cargo, select ships to carry that cargo, arrange stevedores and other wharf matters, collect freight charges, and other related activities. The activities of the Louisiana corporation were very like that of a modern day travel agency. The Court voided the tax holding that the tax amounted to an impermissible burden on commerce in violation of the Commerce

28 McCall v. California, 136 U.S. 104 (1890).
While these cases are of somewhat ancient vintage, they have never been overruled and arguably state legal principles as valid in 1987 as they were 60 to 100 years ago.

Moreover, these cases are not without some modern support; a case decided by the United States Supreme Court in 1979 gives significant credibility to this older line of authority. The controversy dealt with the power of a California municipality to impose a property tax on cargo containers owned by Japanese shipping companies. The containers were used exclusively in foreign commerce and were subject to tax and other regulation by Japan. The containers were physically in California in the normal course of the shipper's business and while there were taxed. The United States Supreme Court invalidated the tax holding that it violated Congress's power to regulate foreign nations.

The facts of this case are not unlike the modern day cruise ship business. Cruise ships frequently fly foreign flags and are owned by non-U.S. companies. Many cruises involve no Florida port. The Florida nexus is often slight and may in fact be only the fact that a Florida business is acting as an agent for such a company and issues a ticket to a Florida or non-Florida resident for passage.

The thrust of these cases is that there are substantial constitutional questions as to the validity of a Florida services taxes as to the cruise ship portion of a travel agency's

31 A similar problem would arise in the airline industry were the services tax to reach foreign government-owned carriers, such as Air France.
32 This information was supplied by the trade association, ASTA.
33 The commerce clause argument of the Wardair case, discussed in depth earlier in this memorandum, supra at text accompanying note 13, is inapposite. There are specific rules and agreements which apply to fuel which do not apply to contracts for passage. There is nothing in that analysis which precludes this analysis of Japan Lines or the earlier cases in which it finds its roots.
ADDITIONAL QUESTIONS

There are several additional legal questions which deserve analysis. The first is whether the preemptive effect of 49 U.S.C. §1513 applies with equal force to travel agencies as it applies to the airlines. The cited cases involved controversies between taxing authorities and airlines. Do their principles apply equally as well to travel agencies in the context of the proposed Florida services tax. The answer is unequivocally "yes" for several important legal reasons.

The first part of the legal analysis finds its root in Professor Hellerstein's analysis and Section 212.07(9) of his draft statute. The early Florida case of State v. Keller, 191 So. 542 (Fla. 1939) invalidated a municipal tax on lawyers. It was held that the tax was a prohibited income tax measured by the lawyer's gross income regardless of the municipality's efforts to structure the tax in some permissible fashion. While there is some question about Keller's continued vitality, the case has never been specifically overruled.

For this reason Professor Hellerstein expressed considerable doubt about a services tax imposed on the provider of the service. He concluded that in order to reach the lawyers or similar professionals, the safer constitutional course was to impose the tax fall upon the "consumer of the service." Professor Hellerstein also felt that there was additional advantage by placing the both the economic and legal burden on the same group--the consumer.

This philosophy was carried forward and embodied in Professor Hellerstein's draft statute. Proposed Section 212.07(9) provides specifically as follows:

34 If both the cruise and airline segments are eliminated, the revenue projection focuses only on the miscellaneous aspects of the business. A 5-15% share would at most produce potential tax revenues of only $1,300,000 to $4,200,000, even if those segments would withstand attack when viewed critically and individually.

35 See pp. 6-7 of his appendix entitled "Consultants Preliminary Thoughts Regarding Preface".

36 A subsequent case, Gaulden v. Kirk, 47 So.2d 567 (Fla. 1950) validated a tax on a motel owner and did not clearly distinguish its holding from that in Keller.
"Any person who has purchased at retail, used, consumed, distributed, or stored for use or consumption in this state tangible personal property, admissions, communication or other services taxable under this chapter,...and cannot prove that the tax levied by this chapter has been paid to his vendor, lessor or other person, is directly liable to the state for any tax, interest, or penalty due on any such taxable transaction."

Thus it is completely clear that the consumer or the beneficiary of the service is the one who has the ultimate liability for the tax.

However, in the travel agency/airline scenario, the (consumer) or beneficiary of the service is the supplier of the service or the airline. This fact is clear when one considers the economic relationship between the airline and the travel agency. The airline sells tickets for the same price that the travel agency sells those self same tickets. Yet, the airline is willing to take approximately 10% of its own profit margin to pay travel agencies for those tickets which those agencies sell.

Why do the airlines do this? The reason is not altruism; it is economic benefit. Travel agencies provide an invaluable distribution arm for the airlines. No airline could afford to open up over 2000 outlets in the State of Florida, not to mention the other 49 states. No airline could afford to staff those outlets or manage the employees. It is clearly worth it to the airlines to pay the commission to the travel agencies for these benefits.

Thus, the travel agencies supply a service to the airlines who pay a commission for the privilege. The scenario is no different from any other sale of services; the consumer in the scenario is a corporation rather than an individual, but that distinction has no legal significance.

If Florida taxes the commission, the incidence of the tax must legally fall on the airline if Professor Hellerstein's model is adopted. If it falls on the airline, the tax is trumped by the preemptation analysis presented in the previous sections. The unique organization of this industry makes the tax suspect. In the state's effort to assure that it could tax the lawyers, the state has jeopardized the validity of the tax in this area.

There are additional legal reasons which supplement the legal argument based on the Hellerstein statute. The travel agency is no more than a middleman between the consumer and the
airline. The agency is providing a service which is also provided directly by the airline. The cases cited and analyzed by this memorandum clearly prohibit the State from levying a tax on ticket sales made by the airlines. Their logic also prohibits the State from accomplishing the same result by indirectly taxing the airline's duly authorized agent. Both the carrier and the travel agency are selling the same product—air transportation. The statute expressly prohibits a direct or indirect tax on "the sale of air transportation or on the gross receipts derived therefrom." Any other interpretation would both frustrate the plain meaning and intent of the statute and run contrary to the thrust of the reported cases. Economically, the proposed Florida service tax amounts to an effective tax of five mills on the gross revenue of the airline. However, a low tax rate is no talisman to ward off the holding of the Aloha case.

A final question is whether cases such as Wardair and the other similar cases cited earlier in this memorandum would save Florida's proposed tax. We would suggest that these cases do not change the likely result. The sale of a ticket is easily distinguishable from the purchase of products. Congress addressed ticket sales and the United States Supreme Court in Aloha made clear that such sales are contained within the prohibition of Section (a) of the statute rather than the valid taxes specified in Section (b). The Wardair line of cases is inapposite.

3. The Position Taken by the Other Four States Which Have Enacted Services Taxes and Which Were Analyzed by the Study Commission.

Both the Department of Revenue and Professor Hellerstein's report to the DOR and the Sales Tax Study Exemption Commission examined the services tax enacted by four other states: Hawaii, Iowa, New Mexico, and South Dakota. Each of these states have addressed the travel agency issue in one form or another, and their approach is instructive and meaningful for purposes of Florida's ultimate determination.

New Mexico exempts the travel agencies by the way it defines taxable revenues. Thus, the "receipts of travel agents derived from commissions paid by maritime transportation companies and interstate airlines, railroads, passenger buses for booking, referral, reservation, or ticket services" are not taxed.38

37 Computed by multiplying the tax rate of 5% by the 10.0% commission percentage earned by the agent.

38 New Mexico Statutes §7-9-76 (1985).
South Dakota's approach is a straight exemption of all travel services from the reach of its tax. Thus transactions constituting the "arrangement of travel services" are not taxed.  

Iowa's approach is somewhat different. Their services tax is not couched in terms of exemptions, but rather limits itself to the taxation of specifically defined services. The statutory list does not include travel agencies. A call to the Iowa Department of Revenue confirmed that they do not classify travel agency revenues as taxable events. 

The only possible exception to this approach is Hawaii, but the validity of their statute as applied to the travel industry is in doubt after the United States Supreme Court decision in the Aloha Airlines case. The Hawaii statute taxes all services in general and facially includes the travel industry. However, this statute has been neither revised nor challenged since Aloha, and it is highly unlikely that it would withstand judicial scrutiny.

In any event, three out of the four states whose services tax has been highlighted as part of Florida's analytical process have exempted or do not tax the travel industry. There is no evidence that these exemptions have created revenue or other problems in those states. These decisions strongly support the wisdom and propriety of the exemption advocated in this memorandum.

4. Analyzing the Economic as opposed to the Legal Burden of the Tax.

Prior to discussing the policy considerations underlying the imposition of the new services tax on travel agencies, I pause to give the three possible scenarios describing who would actually bear the tax. Others testifying before this Commission have assumed that the tax would be passed on to the members of the

41 Call from Joseph Jacobs to the Iowa Department of Revenue, February 18, 1987.
42 Aloha Airlines v. Dir. of Taxation of Hawaii, 464 U.S. 7 (1983); See text accompanying Notes 16-22, supra.
public who are consumers of the services rendered by the industry.¹⁴ The travel agencies are not nearly so sanguine in their ability to predict just who would bear a tax imposed on travel agencies. Indeed, there are three distinct possible scenarios, which have been alluded to previously but are here initially set out for identification purposes.

I. Suppliers Bear the Tax. Under this scenario, agencies would simply add 5% to the commissions charged to the suppliers. If a $100 item of travel were sold, the agency which now retains $10.00 ¹⁵ from the amount deposited next Tuesday into the Area Settlement Plan would now retain $10.00 plus 5% of $10.00, or a total of $10.50.

II. Clients Bear the Tax. Under this scenario, the agency and the airline would add a service charge to the price of the ticket to reflect the amount of the services tax imposed on the agency's commission. Owing to the formatting of the ticket stock in universal use for air travel, this charge would have to be separately stated as an amount in excess of the stated dollar value of the ticket. In other words, clients would be aware of the charge which would come to about 1/2 of 1% of the price of the ticket.

III. Agency Bears the Tax. This is the last resort scenario from the perspective of the agencies. It would occur if the industry were unable, due to market factors, to pass the tax either to the suppliers or to the clients. The result would be a five percent reduction in gross revenues otherwise available to pay agency expenses.

Professor Hellerstein's draft statute clearly and specifically places the incidence of the services tax on the "consumer of the services"—here, the suppliers.¹⁶ In other words, it is assumed

¹⁴ To give but two examples, at the February 3rd meeting in Tallahassee, Insurance Commissioner Bill Gunter assumed that a tax on insurance would by borne by policyholders. Florida Bar President Joe Rieiter assumed that a tax on lawyers would be passed onto and borne by clients.

¹⁵ $100 item x average commission rate of 10%.

¹⁶ His Appendix entitled "Consultants Preliminary Thoughts Regarding Preface" explains, on pages 6 and 7 thereof, that this is the "safer course from a constitutional standpoint." Placing the incidence on the provider, rather than the consumer, was considered and rejected because of constitutional considerations. Professor Hellerstein's draft statute, §212.07(9), makes the "consumer of taxable services" liable for payment of the tax. See, also, the more thorough discussion accompanying Note 35, supra.
that Scenario I would describe the tax system in practice.

Scenario I, however, presents significant practical problems. For example, if agencies were simply to withhold the tax on deposits into the Area Settlement Plans, nationwide chaos would result. The national electronic system is programmed on the assumption that the only permissible deduction is for allowed commissions. It is not programmed for exceptions. If the agencies withheld, therefore, as Scenario I contemplates, there would be shortfalls of about 1/2 of 1% in all deposits made by Florida agencies, even as to those airlines having no Florida presence. The accounting system could not accommodate the difference and confusion would be the result.

There are other practical problems. First, the airlines could renegotiate the commissions payable to Florida agencies downward so that the new commissions plus the tax equalled the old commission. This would simply change the operation of the system to Scenario III, where the agencies bear the tax. Or, the airlines could agree to pay the tax and receive a smaller net amount for services provided by Florida agencies.

If the latter occurred—an outcome which is extremely unlikely given the relative bargaining power of agencies and airlines—then the airlines would find themselves in direct competition with their Florida agencies. The airlines could earn more money by selling the tickets directly to the customers, eliminating the travel agencies. The incentive to increase their margin, even by the 1/2 percent savings realized on direct sales, may prove very significant in today's highly competitive, deregulated airline industry. At a minimum, one might expect the larger airlines to become more aggressive in their direct marketing efforts in major Florida metropolitan centers. The result would be the demise of some potentially significant number of the existing 2,000 plus agencies.

Perhaps a more appealing response to the airlines and the travel industry would be a joint effort by the agencies and the airlines to pass the burden of the tax onto the retail clients. However, no matter how appealing this option might be to the

47 For example, if a Florida agent wrote a ticket for travel on Western Airlines (an airline having no presence in Florida), the tax would nonetheless apply, since the services would be performed in Florida. See, Hellerstein Draft Statute, §212.059(1)(a).

48 As explained in the previous section of this memorandum, a federal statute prohibits Florida from imposing the services tax on the airlines themselves.
airline and travel agency industries alike, it is highly unlikely that the tax could in fact be passed onto the retail purchasers. At present, there is no difference in the cost to the traveler of tickets purchased from an agency versus one bought directly from the supplier. History suggests that the public is acutely aware of, and highly adverse to, any add-on service charge imposed by agencies. To the best of our knowledge, no Florida agency presently adds a service charge. If tickets purchased through travel agencies were subject to a service charge to cover the tax, then it is almost inevitable that most travelers would cease using Florida agencies. They could do so because of the readily available alternatives: they could either book directly with the airlines (or other suppliers) or use out-of-state travel agencies who already serve the Florida markets with 1-800 inwats telephone service and prominent listings in the metropolitan area yellow pages.

Unfortunately for the industry, then, the most likely scenario is that described as Scenario III. The industry would have to absorb the tax. This means that the $138,000 of gross income now earned by the typical Florida agency would have another claim against those revenues: a payment to the Department of Revenue in the amount of $6,900. This would of course come out of the already modest bottom-line profit available to the owner-employee, and would likely case the failure of many now barely profitable Florida agencies.

5. Policy Considerations. There are a number of reasons why the tax, even if not blocked by federal law, would be unwise to impose on travel agencies as a matter of public policy.

a. Small Revenue Impact. The average agency gross income is $138,000. If this were subject to tax, some $6,900 per agency would be raised. Total revenues to be expected, even under the most optimistic scenario then, would only approximate $27 million per year. Under more likely scenarios, the revenue raised would be much, much less. When balanced against the cost in terms of lost jobs and lost business locations as some agencies collapsed from having (most likely) to bear the $6,900 annual tax burden, the net result to the economy would likely be negative.

b. Discrimination Against Small Businesses. The tax would tend to favor large businesses (the air carriers exempt from the services tax) over small businesses.

c. Easy Avoidance. Were the tax to be passed along to the ultimate consumer of the service, it could be avoided both easily and legally. Sophisticated travelers would soon learn to save the service charge by either direct contact with the suppliers or by using 1-800 inwats telephone service to agencies locates elsewhere in the nation.
d. Pyramiding of Taxes. Air transportation is a heavily taxed transaction, owing to the eight percent federal excise tax. If a tax on travel agencies were not preempted by federal law, the result would be a pyramiding of taxes (state and federal).

e. Tourism Effects. Damage to the travel agency industry seems inevitable were the services tax imposed on travel agencies. While many of the industries testifying before this Commission have invoked the dual litany of "administrative nightmare" and "mortal blow to the industry," we suggest that the peril to the travel agency industry is a real one, because of its small size and its economic inability to pass the tax on to the consumer.

Damage to the Florida travel agency industry would ineluctably damage the tourism industry. Florida agencies do more than arrange outbound travel for Florida residents. Many visitors to Florida use Florida travel agencies to modify their travel plans once on vacation within the State. Fewer agencies would mean reduced access for our tourists. And, perhaps whimsically, were such travelers to discover that a modification of their plans through a Florida travel agency triggers a service charge to cover the services tax, they might well feel abused by an unfamiliar system.

f. Violation of a Fundamental Premise of the Hellerstein Statute. One of the fundamental premises of the Hellerstein draft statute is that the tax can be passed on to the retail purchaser of the service being taxed. The affected industry would thus suffer the administrative inconvenience of collecting the tax under the sales tax dealer provisions of Chapter 212, but would generally suffer no direct industry harm. The point has been made repeatedly in this memorandum that most likely the burden of the services tax could not be passed on by travel agencies to either the suppliers or the clients. We stress again that this fact alone distinguishes the travel agency industry

---

49 See, 26 U.S.C. §§4261 and 4271.

50 The Hellerstein Statute, unlike Chapter 86-166, would impose a compensating use tax on services provided from without, but consumed within, the State. §212.059(2). Thus, most industries would be protected against out-of-state competition.

The real risk to industry would be that it is a non-essential service to which consumers are acutely price sensitive. For these industries, if they exist, the services tax could result in consumers shifting dollars from spending on existing services to savings or some other activity.
from most others. Other industry classifications are, almost definitionally, monopolies or quasi-monopolies. They can pass the tax on, so long as everyone offering the service must impose it. This, again, is not true of the travel agency industry, where because of the unique situation that the suppliers of the service are in fact tax-exempt, not everyone offering the service must pay the tax.

6. Validity of exemption against the background of the statutory criteria.

Subsection 3(a) of Section 9 of Chapter 86-166 lists seven criteria to be examined by this Study Commission when evaluating exemptions. We strongly suggest that an examination of those criteria supports an exemption for the travel industry.

The first criterion deals with the economic impact of the exemption. As has been suggested earlier in this memorandum, there would be a substantial adverse economic impact if the exemption was not granted. Many small businesses would be forced out of business as they would lose out to the larger travel agencies better able to absorb the economic impact, to competitor's from other states, or to the carriers themselves. No travel agency would be motivated to open a business in Florida. Many cruise and other carriers may avoid Florida agencies. The national clearing/collection system would be adversely affected and would have less motivation to deal with Florida providers.

The second criterion deals with the relationship of the exemption to other statutory policy such as environmental or growth management laws. The best nexus would be found in the fact that the tourism industry is central to Florida's growth and development. Any act which endangers or harms that industry is inconsistent with other efforts to promote the industry and the Florida economy. There is simply no basis to promote on the one hand and harm on the other.

The third criterion deals with the question of whether the exemption would be consistent with state tax policy. The exemption would be consistent in that it avoids double state and federal taxation. Indeed, this is the purpose of the federal statute which forbids state taxation of airline gross revenues. It would be further consistent because the failure to grant the exemption would definitely create a regressive tax. The small businessman would be unduly harmed to the benefit of the larger businessman.

The fourth criterion deals with the whether the legislature would have to appropriate money to fund the exemption. The answer is probably not. The revenue potential of this exemption,
net of the likely successful legal challenges is relatively minimal. There would not be a significant revenue drain if this exemption were allowed. Moreover, this exemption has been allowed by other states without a major effect on their revenue needs.

The fifth criterion deals with whether the exemption would be an efficient way to provide a more favored status for an industry or group. The answer is definitely yes. It is a simple and effective way to accomplish the goal.

The sixth criterion is concerned with whether the reasons for granting an exemption are still valid. The answer, as described in this memo at great length, is definitely yes.

The final criterion deals with whether the exemption should be subject to periodic review or repeal. Such a provision is probably unnecessary since the reasons for granting the exemption are unlikely to change in the near future.

In sum, the Commission's own criteria for exemption strongly argue for granting an exemption from the proposed services tax to the travel agency industry.