August 4, 1987

Professor Walter Hellerstein
University of Georgia School of Law
Herty Drive
Athens, Georgia 30602

Dear Professor Hellerstein:

Enclosed is the July 24, 1987 draft of the task force report on the Florida sales tax as applied to legal services. I regret that you did not receive a copy last week (the work of office gremlins or postal gremlins—we don't know which!) We are, of course, very interested in your response to the report.

Sterling will be in the Washington office on Wednesday afternoon; he would appreciate your calling him there at your convenience, telephone (202) 842-3600.

Sincerely yours,

Dorothy H. Cusker

DHC:sdd
Enclosure
AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

Comments on the Florida Sales and Use Tax
On Services and Other Transactions

July 24, 1987

This report was prepared by members of a task force of the Committee on State and Local Taxes. The principal draftspersons were Dorothy Cusker and Joseph C. Kempe. Helpful comments were received from Bernard Barton, J. Whitney Compton and Joanne E. Sciullo, John C. Duffy, Jr., Robert Joe Hull, C. James Judson, Gerald C. Neary, Albert C. O'Neill, Jr., William B. Prugh, Janice L. Robertson, Philip M. Tatarowicz and Cass D. Vickers. Also received from Barry Richard were copies of briefs submitted on behalf of the Florida Bar to the Supreme Court of Florida in its advisory opinion concerning the tax on services.
SECTION OF TAXATION

AMERICAN BAR ASSOCIATION

Comments on the Florida Sales and Use Tax on Services And Other Transactions, Contained In Chapters 87-6 and 87-101, Laws Of Florida.

The following comments concern the application of the tax to the provision of legal services. These comments are the individual views of members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or the Section of Taxation.
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(ii)
PURPOSE OF THE REPORT

The report briefly reviews the traditional sales and use tax, briefly discusses the constitutional framework for such taxation, analyzes the problems of the Florida statute relative to that framework, and concludes with a discussion of the workings of the statute and attendant technical problems. It is intended as a working paper for the Committee.

INTRODUCTION

When first introduced approximately fifty years ago, the sales tax was a marvel of simplicity. It was a tax on a retail sale, paid by the consumer. The sales clerk simply collected a percentage of the sales price from the customer, and remitted it the state. The taxpayer-customer filed no returns, did no research, and asked very few questions. It was in the interest of the selling organization to know the law so as not to aggravate customers by charging the tax when it was not
due, and to avoid personal liability for failure to collect the tax when it was.

The earlier versions of the tax were also analytically simple. The tax was paid only once, at the end of the distribution chain (cf. value added taxes, which are collected and credited all along the way.) It was imposed on a readily identifiable "transaction." Each "transaction" had a definite situs, or place, that identified the jurisdiction entitled to the tax. The later-introduced "use tax" has shared these relatively clear concepts of "transaction" and "place."

Florida's new sales and use tax on services has extended the bounds of a sales and use tax. In the process, it has lost at least the simplicity and certainty which traditionally attended such taxation.

The newly-enacted Florida sales and use tax on services, effective July 1, 1987, has evoked considerable comment among lawyers and non-lawyers alike. Although a few states tax some service transactions, Florida's new tax on the sale or use of services stands out, not only because of its statutory breadth and the size and nature of the underlying Florida market, but also because its effect will be felt beyond Florida's borders. One of the authors of the legal study commissioned by the Florida
legislature prior to enacting the tax has described the tax as a "legislative time bomb." ¹

Political and economic realities may have driven the Florida legislature to adopt this tax: While Florida's significant population growth has put corresponding demands on its infrastructure, the Florida Constitution prohibits the taxation of individual income. Practically, the legislature chose to expand the scope of the tax to services rather than increase the existing rate (5%) with respect to the sale or use of property.

Once passed, the tax triggered strong reactions from various sectors of the service economy, especially from the media (the bill provides for taxation of advertising) and from lawyers, acting both individually and through the organized bar.

Lawyers oppose the tax for economic and practical reasons: It increases the price of legal services, and it burdens many service providers and most purchasers with substantial record-keeping. As the report discusses, lawyers oppose the tax on constitutional as well as technical grounds. What is to be determined is whether

¹/ Hellerstein, W., Extending the Sales Tax to Services: Notes from Florida, 34 Tax Notes 823, 824 (1987).
such objections are well-grounded, or merely a reaction to a novel and expanded form of taxation.

This report discusses both the constitutional and practical objections to the tax as it applies to the provision of legal services. While the focus of this report is the taxation of the sale or use of legal services under the Florida statute, many of these issues relate to the tax on other services as well. The analysis is relevant not only to lawyers practicing in Florida, those practicing on behalf of Florida clients and on behalf of multi-state clients with a Florida nexus, but also to lawyers in any of the numerous other states which are considering a similar tax.

BACKGROUND

In the last 50 years, the Supreme Court has held that the power of the states to tax extends to activity within interstate commerce as well as to activity within their own borders. See, e.g., Western Livestock v. Bureau of Revenue, 303 U.S. 250 (1938), holding that interstate commerce may be required to "pay its own way"; Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), holding that a tax upon the privilege of doing business was not
per se unconstitutional when applied to interstate commerce, provided the tax met certain requirements. Generally, the Court has evidenced reluctance to interfere with state legislative decisions in the area of fiscal policy. See, e.g., Regan v. Taxation with Representation of Washington, 461 U.S. 540 (1983); San Antonio Independent School District v. Rodriguez, 411 U.S. 1 (1973).

The power of the states to tax is not unbridled. Taxation must comport with due process and equal protection; if it interferes substantially with fundamental rights, it is subject to strict constitutional scrutiny. In the main, however, "where taxation is concerned and no specific federal right, apart from equal protection, is imperiled, the States have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation." Lehnhauser v. Lake Shore Auto Parts Co., 410 U.S. 356, 359 (1973), upholding an Illinois tax imposed on the personal property of corporations but not of individuals.

While residents can express their displeasure with taxation at the voting booth, non-residents have turned necessarily to the courts to establish the limits of the state taxing power. In determining whether a state
tax complies with due process requirements, the "simple and controlling question is whether the state has given anything for which it can ask return." Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1941). When a state taxes activity in interstate commerce, due process requires (i) that a minimal connection exist between the interstate activities and the taxing state and (ii) that the revenues attributed to the state relate rationally to the intrastate values of the enterprise to be taxed. Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978).

State taxation of activity in interstate commerce is subject to analysis under the commerce clause (U.S. Const. Art. I, § 8, cl. 3) as well as under due process. State taxation of interstate commerce does not offend the commerce clause provided that (i) the activity to be taxed has sufficient nexus with the taxing state; (ii) the tax is fairly related to the benefits provided by the state; (iii) the tax does not discriminate against interstate commerce; and (iv) the tax is fairly apportioned to the local activities of the taxpayer. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).\(^2\)

\(^2\) Points 1 and 4 of the Brady test emerge as the due process requirements articulated in Moorman, 437 U.S. 267 (1978). Thus, cases decided on the basis of sufficient nexus or apportionment may be grounded on the commerce clause and/or due process.
Recent Supreme Court cases involving state taxation of interstate commerce have also required "internal consistency" of such taxation. "Internal consistency" requires the tax to be "such that if applied by every jurisdiction, there would be no impermissible interference with free trade." Tyler Pipe Industries, Inc. v. Washington Dept. of Revenue, ___ U.S. ___, 55 U.S.L.W. 4978 (1987). This case held that Washington's business and occupation tax discriminated against interstate commerce by exempting from the tax in-state manufacturers selling their goods within the state. American Trucking Associations, Inc. v. Scheiner, ___ U.S. ___, 55 U.S.L.W. 4988 (1987), decided the same day as Tyler Pipe, held that Pennsylvania's flat tax imposed on the operation of trucks within the state discriminated against interstate commerce by providing to in-state trucks a reduction in registration fees equal to the tax paid. Furthermore, the state may impose a complementary tax upon activity in interstate commerce.

3/ The fundamental requirement of an apportionment formula is fairness. Exxon Corp. v. Wisconsin Dept. of Rev., 447 U.S. 207 (1980). For discussion of the consistency requirement -- both internal and external consistency -- which the Court has grafted onto this fairness requirement, see Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) as well as Armco, 467 U.S. 638; Tyler Pipe, 55 U.S.L.W. 4978; and Am. Trucking, 55 USLW 4988.
only if the instate and interstate activities to be taxed are "substantially equivalent." See *Tyler Pipe*, 55 U.S.L.W. 4978 and *Armco Inc. v. Hardesty*, 467 U.S. 638, 643 (1984), stating that manufacturing and wholesaling are not substantially equivalent activities; *Maryland v. Louisiana*, 451 U.S. 725 (1981), stating that first use and severance are not substantially equivalent activities.

**CONSTITUTIONAL IMPLICATIONS OF THE FLORIDA SALES AND USE TAX ON SERVICES AS APPLIED TO LEGAL SERVICES**

As this report has discussed, a state's exercise of its taxing power raises constitutional issues, and those issues vary depending on the object of the taxing power. The report will next discuss the federal constitutional issues raised both by the general application of Florida's sales and use tax on services to legal services and by its application to such services in interstate commerce.\(^4\) The reader should consider this

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\(^4\) The report does not address the constitutionality of the statute under the Florida Constitution. The Florida Supreme Court upheld (with the exception of provisions affecting the construction industry) the statute under the Florida Constitution in an advisory opinion issued July 14, 1987. The Court's opinion, however, is expressly non-binding, is inapplicable to the federal constitutional issues, and left for private litigation questions concerning the application of the tax to advertising and its application of the apportionment formula.
discussion in light of the broad severance clause contained in the statute:

[I]f any provision of this act or the application thereof to any person or circumstances is held invalid, the validity [sic] shall not affect other provisions or applications of the act which can be given effect without the invalid provision or application.

I. GENERAL APPLICATION OF THE TAX TO LEGAL SERVICES

The application of the Florida sales and use tax on services to legal services is limited by Florida Statutes § 212.0592(27)(a), (b). These provisions exempt from the tax (i) legal services rendered pursuant to the right to counsel guaranteed by the Sixth Amendment and the Florida Constitution and (ii) legal services rendered to natural persons and relating to (a) child support; (b) enforcement of civil rights; or (c) bankruptcy proceedings. The exemption under (i) above applies only if criminal charges are dismissed or the defendant is adjudicated not guilty, and takes the form only of a refund of a previously paid tax.

II. CONSTITUTIONAL ISSUES CONCERNING THE GENERAL APPLICATION OF THE STATUTE

A. The Constitutional Right To Counsel

At Section 212.0592(27)(a), the statute exempts from tax those legal services incurred pursuant to the
right to counsel articulated in the Sixth Amendment and the Florida Constitution, Art. I, § 16. The right to counsel, however, is protected by due process as well as by the Sixth Amendment. Powell v. Alabama, 287 U.S. 45 (1932). See also, Gideon v. Wainwright, 372 U.S. 335 (1963), holding that the Sixth Amendment cannot be infringed by state action. While Sixth Amendment rights attach when "adversarial judicial proceedings have been initiated," Kirby v. Illinois, 406 U.S. 682, 688 (1972) (plurality op.), the right to counsel guaranteed by due process may be triggered prior to the Sixth Amendment right. See In Re Grand Jury Subpoena, 781 F.2d 238, 258 (2d Cir. 1985) (Cardamone, J., dissenting), cert.denied, Roe v. U.S., ___U.S.____, 89 L.Ed.2d 914, 106 S.Ct. 1515 (1986). Thus the taxation of legal services rendered in a criminal or quasi-criminal matter prior to the initiation of "adversarial judicial proceedings" may constitute a violation of the right to counsel which is protected by due process.

The statute provides for a refund of taxes only in cases where the charges are dismissed against the taxpayer or where the taxpayer obtains a final adjudication of not guilty. This classification facially discriminates against defendants who are adjudicated
guilty. While research revealed no controlling precedent on this issue, several Supreme Court cases suggest that such classification is subject to challenge. See James v. Strange, 407 U.S. 128 (1972), striking down a Kansas recoupment statute empowering a state to recover in civil suit funds expended for the defense of indigents. While expressly declining to rule on the Sixth Amendment implications of such suit, the Court held that the statute violated equal protection because it denied to indigent defendants the protections afforded to all other debtors. The Court also stated without comment that most, but not all, state recoupment statutes require repayment by both successful and unsuccessful defendants. See also, Rinaldi v. Yaeger, 384 U.S. 305 (1966), in which the Court held that a New Jersey statute violated equal protection by imposing reimbursement costs for unsuccessful appeals on defendants sentenced to prison but not to those placed on probation or penalized by fine. The Court found no rational basis for this discrimination among defendants in their pursuit of the right to appeal a conviction.

Although an activity's relation to a fundamental right does not automatically exempt it from taxation, any such taxation must be nondiscriminatory. Minneapolis Star and Tribune Co. v. Minn. Comm'r of Revenue, 460 U.S. 575
(1983), striking down a special use tax on paper and ink on First Amendment grounds. It must be generally applicable to otherwise similar activities. See Grosjean v. American Press Co., 297 U.S. 233 (1935), in which the Court struck down on First Amendment grounds a special tax on large-circulation newspapers. While research revealed no cases concerning the constitutionality of a tax which applies to services related to fundamental rights but exempts some services not so related, such a tax structure seems suspect.\footnote{5/}

The statute exempts from taxation services rendered by employees to employers. As applied to legal services, this exemption discriminates between purchasers of in-house legal services and purchasers of legal services from independent counsel.

The Florida sales and use tax on services contains a list of other exempted services whose only common factor may be the employment of effective lobbyists. In the face of these exemptions, the application of the tax to legal services appears vulnerable under both the strict scrutiny and rational basis tests.

\footnote{5/ See Shapiro v. Thompson, 394 U.S. 618 (1969), in which the Court invalidated a durational residency requirement for welfare eligibility, stating that pressing fiscal needs do not in themselves justify infringement of fundamental rights.}
Finally, the refund form of this exemption, unique in the statute, requires all criminal defendants to pay the tax initially. Taxpayers can claim a refund when they have established their eligibility for the exemption. Contrary to the fundamental presumption of innocence, this tax scheme presumes defendants guilty. It is questioned whether administrative convenience justifies such a presumption.

B. Discrimination Between Legal Services Rendered To Natural And Non-Natural Persons

The statute exempts from taxation legal services rendered to natural persons concerning child support, enforcement of civil rights and bankruptcy. The Emergency Rules applicable to the statute define civil rights to include, among others, "equal protection and other guarantees of the United States Constitution and Federal Statutes. . ." 87-11(25)(6)(b)(2)(b). The Fourteenth Amendment guarantees due process and equal protection to both natural and non-natural persons. See Covington & L. Turnpike Rd. Co. v. Sandford, 164 U.S. 578, 592 (1896) and Smyth v. Ames, 169 U.S. 466 (1898), stating that a corporation is a person for purposes of equal protection and due process. Equal protection does not require identical taxation of individuals and corporations. See
Lehnhauser, 411 U.S. 910, upholding the rationality of a property tax imposed on corporations but not individuals. This exemption, however, discriminates between persons seeking to enforce fundamental rights. As such, it is subject to strict scrutiny, requiring the state to establish a compelling state interest which justifies such classification.

This distinction also applies to legal services concerning bankruptcy matters. While bankruptcy is not a fundamental right, such classification may still be subject to a rational basis test.

C. Discrimination Among Legal Services

In addition to discriminating between purchasers of legal services, the statutory exemption discriminates among substantive legal services by exempting services relating to child support. While the State has an obvious interest in seeing that child support is paid, it has a similar interest in seeing to various other payments (e.g., alimony) which are similarly necessary to prevent additional burdens on the State welfare system and yet are not exempt. To exempt legal services relating only to child support appears an irrational distinction in light of the purpose of both the tax and the exemption.
D. Discrimination Between Providers Of Legal Services

Because the statute exempts employee services from taxation, it effectively exempts legal services rendered by in-house counsel. Florida Statutes § 212.0592(2). In this respect, the tax not only puts outside and in-house counsel on unequal footing, but also places an unequal burden on those litigants who hire independent counsel, either by choice or by necessity.

III. APPLICATION OF THE TAX TO LEGAL SERVICES IN INTERSTATE COMMERCE

As discussed earlier in this report, the Constitution imposes requirements on state taxation of interstate commerce under both due process and the commerce clause.

A. Due Process

Due process requires (i) a sufficient nexus between the taxing State and the activity to be taxed and (ii) a rational relationship between the revenue sought to be taxed and the intrastate value of the activities of the taxpayer. Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978). Although the statute appears to acknowledge this dual requirement by providing an exemption for a business or a non-resident without a tax nexus to Florida, the statute
requires the claimant of such exemption to either apply for an Exempt Service Purchase Permit or submit an Exempt Service Purchase Affidavit. 12-AER-87-3(2)(a).

Both of these forms include a consent to Florida jurisdiction for purposes of determining liability under the tax. Thus the forms whipsaw a non-resident in the exercise of constitutional rights: In order to claim the exemption which is of right because no tax nexus to Florida exists, the non-resident must surrender that right or submit to the jurisdiction of the Florida courts absent the requisite minimum contacts as articulated in Florida's long-arm statute. Fla. Stat. Ann. § 48.193 (West Supp. 1987). The consent requirement raises serious issues concerning the State's ability to deprive a citizen of constitutional rights. See National Bellas Hess, Inc. v. Dept. of Revenue of Illinois, 386 U.S. 753 (1967), holding that a statute requiring an out-of-state mail order business to collect use tax violates due process and equal protection.

The difficulties both with applying the apportionment formula and with complying with the bookkeeping required by the statute suggest that many providers and purchasers of services for use in Florida will be hard put to know when they are in compliance with the statute. Some of these difficulties are a function of
the statute's newness and innovation. Yet this vagueness may constitute another due process problem, since those of "common intelligence exercising ordinary common sense can[not] sufficiently understand and comply with [the law]." U.S. Civil Service Comm'n v. Nat'l Ass'n of Letter Carriers, 413 U.S. 548 (1973); see also, Old Dearborn Distr. Co. v. Seagram Distillers Corp., 299 U.S. 183 (1936).

The basis for determining the application of the use tax, i.e., the enjoyment in Florida of the services purchased outside Florida, raises another due process issue. The enjoyment of the benefit of a service is not an identifiable, quantifiable, or integral part of the sales transaction which a use tax is intended to pick up. The tender and receipt of the service completes the transaction, and while the enjoyment of the service derives from that transaction, it is neither co-extensive with it nor restricted by it. Example: A multi-state business requests legal advice from a Texas law firm. The advice is rendered and paid for in Texas. The client benefits from that advice in Texas, Georgia, California and Florida. Having no nexus with the underlying sales transaction, and having no way to fix the amount and value of the service benefit that is related to Florida, the State seizes upon its existing nexus with the purchaser --
property, payroll, and sales in Florida -- to establish a transactional nexus that in fact does not exist.

The use of the apportionment formula to determine the taxes of a multi-state purchaser further defines this issue. The misapportionment of tax is in itself a due process violation, Asarco, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982), and the apportionment of income does not necessarily relate rationally to apportioning the enjoyment of a service.

B. Commerce Clause

As discussed earlier in the report, state taxation of interstate commerce is subject to a commerce clause analysis. While such taxation is no longer considered per se unconstitutional, it must (i) tax an activity sufficiently related to the taxing State; (ii) relate fairly to the benefits provided by the State; (iii) not discriminate against interstate commerce and (iv) be fairly apportioned to the local activities of the party to be taxed. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).

It should be noted immediately that the cases dealing with the apportionment of taxation on interstate commerce are dealing with the apportionment of income; the Supreme Court has not required apportionment of a
traditional sales and use tax. Neither has it determined whether such an apportionment formula transfers with requisite fairness to a sales and use tax. The use of such a formula may be significant in this case, where Florida has resorted to the sales and use tax on services as a fiscal solution to its prohibition against a personal income tax.

The Supreme Court has held that multi-state taxpayers need not prove actual discrimination by pointing to a taxing scheme of another state which results in discrimination.  Armco Inc. v. Hardesty, 467 U.S. 638 (1984). Rather, in a line of recent cases concerning state taxation of interstate commerce, the Court has stated that the tax must have "internal consistency -- that is the tax must be such that, if applied by every jurisdiction, there would be no impermissible interference with free trade."  Tyler Pipe Industries, Inc. v. Wash. Dept. of Revenue, 55 U.S.L.W. 4978 (1987), quoting Armco, 467 U.S. at 644. In American Trucking Associations, Inc. v. Scheiner, 55 U.S.L.W. 4988 (1987), decided the same day as Tyler Pipe, the Supreme Court discussed the impermissibility of a tax whose "inevitable effect is to threaten the free movement of commerce by placing a financial barrier around [the state]."  55 U.S.L.W. at 4992.
The imposition by each state of a sales and use tax upon services, applying similar apportionment formulae to multi-state taxpayers, would undoubtedly affect commerce among the states. Because we have had no experience with such a sales tax on services or an apportionment thereof, it has not been determined whether such an impact impermissibly burdens interstate commerce.

APPLICATION OF THE TAX TO LEGAL SERVICES AND ATTENDANT TECHNICAL PROBLEMS

The following is a discussion of some of the technical problems raised by the imposition of the tax on legal services. The technical problems identified are subject to revision because of the unsettled status of both the law and its administrative rules.

I. GENERALLY

Applying the Florida sales and use tax to a particular provision of legal services is generally a two-step process: If the benefit of the legal service is enjoyed in, or apportioned to, Florida, it is taxable unless covered by the limited exemption; secondly, if the

6/ While Container Corp., 463 U.S. 159, discussed internal consistency in terms of applying identical apportionment formulae, discussion in subsequent cases, cited supra note 3, does not appear to require application of identical formulae.
service is taxable, a determination must be made as to who must collect and remit the tax to the Department of Revenue.

The statute imposes a tax on the sale of legal services within the State of Florida, provided the majority of the service is performed within the State and its benefit is enjoyed within the State. If the majority of the cost of performance occurs outside of Florida, enjoyment of the legal service in Florida is subject to a complementary use tax. Florida Statutes §212.059(1)(b) and (3)(b); 12-ER-87-1(2); 12-ER-87-2(2). The legal service may be enjoyed within the State either directly or through apportionment.

Thus, the linchpin of taxation of legal services under the statute is their beneficial enjoyment within the State of Florida. The report discusses at 17-18 the constitutional difficulties with imposing a tax based on the enjoyment of a service. The report will now discuss the statute's various "presumptions" concerning the determination of this enjoyment.

If the majority of the cost in rendering legal services is incurred within the State of Florida, the service is presumed to be sold within the State and is therefore taxable. Florida Statutes §212.0591(9)(a)(2); 12-ER-87-2(2)(a)(3).
If the legal service directly relates to real property, it is presumed enjoyed in the state where the realty is located. If it relates to tangible personal property and either (i) the tangible personal property represents legal service received by an individual within a state or (ii) the tangible personal property acquires a business situs in that state, the legal service is presumed enjoyed within that state. Florida Statutes §212.0591(9); 12-ER-87-2(2).

If, however, the legal service relates neither to tangible personal property nor to real property in a state and the client is an individual, the benefit is presumed enjoyed where the greatest amount of the cost of performance is incurred. Florida Statutes §212.0591(9)(a)(2); 12-ER-87-2(2)(a)3. Thus, some legal services enjoyed by individuals in Florida presumptively become tax-exempt if they are obtained outside of Florida.

This generous loophole in the tax for individuals disrupts the symmetry of the application of the complementary use-tax. Since this effect of the tax favors rather than disfavors interstate commerce, it may not offend the commerce clause. It does, however, appear irrational, if the legislature intended to impose the tax on all non-exempted sale and use of services in Florida.
If the client is a business, whether a Florida concern or a multi-state concern doing business in Florida, and legal services directly relate to realty, personality or a local market, they are presumed enjoyed in the state where that related factor is located. If the client is a multi-state business operating within the State, and the legal services do not relate to any of those three factors, they are presumed to be enjoyed within the State under a weighted apportionment formula based on the taxpayer's sales, property and payroll within Florida. (If there is no payroll or property attributable to Florida, the sales factor is increased.) Florida Statutes §212.0591(9)(b)14; 12-ER-87-2(2)(b)(4).

II. COLLECTION

A. Sales Tax

The general rule is that a law firm collects the sales tax from a client at the time of the sale of services. If the client provides a "Certificate of Registration" or a "Exempt Service Purchase Permit," the law firm is absolved from collecting and remitting the tax to the Department of Revenue. Clients entitled to use these forms are respectively multi-state concerns with or without tax nexus to Florida.
B. Use Tax

As a general rule, the client remits the 5% use tax on the cost of the service. Florida Statutes §212.059(2); 12-ER-87-2. In certain circumstances, however, the tax requires out-of-state law firms with sufficient contacts in Florida to collect and remit a use tax.\textsuperscript{7} If the law firm has a tax nexus with Florida, the law firm is responsible for collecting and remitting the tax when (i) the legal service relates directly to real property in Florida; (ii) the legal service relates directly to tangible personal property in Florida (except for vehicles and vessels engaged in interstate or foreign commerce); or (iii) the legal service is represented by tangible personal property which is forwarded to a person in the State of Florida.\textsuperscript{8} Florida Statutes §212.059(3)(b); 12-ER-87-2(1)(b). The statute provides no guidance, however, to the multi-state law firm rendering to a multi-state client legal services which are subject

\textsuperscript{7} The Dorgan Bill, currently pending in Congress, is an attempt to circumvent National Bellas Hess, discussed at 16, in order to diminish the nexus required of out-of-state sellers before they may be burdened with a collection obligation for a use tax.

\textsuperscript{8} An example of such tangible personal property is a memo, opinion letter or contract in contrast to a bill for services which merely documents that services were rendered.
to the tax on the apportionment basis. Neither the statute nor the rules relieve the law firm from its obligation to collect a 5% tax upon the entire fee, even in those matters where the statute requires only an apportioned tax from the multi-state client. Florida Statutes § 212.059(3)(b).

III. OTHER DIFFICULTIES: EXEMPTIONS, RECORD-KEEPING, AND PYRAMIDING

The report has dealt at some length with the constitutional issues presented by the limited exemption of taxation of legal services. The following discussion raises other substantive and procedural difficulties with the imposition of the tax on legal services.

A. Procedural Difficulties

The exemptions applicable to legal services differ from other exemptions under the statute in two significant ways. First, the limited exemption on the sale of legal services in criminal matters is in the form of a refund, for which the "purchaser" must apply to the Department of Revenue. Florida Statutes § 212.0592(a); 1287-11(25)(6)(d). No other exemption is in the form of a refund. The statute's retrospective determination of
eligibility for the exemption probably explains this form. This form poses a problem to the attorney, who may be required to reduce fees in order to collect the additional 5%, as mandated by both the statute and professional ethics. Secondly, when an attorney provides both exempt and non-exempt services to a client, the burden of proof of a reasonable apportionment falls upon the attorney, rather than upon the client, as it does in other applications of apportionment under the Statute. ER 87-11(25)(6)(e).

B. Benefit Of Service Not Enjoyed In State

A multi-state client may demonstrate to the Department of Revenue that no tax is owed because the benefit of the legal service was enjoyed outside of the State of Florida. Florida Statutes § 212.0591(9)(a)(4) and (b)(6). The Department of Revenue will consider such applications individually, on the basis of whether the result of the service provided to a client that is a business could give rise to a cause of action in Florida under the Florida long arm statute. 12-ER-87-2(2)(a)(4) and (b)(6). Note, however, that sufficient minimum

9/ Model Rules of Professional Conduct Rule 1.8(e) states the restrictions on an attorney's advancing costs to a client.

If the client claims that no tax is due because no tax nexus exists with the State, the client must present to the Florida law firm an Exempt Service Purchase Permit for Out of State Businesses and Persons (Form DR-14P) in order to claim the exemption. Alternatively, the purchaser can present an Exempt Service Purchaser Affidavit (Form DR-14A). Both forms require consent to jurisdiction for purposes of enforcement of the sales tax on services. The report discusses at 16-17 the constitutional problems with this requirement.

C. Exemption From Collection For Multi-state Purchaser

If a Florida law firm provides legal services to a multi-state business having tax nexus with Florida, the client can claim an exemption from collection of the sales tax by the law firm. As noted above, in order to claim this exemption, the client must present to the law firm a valid Exempt Service Purchase Permit (Form DR-11T). If
any tax in fact is due under the apportionment rules, the client must self-accrue the tax.

D. Record-Keeping and Confidentiality

A law firm relying on Exempt Purchase Permits or Affidavits in not collecting and remitting the tax must maintain a monthly log containing prescribed information for a period of five years. House Bill 1506 amendment to Florida Statutes § 212.0593(3); 12-ER-87-3(5).

This record-keeping burdens not only the law firm but also the attorney-client relationship. While the statute makes the information privileged, it remains to be seen whether the confidence can survive Department of Revenue audits of lawyers and law firms. The attorney called to testify concerning a client's records may have to be disqualified from representation; thus the client is effectively denied the right to chosen counsel. See In Re Grand Jury Subpoena, 781 F.2d 238, 258 (2d Cir. 1985) (Cardamone, J., dissenting).

The tax raises another confidentiality problem in that prevailing criminal defendants must submit evidence of their acquittal/dismissal in order to claim a refund. This may present no problem when that information is already a matter of public record. But when charges are
brought and dismissed without a public record being created, the application for a refund may be impermissibly intrusive.

E. Pyramiding

While the tax is purportedly a tax on the retail sale of services, it functions to require both the law firm and the client to pay a tax on many of the ancillary services which are necessary to the provision of legal services. Given the Department of Revenue's interpretation of the sale for resale exemption, that exemption will not apply to many of these discrete services because the law firm is considered their ultimate consumer.

The statute does not recognize a fundamental difference between two general categories of services used in providing legal services. Lawyers use (i) some services which relate to the legal services provided, e.g., title reports, property appraisals, and (ii) some services which relate only to the way in which legal services are provided, e.g., travel and hotel services. The tax should reflect that a lawyer does not "consume" these services in the same way in providing legal services to a client.
Discussion with the Office of General Counsel for the Department of Revenue had suggested that a pyramiding of tax could be avoided by requiring a particular client to directly "contract" with the subcontracting service provider, i.e., court reporter. The Department indicated that it would look at the contract for a service and would only tax the transaction between the parties involved in the particular contract. Under this analysis, therefore, information provided by a client pursuant to a contract between the client and a third party service provider would not be subject to pyramiding.

This peculiar result was corrected in the amended rules released July 1, 1987. An amendment to 12 AER 87-11(25)(i) provides that such services will not be taxed twice if the law firm pays for them from client funds deposited in a regulated trust or escrow account.

F. Closing Comment

The correction to the rules regarding pyramiding, discussed above in Section F., coincided with the effective date of the statute. It seems to demonstrate the Department of Revenue's awareness of perceived inadequacies in the statute and its regulation. In a way, it provides both a focus and a starting point for analyzing the statute itself: Perhaps the statute needs
correction merely because it is so different from the existing sales and use tax framework that the old rules must be reworked to fit it. Perhaps it is a legislative experiment for which Florida is the laboratory. The analysis must also consider, however, whether the statute is unwieldy because of some essential flaw, and whether it sacrifices federally-guaranteed rights to the pressures of fiscal demands and the Florida constitution.