

Reforming Florida's Tax System

Building a foundation for Florida's future



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President of the Senate

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Reforming Florida's Tax System

Building a foundation for Florida's future

Why does Florida need tax reform?

- ◆ Florida has an antiquated tax system that was basically created in 1949.

The needs of modern Florida can not be met by a 1949 system.

Our state has modernized its Cabinet structure and its education, welfare, tort, and budget systems, but has not modernized its tax structure.

- ◆ The current system is not capable of meeting Florida's long-term budget needs.

Florida will face a revenue crisis in the very near future.

Between the loss of the inheritance tax and the increasing loss of revenue from remote sales (such as Internet sales), Florida will lose approximately \$4 billion in revenues by 2006.

The current sales tax is primarily a tax on goods, and goods are a shrinking portion of the economy.

In 1964, the Florida sales tax applied to approximately 68% of our economic activity – today the sales tax applies to only about 55%.

- ◆ The tax structure does not mirror Florida's current economy and it exaggerates economic fluctuations.

Next year, Florida will collect approximately \$17 billion in sales tax, but will exempt approximately \$23 billion in taxes.

The number of new exemptions has increased continually during the last three decades.

- ◆ The current tax system is not fair and is illogical.

Many current exemptions make no sense:

Hair care products are taxed; hair cuts are not.

Laundry detergent is taxed; dry cleaning is not.

Lawn mowers are taxed; lawn care is not.

The current tax system is not fair to average families. A broad array of exemptions protect special interests while the average Floridian pays a 6% sales tax on many household purchases.

What is the proposal to address these problems?

- ◆ To place a constitutional amendment before the voters during the 2002 election.
- ◆ To broaden the sales tax base by eliminating sales tax exemptions.
- ◆ To reduce the state sales tax rate from 6% to 4%.
- ◆ To keep revenues neutral during the first year of implementation.
- ◆ To require a 3/5's vote of the Legislature to increase the sales tax rate.
- ◆ To require a 3/5's vote of the Legislature to adopt any new sales tax exemptions.
- ◆ To promote fairness in the system by maintaining exemptions for groceries, residential rent, health care services, prescription drugs, and basic residential telephone service.
- ◆ To eliminate several antiquated and inefficient taxes: the intangibles tax; the health care assessment that drives up the cost of health care; and the "by the drink" tax.

- ◆ To reduce the tax on commercial utilities to 4%.
- ◆ To require that the new system be in place by July 1, 2004.

What needs to be done and why now?

- ◆ We must bring Florida's tax structure into the 21st Century.
- ◆ We must provide the revenues to meet future needs in education, services for the elderly, transportation, and criminal justice.
- ◆ We must create a tax system that is equitable and efficient and that mirrors Florida's modern economy, not the economy of 1949.
- ◆ We must act now, not after a crisis has already hit.
- ◆ We must plan for the future and not just react to it.



Sales Tax Reform: Strengthening Florida's Future

Objectives

- Make the tax system more equitable
- Encourage economic growth
- Reduce variability in state revenues
- Reduce the tax burden on low and moderate income households
- Tax reform without tax increases



Proposal

- Lower sales/use tax from 6% to 4%
- Eliminate many sales tax exemptions
- Maintain revenue neutrality
- Eliminate inefficient taxes
- Require extraordinary vote for future rate increases or exemptions



Reduce State Sales Tax Rate

The current 6% rate would be reduced to 4% for all of the goods and services currently taxed

- This would have the impact of slightly *increasing* the total sales of these goods and services



Broaden the Tax Base

The new 4% rate would be applied to some goods and services not currently taxed



Reduce Exemptions

Current sales tax exemptions of \$9.5 Billion would be eliminated without impacting:

- Groceries
- Residential Rent
- Prescription Drugs
- Health Care
- Basic Residential Phone Service



Economic Efficiency

Eliminating the number of sales tax exemptions would reduce market inefficiencies

- A sales tax base more consistent with Florida's economy would result
- State revenues would more accurately reflect economic activity



Eliminate Taxes

Several inefficient and outdated taxes would be eliminated:

- Health care assessment
- Intangibles tax
- Discriminatory taxes on commercial utilities
- By-the-drink tax



Florida's Households

Florida's households could save \$750 million annually on their purchases

- Households in all income brackets would benefit from a sales tax that consistently reflects Florida's current economy
- Older Floridians could save \$135 million annually on their purchases



Florida's Households

Many of Florida's households spend a large percentage of their budget on transportation related products

- With tax reform, the average household will save over \$80 annually on transportation related products



Lower Tax Rate for Business

The new 4% rate would be applied to many significant business purchases currently taxed at higher rates

- Rent
- Utilities/Telecommunications
- Tangible Property



Florida Business

Since the tax reform is revenue neutral, the savings incurred by Florida's households would come from:

- Federal government
- Some Florida businesses



Federal Tax Savings

Sales taxes paid on business/professional services would be included in the deductions for federal income tax purposes



Eliminate other Taxes

Business would benefit by eliminating the inefficient and outdated:

- Health care assessment
- Intangibles tax
- Discriminatory taxes on commercial utilities
- By-the-drink tax



Florida's Small Business

Many of Florida's small businesses that spend more on rent, utilities, and supplies than they do on professional services would benefit from sales tax reform



Typical Small Business

A small business with \$500,000 in expenses that spends:

- 35% on rent, utilities, telecommunications, and supplies
- 10% on professional services

Will save \$500 a year in taxes



Summary

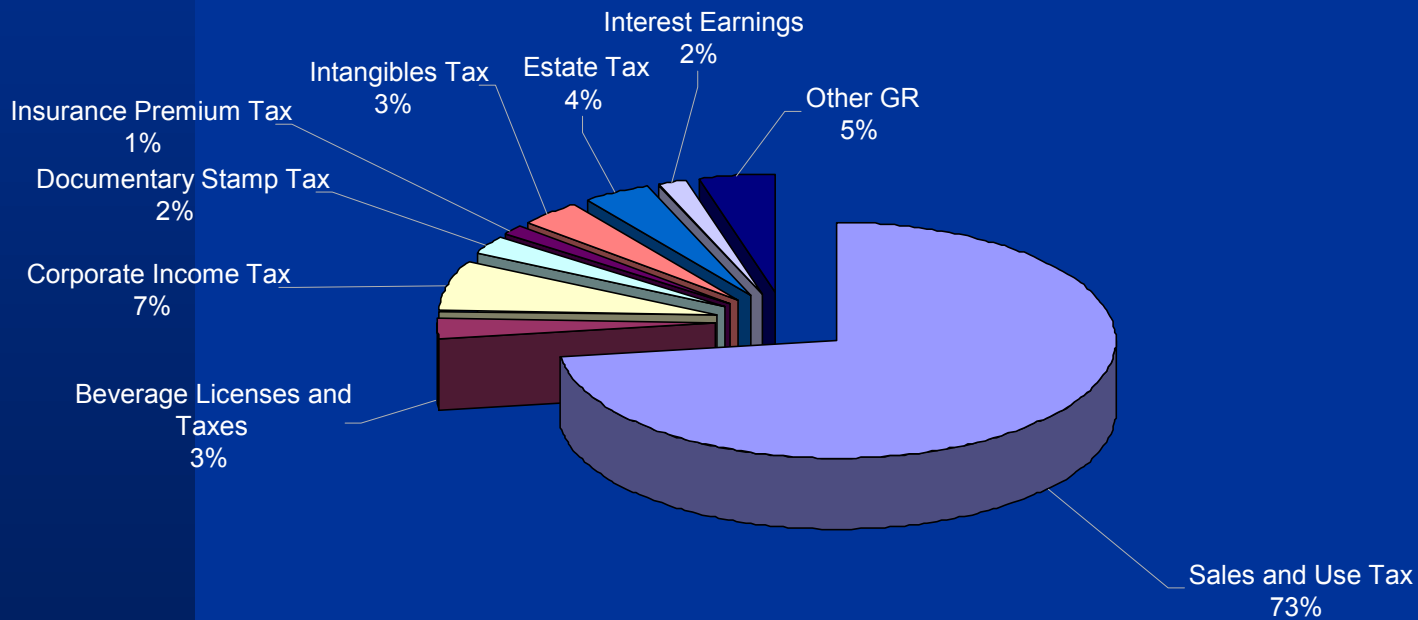
The proposal to reform Florida's tax system would:

- Reduce the sales/use tax from 6% to 4%
- Broaden the tax base
- Eliminate inefficient and outdated taxes
- Create a tax system that mirrors Florida's economy
- Reduce variability in Florida's tax revenues
- Implement tax reform without tax increases

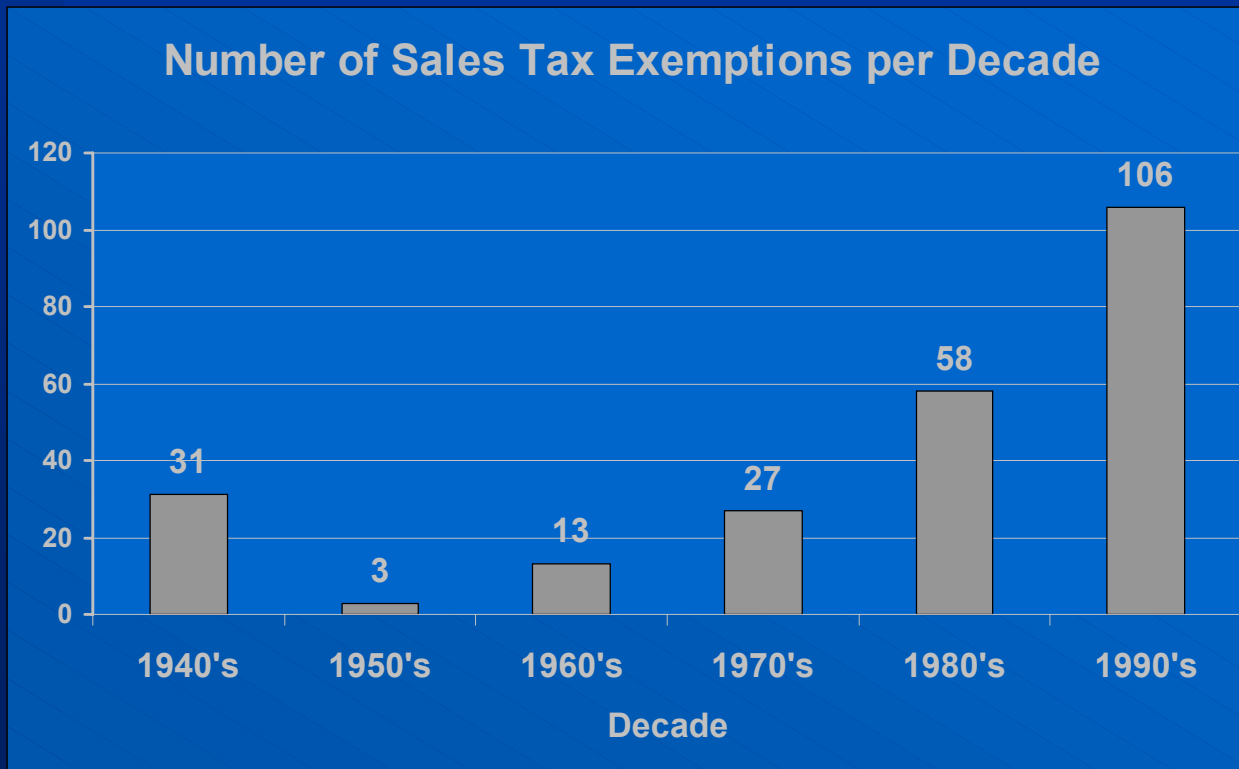


Sources of General Revenue

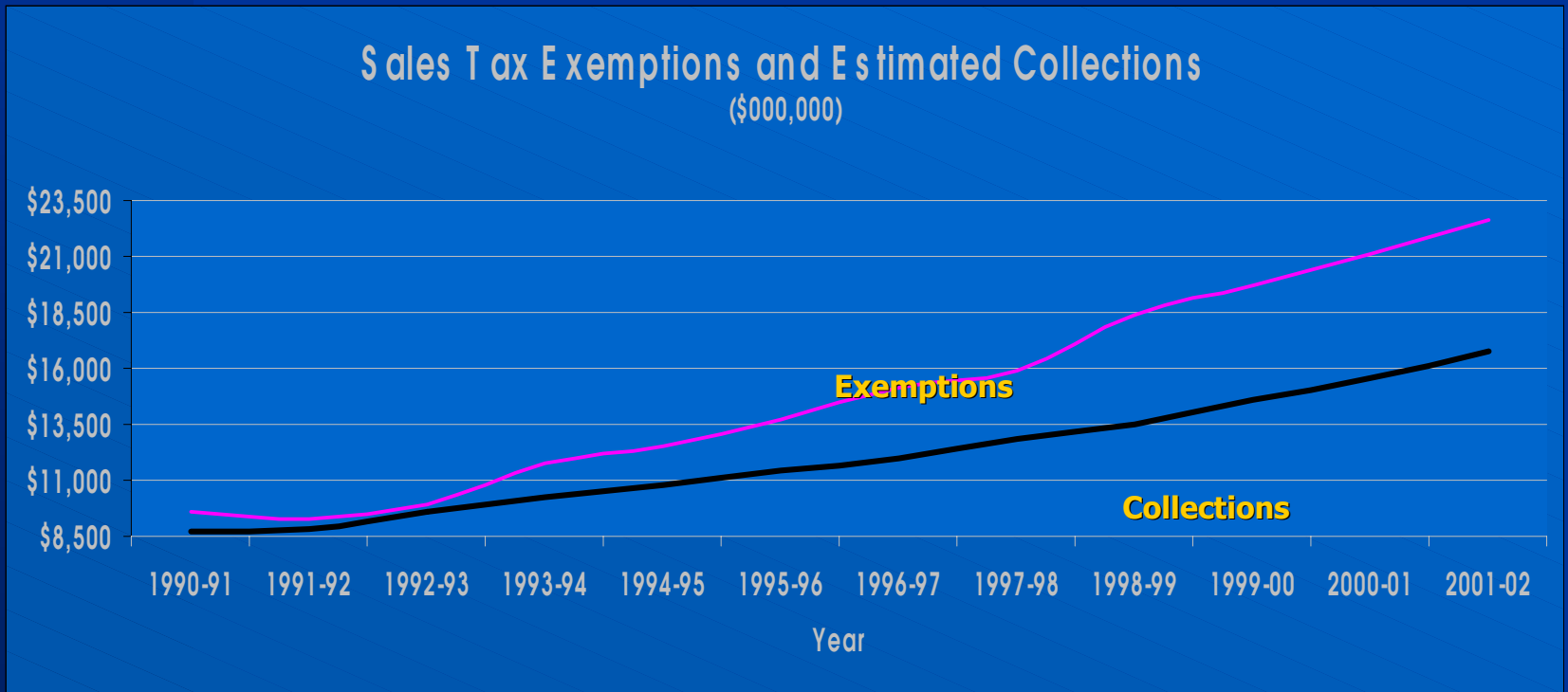
Sources of General Revenue 2000-2001
\$18,752.5



Sales Tax Exemptions by Decade



Exemptions and Collections



Questions and Answers on Tax Reform

Is this a tax increase?

No. The constitutional language will require that revenue growth be neutral during the first year of implementation. After that point and over time, it is possible that revenues will grow more quickly than they would have under the old tax base.

Remember that the old tax base is already changing. We are losing significant revenues from the inheritance tax, and that loss will increase over the next several years. Changes in the economy, such as the rise in Internet commerce, are making our current tax base a shrinking one as a percentage of economic activity. We cannot maintain a modern state on a tax base that does not grow with the economy.

Under this proposal, the voters will decide whether they want a tax structure based on 1949 or one based on the 21st century Florida economy.

Is this just the same proposal from 1987?

Absolutely not. This is a different proposal for a different time. The 1987 legislation was a \$1 billion tax increase hatched in the middle of the night by a small group of people, and it did not include a rollback in the tax rate. This proposal is designed to maintain current revenue levels for at least the first fiscal year. The voters will decide on this constitutional amendment after a thorough airing of the issues. The implementation of this plan will then be openly debated and developed within a deliberative process.

Do you have a recommended list of exemptions for repeal?

I have a list of items that can not be taxed: groceries, residential rent, health care services, prescription drugs, and basic residential telephone service. Other than that, every other exemption will be on the table.

That does not mean, however, that every other exemption should be repealed. There is flexibility in the proposal for the Legislature to evaluate and maintain current exemptions based upon criteria such as economic development and competitiveness, fairness and reduction of regressivity, and support for charitable institutions.

How many exemptions need to be repealed to get the base rate to 4%?

The current sales tax raises approximately \$17 billion annually. The reduction of the sales tax rate from 6% to 4% will require raising just under \$6 billion from previously exempted purchases. In order to reduce the rate and eliminate specified antiquated and inefficient taxes, approximately \$9.5 billion in current exemptions (based upon the current tax rate) will need to be repealed.

There are approximately \$23 billion in current exemptions. Protecting the exemptions for groceries, residential rent, health care services, prescription drugs, and basic residential telephone services reduces this number to \$17 billion.

Consequently, the Legislature could maintain approximately \$7.5 billion more (\$17 billion minus \$9.5 billion) in current exemptions.

How would the local option sales tax be handled?

The issue is addressed in the constitutional amendment. The revenue from the local option sales tax will also be kept neutral either through a reduction in the local option rate itself or through the rollback of other local government taxes, such as property taxes.

How will tax reform affect businesses?

My proposal does involve a transfer of some direct tax burden from households to business. Businesses, however, will also receive some important benefits from the plan. Reducing the overall rate from 6% to 4% will encourage consumer purchases in some areas of the economy. Repeal of antiquated and inefficient taxes on business, such as the intangibles tax, will help business. Reduction of the discriminatory taxes on commercial utilities from approximately 7%

to 4% will benefit businesses. Many businesses will benefit from the reduction of the sales tax on commercial rent.

A typical small business with approximately \$500,000 in expenses and that spends 35% of its expenses on rent, utilities, telecommunications and supplies would save approximately \$500 a year in taxes.

The sales taxes paid by businesses on professional business services would be deductible for federal income tax purposes. That will also offset some of the tax that may be shifted to businesses.

Will tax reform encourage Florida businesses to use out-of-state services, thus hurting Florida companies?

No. Any taxes on services would be on those services used and consumed in Florida. A Florida company could not avoid the tax by contracting for a service with an out-of state firm, nor would an out-of-state company be subject to the tax from services purchased from a Florida provider.

How will tax reform affect the way our economy operates?

Tax reform will promote an efficient economy by having the tax structure more accurately mirror the economy. When taxes are selectively focused upon segments of the economy, economic decisions are distorted and there are disincentives for purchasing the taxed goods. Also, the lower rate will reduce current inefficiencies.

After voter approval of the constitutional amendment, the Legislature would evaluate exemptions to assure that exemptions that protect basic competitive commerce remain. For example, the sale for resale exemption is critical to business and must be maintained.

Will this make Florida's tax base more stable and less susceptible to economic fluctuations?

That is an important goal. Although the level of stability of the tax base will ultimately depend upon the mixture of exemptions selected

for repeal, diversification of the tax base should have the same stabilizing impact as diversification of an individual's portfolio.

When would this change become effective?

The new system would become effective on July 1, 2004.

Estimates accurate enough for the revenue estimating conference process do require study and analysis. The Legislature will also need time to evaluate thoughtfully what is currently exempted. That is why the constitutional amendment will not require the Legislature to finalize the list of exemptions for repeal until the 2004 Session.

Reforming Florida's Tax Structure

I am here today to talk with you about the most important task I will undertake as President of the Senate – tax reform. I am dedicating myself to this effort so that we can deal with a crisis before it occurs.

Many of you may wonder why I am tackling such a politically difficult task as the reform of our tax structure.

I do so for the same reason that I support school vouchers for students with disabilities – not because it is popular, but because I believe it is the right thing to do. I believe this effort will make a difference in Florida, long after I leave public office next year.

Our state already faced great challenges prior to the events of September 11. Stung by the human and emotional loss, we now find ourselves grappling with the economic consequences of that devastation.

Prior to those tragedies, I believed Florida's tax structure should be revamped. With the realization of the damage done to our economy in the last two months, particularly as a result of our over dependence upon tourism, I believe that now more than ever.

Let me first tell you why our current tax structure needs to be reformed.

In the simplest terms, we have an antiquated system requiring modernization. Today, Florida's single largest source of revenue is our state sales tax, created in a different era by the 1949 Legislature. You can imagine what a different state Florida was at that time.

With a population of 2.25 million, Florida was the 20th most populated state. Today we are 4th and have a population approaching 17 million. That year, along with the sales tax, the Legislature passed a \$240 million biennial budget. Today, the annual budget is approximately \$50 billion.

That year the Legislature deemed it necessary to outlaw livestock from our highways. Our state constitution required a poll tax, and segregation was still legal in our public schools.

The average salary for a week's work was \$40 dollars, and 17% of our workforce was employed in agriculture, compared with only 3% today. Robert E. Lee's birthday was celebrated on January 19th, and our state budget still provided for confederate soldiers' pensions.

Exemptions from sales tax were provided for automobiles, and to places of amusement costing less than 41 cents.

It was a different time with different needs.

In most areas, our state has kept abreast of changing times. In others, we have led the way.

We have embraced Civil Rights legislation and the concept of "one man one vote." We have made sweeping changes to our education system so that all children, regardless of means, have access to a world class education.

We have endeavored to reform Florida's Cabinet structure, and have instituted zero-based budgeting to achieve fiscal accountability by our government agencies. We have witnessed fundamental change in our tort structure and succeeded in transforming our welfare programs to give those who *want* to work the opportunity to do so.

And yet, we still rely on the same basic approach to funding our state's needs that was developed 52 years ago.

Since September 11, every business person has reevaluated their business plans, but we have not reevaluated the tax structure in 52 years. That makes no sense.

I have never been one to advocate change just for the sake of change, so let me get specific about our current system's problems.

The key flaw is that this system does not mirror Florida's current economy and it exaggerates economic fluctuations. Consequently the current system is not capable of meeting Florida's long-term needs.

Next year, Florida will collect approximately \$17 billion in sales tax. However, we will exempt approximately \$23 billion in taxes, and it is the

exempted portion of our economy that is growing the fastest. This means that we are increasingly becoming more dependent on a relatively shrinking resource.

In 1964, the sales tax applied to approximately 68 percent of Florida's economic activity. Today, the sales tax applies to only 55 percent. Simply put, Florida's tax system is not in sync with today's economy. **LET ME SAY THAT AGAIN!**

The disjointed evolution of the sales tax has also resulted in numerous tax exemptions that make no sense. Let me give you a few:

Hair care products are taxed; Hair cuts are not.
Laundry detergent is taxed; Dry cleaning is not.
Lawn Mowers are taxed; Lawn care is not.

There is no rhyme or reason to this pattern.

Finally, beyond these issues of economic efficiency, the current tax structure is basically not fair to the average household. While a broad array of exemptions protect special interests, the average Floridian pays a 6% state sales tax on most basic household purchases.

Is it fair to tax clothes or a new washing machine at a high rate, but not tax services by lawyers and accountants? There should be no sacred cows! A fair tax structure is one that spreads responsibility equitably across all segments of society.

Our tax structure is antiquated and should be modernized to reflect the state's 21st century economy. As business people, each of us plan for the future. As taxpayers, we should accept no less from our state government.

Now that we've identified the problem, let me explain my solution. In crafting this proposal, I enlisted the aid of the business community, economists, and average citizens. My proposals are based upon the common sense recommendations and the technical advice that I received from those folks.

I am proposing a constitutional amendment to decrease the state sales tax rate from 6% to 4% and yet maintain the same level of revenue by

broadening the base through the repeal of many exemptions. Just as we have been advised to diversify our investment portfolios, Florida must diversify its revenue sources.

A broader tax base should be more reflective of Florida's current economy. Let me be clear that I am *not* proposing a tax increase. I cannot over emphasize this point – my proposals *are* revenue neutral. *This is an initiative for smarter government, not bigger government.*

To maintain fairness in the system, certain basic needs must be protected. There will be no sales tax on groceries, residential rent, health care services, prescription drugs, or the basic residential telephone service that many seniors rely upon. Everything else is on the table.

We should also eliminate several antiquated and inefficient taxes. The “drink tax,” the “hospital bed tax” that drives up the cost of health insurance, and the intangibles tax must be eliminated. In addition, the sales tax on utilities paid by business would be lowered from 7% to 4%. Think what that 3% can mean to your company's bottom line.

Let me give you a specific example of the impact of this latter rate reduction. One major Florida retailer spends \$110 million on electricity alone. This rate reduction would save that company \$3.3 million PLUS the telecommunications portion of that tax.

Since its enactment in 1949, the Legislature has raised the sales tax rate from 3% to 6%. Any tax reform measure must protect Floridians from unnecessary increases in the future. Further, we must also be sure that any future exemptions are carefully evaluated on the basis of sound tax principle – not on the basis of politics.

Exemptions that made sense 25 years ago, or even 2 years ago may not make sense today. To achieve these protections, I will include two other components in the constitutional amendment.

First, the amendment will require a 3/5's vote of both legislative houses before the sales tax rate can be raised.

Second, the amendment will require a 3/5's vote of both legislative houses before any *new* exemption can be adopted. These super-majority

votes will help to ensure responsible policy decisions and restrict the Legislatures ability to unnecessarily raise taxes in the future.

What will the critics say? Some may say that this is just the old services tax revisited. **Nothing could be further from the truth.** While some services will be taxed under my plan, there are significant differences between the 1987 services tax proposal and this one.

The 1987 legislation was a tax increase, my proposal, while taxing products that are not currently taxed, is a revenue neutral plan that reduces the basic tax rate by 1/3. My proposal also has safeguards against future tax increases - that one did not.

Critics will also argue that this really does represent a tax increase since, over the long term, the new sales tax base will grow more quickly than the current base.

However, if revenue grows at a faster rate than it would have under the old sales tax base, the Legislature will have the option to roll back the sales tax rate to compensate for the growth. But, yes, a tax structure that better mirrors Florida's overall economy may over time produce revenues at a faster rate, a rate more consistent with our state's growing demands in education, social services, transportation, and criminal justice.

We can have a tax structure that is based on Florida's modern economy - that will meet Florida's future demands in a fair and equitable way, that will not place special interests above the interests of our working families – and that will make it more difficult for politicians to raise taxes in the future.

I can assure you the time to develop that new tax system is now...not three years down the road when a loss of revenue from the estate tax and the impact of the Internet will cost Florida \$4 billion per year.

Just as you repair your roof before the storm arrives, we must be prepared for a crisis, not react to one.

Florida Tax Watch recently stated that “If Floridians wish to avoid taxes that we don't want such as the state income tax or a state property tax, then we must make our system work.” That is precisely what my proposal aims to do.

But, support must come from the local level – from the people, from the businesses – if true reform is to occur.

I need your help to make this idea a reality, so I ask you to contact your State Senator and State Representative and tell them to support tax reform for the economic stability of our state.

As, a concerned citizen and businessman, I ask that you join with me in this effort for Florida's future.

Opinion Editorial
By Senate President John McKay
December 2001

How long can a modern Florida continue with an unfair and out dated tax system? That's the fundamental question that prompted me to pursue the difficult task of reforming Florida's tax system.

Stung by the human and emotional loss of September 11, we find ourselves grappling with the economic consequences of that devastation. Prior to this tragedy, I believed Florida's tax structure should be revamped. With further strain on our economy in the last three months, I believe that now more than ever.

Simply put, we have an antiquated tax system which requires modernization. Today, Florida's single largest source of revenue is our state sales tax, created in a completely different era by the 1949 Legislature.

- In 1949, our population of 2.25 million made us the 20th most populated state. Today, we are 4th, and have a population approaching 17 million.
- Along with the sales tax, the Legislature passed a \$240 million biennial budget. Today, the annual budget is approximately \$50 billion.
- That year the Legislature deemed it necessary to outlaw livestock from our highways.
- Our state constitution required a poll tax, and segregation was still legal in our public schools.
- The average salary for a week's work was \$40 dollars.

1949 was a different time with different needs.

In most areas, our state has kept abreast of changing times. In others, we have led the way – from civil rights legislation to sweeping education changes to fiscal accountability in government agencies to transforming our welfare programs and yet, we still rely on the same basic approach to funding our state's needs that was developed 52 years ago.

The current system doesn't mirror today's economy and is incapable of meeting Florida's long-term needs. In 1964, the sales tax applied to approximately 68 percent of Florida's economic activity. Today, the sales tax applies to only 55 percent. Next year, Florida will collect approximately \$17 billion in sales tax – and we will exempt about \$23 billion in taxes. And it is the exempted portion of our economy which is growing the fastest. This means that we are becoming increasingly dependent on a relatively shrinking resource.

The disjointed evolution of the sales tax has also resulted in numerous tax exemptions that make no sense.

- Hair care products are taxed; haircuts are not.
- Laundry detergent is taxed; dry cleaning is not.
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There is no rhyme or reason to this pattern.

In addition to the economic inefficiency, the current tax structure is unfair to the average household. While the average Floridian pays a 6 percent state sales tax on most basic household purchases, a broad array of special interests are exempt.

Is it fair to tax clothes or a new washing machine, but not tax services by lawyers and accountants? A fair tax structure is one where everyone contributes.

Our tax structure should be modernized to reflect the state's 21st century economy. Everyone – families, businesses – must plan for the future. As taxpayers, we should accept no less from our state government.

Now that we've identified the problem, what's the solution?

I propose a constitutional amendment to decrease the state sales tax rate from 6 percent to 4 percent and yet maintain the same level of revenue by broadening the base through the repeal of many exemptions.

A broader tax base will be more reflective of Florida's current economy. This is not a tax increase. I cannot over emphasize this point –

this proposal is revenue neutral, it does not raise taxes. This is an initiative for smarter government, not bigger government.

To maintain fairness in the system, certain basic needs must be protected. There will be no sales tax on groceries, residential rent, health care services, prescription drugs, or the basic residential telephone service that many seniors rely upon.

Any tax reform measure must protect Floridians from unnecessary increases in years to come and any future exemptions must be carefully evaluated on the basis of sound tax principle – not on the basis of politics.

A 3/5's votes of both legislative houses will be required before the sales tax rate can be raised and before any new exemption can be adopted. These super-majority votes will help to ensure responsible policy decisions and restrict the Legislature's ability to raise taxes unnecessarily in the future.

We should have a tax structure that is based on Florida's modern economy that will meet our state's future demands in a fair and equitable way. We should have a system that places working families above special interests. And we should have a structure that makes it more difficult for politicians to raise taxes in the future.

The time to develop that new tax system is now...not several years down the road when a loss of revenue from the estate tax and the impact of the Internet will cost Florida \$4 billion per year.

Support must come from the local level – individuals, families, business owners – for true reform to occur. Your help is needed. Contact your State Senator and State Representative and tell them to support tax reform for the economic stability of our state. Let's join together – for Florida's future.

Word count: 873