Preliminary Thoughts Regarding Preface - Hellerstein 10/8/86

In utopia, a sales tax would conform to the following "widely accepted" standards for evaluating sales tax structures. First, the tax would be a uniform levy on consumer expenditures, except where there was a justification for exception. Second, the tax structure would be designed to minimize regressivity in the distribution of the tax burden in order to accommodate to generally accepted standards of equity. Third, the tax structure would not create economic inefficiency by favoring particular methods of doing business, particular forms of business organization, or particular modes of delivering goods and services. Finally, the tax structure would facilitate tax administration and tax compliance.

In approaching the revision of Florida's sales and use tax in light of the enactment of Chapter 86-166, we should make it clear from the beginning that we do not envision our task as embracing the creation of a utopian sales tax structure for the State of Florida. To be sure, by drafting legislation extending Florida's sales tax to services, we may be able to move Florida's sales tax closer to the perceived ideal because we will be extending the levy to a broad class of consumer expenditures that up to now have been excluded from the sales tax base without


2. Presumably we are talking about exceptions based on principled justifications such as a desire to avoid pyramiding (e.g., sale for resale), constitutional necessity (e.g., sales to the Federal Government), or commonly held notions of equity (e.g., sales of prescription drugs).
principled justification. In a number of other respects, however, we will either ignore or consciously deviate from the goals of a model sales tax in our effort to refashion Florida's sales tax structure to accommodate Chapter 86-166. We wish to make explicit our assumptions in this regard at the outset.

First, in extending the Florida sales tax base to services, we will not systematically seek to make the Florida sales tax a uniform tax on consumer expenditures. Indeed, to implement this objective of an ideal sales tax, one would have both to broaden the sales tax base to include all services (which is one of our objectives) and to confine the sales tax base to purchases for personal consumption (which is not on our agenda). Indeed, to achieve the latter goal, all purchases for business use (whether of tangible personal property or services) would be exempt from the sales tax base because their cost will later be reflected in the price of the goods or services that are sold to consumers and, under a broad-based tax on goods and services, would be subject to taxation at that time. No state has ever attempted to implement this objective completely. Even within the confines of sales of tangible personal property most states, including Florida, fail to do so. For example, Florida taxes sales of machinery and equipment used in manufacturing and processing tangible personal property that will be taxed when sold, unless the machinery and equipment is used in new or expanding industry. Fla. Stat. Ann. §§ 212.05(f), 212.08(5)(b) (Supp. 1984). Presumably the cost of non-exempt machinery is taxed twice, once when purchased and again as an element of the price of the goods they produce, when
such goods are sold at retail. In short, Florida, like most states, presently does not impose a uniform tax even on sales of tangible personal property and its taxing scheme tolerates substantial pyramiding.

The Florida Legislature nevertheless professes an "intent that there shall be no pyramiding or duplication" of sales taxes. Fla. Stat. Ann. § 212.081 (Supp. 1984). We take this to mean that pyramiding and duplication are to be avoided with respect to the imposition of a sales tax on the same property qua property or service qua service. A sale for resale exemption will exempt from taxation the sale, say, of goods by a wholesaler that will be resold in the same form by a retailer, who will collect a tax on the retail sale. The injunction against pyramiding or double taxation does not extend, however, to tangible personal property that is used but not resold as such by a wholesaler, even though the price of such property will ultimately appear in the price of the final product sold by the retailer. By a parity of reasoning, a service would be subject to a sale for resale exemption if the service were to be resold as such. For example, transportation charges on items shipped to a wholesaler would not be taxable if the wholesaler resells the transportation as such to the retailer, presumably by separately stating such charges on his invoice to the retailer. On the other hand, if either tangible personal property or services are purchased by a provider of taxable services who does not resell the property or services as such, these goods or services will be taxable even though they will enter into the price of the taxable services sold by the service provider. For example, paper or courier services pur-
chased by a law firm would be taxable unless the law firm separately stated to its clients the charge for its services, on the one hand, and the paper and courier services on the other. If separately stated, then the purchases by the law firm would, at least in principle, constitute sales for resale, although one might want to limit the "separately stated" rule because of its negative revenue effects.

The approach outlined above appears to reflect current Department of Revenue policy with respect to taxable services. For example, after the Legislature extended the sales tax to cleaning, laundry, and garment services in Chapter 86-166 (see Fla. Stat. Ann. § 212.05(i)), the Department of Revenue issued a Notice that provided, among other things, that cleaning services provided by a hotel or motel are taxable and that the hotel or motel must give a resale certificate to the laundry or dry cleaning establishment that provides the service. In this instance, the service is being resold *qua* service. On the other hand, businesses providing cleaning, pressing dry cleaning, and laundry services directly to consumers are taxable on the services they provide and, in addition, must pay tax on materials and supplies they use in performing their taxable services. In this instance, the supplies are not being resold as supplies and therefore do not qualify for a sale for resale exemption, even though their cost will be reflected in the service tax base.

Second, in extending the Florida sales tax base to services, we do not take into account questions of tax equity. We view our fundamental task as the technical one of creating a workable sales and use tax structure that embraces all services. The only exemptions for services that we contemplate in the basic draft legislation are those that may be required by the structure of the tax itself (e.g., sale for resale) and those that parallel existing exemptions with regard to sales of tangible personal property. For example, since Florida presently exempts sales or leases of tangible personal property to or by churches, Fla. Stat. Ann. § 212.08(07), presumably the Legislature would wish to exempt the sale of services to or by churches. In short, subject to additional guidance from the State, we will take the present exemptions in the Florida sales tax statutes as evidence of legislative policy and attempt to implement a sales tax on services that reflects that policy.4

Because we do not view our task as making independent judgments about tax equity, we contemplate no exemptions for services in the basic draft legislation other than those suggested by the preceding paragraph. Hence services provided by employees to employers, medical services (e.g., kidney dialysis), and other services that have traditionally been excluded from the sales tax

4. In light of the Legislature's sunset of a number of exemptions in Chapter 86-166, § 8, and in light of the questionable basis for other exemptions in the present sales tax statute, it may well be that the State does not wish us to operate under the assumption set forth in the text. This is clearly a matter on which we will need further guidance if our assumption is wrong and, indeed, perhaps even if our assumption is right.
base would be taxable in the draft legislation.\footnote{5} Needless to say, we recognize that the Legislature may wish to modify this sweeping approach to the taxation of services, and, if directed to do so, we are fully prepared to offer alternative language that would exempt from the sales tax base specified services. Unless we are instructed differently, however, our initial draft will embody the broad approach suggested above.

Beyond these broad assumptions, we have considered on a preliminary basis a number of other issues bearing on the draft legislation and related matters identified in our contract. Our tentative views on these issues are as follows:

1. **Should the legal incidence of the tax on the sale of services be on the provider or the consumer of the services?** Our initial thinking favored placing the legal incidence on the provider. This preference was based primarily on the fact that it accorded with the present Florida sales tax statute and that the tax on services would therefore be easier to integrate with the existing law. Moreover, existing legal precedents, which are largely directed to the sales tax on the taxable dealer, would provide greater certainty with regard to a sales tax on the provider of services than they would with regard to a sales tax on the consumer of such services. We place a high premium on

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5. Given the broad exemption for sales of medical products in the present sales and use tax, see Fla. Stat. Ann. § 212.08(2), one could argue that a number of "parallel" medical services should likewise be exempt under a sales tax that extended to services. This thought indicates the importance of reaching an understanding of the extent to which the exemptions in the present sales and use tax should be viewed by us as mandates for carving out parallel exemptions for sales of services.
certainty in this somewhat uncertain venture.

After considering State v. Keller, 191 So. 542 (Fla. 1939), however, we concluded that the safer course from a constitutional standpoint would be to place the incidence of the tax on the consumer of services. To be sure, the tax at issue in Keller may be distinguishable from a tax on the privilege of providing services, and Gaulden v. Kirk, 47 So. 2d 567 (Fla. 1950) may be read as undermining Keller. We nevertheless feel that the risk of successful constitutional challenge to a sales tax on the privilege of providing legal, medical, or other professional services is sufficient to counsel the safer course of imposing the tax on the consumer of services.

Although placing the legal incidence of the service tax on the consumer of services does have the disadvantage of differentiating it from the tax on sales, it also has several advantages. It places the legal burden where the economic burden (or is designed to lie)---on the consumer of services. Moreover, in extending the sales tax on services to services provided by employees for employers, the choice of the consumer as the taxpayer is clearly preferable. Indeed, it would be impossible as a practical matter to register employees as "dealers" in accord with the basic sales tax scheme. Placing the legal incidence of the tax on the consumer may facilitate making the employer-consumer the collector of such a tax and makes it easier to defend against objections that the levy is simply a payroll tax which, arguably, would constitute a forbidden income tax. Finally, in terms of legal precedent, the tax on the consumer of
services is analogous to a use tax, which has long been a component of Florida's sales and use tax structure.

2. Does Chapter 86-166 levy a tax on services? Chapter 86-166 levies a tax on "any" service, which we read to mean all services. Section 212.05 of the Florida Annotated Statutes is the operative provision that imposes a tax on "services taxable under this chapter," and Chapter 86-166 goes on to specify that the tax is imposed "[a]t the rate of 5 percent of the consideration for performing or providing any service." We do not see how the legislative language could be clearer.

3. Where is a service consumed and how does one impose a compensating use tax on services? We are just beginning to explore these questions and believe they will be among the most difficult in the drafting process. We are examining New Mexico's and Hawaii's experience for guidance. Our goals in this regard will be to draft provisions that are administrable, that protect the tax base and that remove the incentive, within constitutional limits, for providers or consumers of services to divert their activities to other states.