

Reviewing Sales Tax Exemptions

Presentation to Florida Senate
Committee on Finance and Tax
Senator Thad Altman, Chairman

March 12, 2009

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Florida TaxWatch Has Long Promoted The Review of Sales Tax Exemptions

1986 – *Sales Tax Exemptions: A Prescription to Help Pay For Growth in Florida's Dynamic Economy* called for a comprehensive review of exemptions based on sound criteria.

1987 – A series of reports recommending fixing, not eliminating, the newly enacted sales tax on services by affirmatively listing those to be taxed instead of taxing all services “except the following.”

2003 - Report of the Cost Savings and Tax System Modernization Task Forces



“A Crisis is a Terrible Thing To Waste”

Transform Spending

Prioritize Spending

Eliminate Duplication, Waste and Fraud

Maximize Existing Revenues Source

Increase Federal Drawdowns

Enhance Tax Compliance

Reform the Regulatory Process



Taxation is challenging in good times, it can be devastating in bad times

Any review of the tax system in Florida should not be undertaken with a target amount of revenue to generate. We should not be merely looking to fill budget holes. The goal of a sales tax review is long-term sustainability and tax modernization.



Billions of \$ in Loopholes?

15 Largest Sales Tax Exemptions

Groceries	\$2,544.6	Metered Water	\$305.4
Electric Power	2,295.5	Non-Prescription Drugs	204.8
Residential Rent	1,354.0	Non-Retail Pharmacies	189.7
Prescription Drugs	906.0	Imported Items/6 mos	157.5
Vehicle Trade-ins	524.0	Medical Supplies	135.5
Government Purchases	468.2	Boats/Plane Leaving FL	113.7
Hospital Rooms/Meals	448.2	Satellite/Space Vehicles	96.0
Fuel of Utilities	337.6		

Total: \$10.1 billion out of \$12.3 billion (82%)



2003 Report of the Cost Savings and Tax System Modernization Task Forces

The Florida TaxWatch Task Force concluded:

- ✓ that expanding the sales tax base has the most promise for tax system modernization
- ✓ expansion should be done slowly with consideration of economic consequences
- ✓ the majority of exemptions (by value) serve legitimate public purposes



Three Categories of Exemptions Should Be Retained

Structural Exemptions

Life's Necessities Exemptions

Economic Development Exemptions



Structural Exemptions

Maintain the basic structure and integrity of the sales tax

(Not included in Tax Handbook exemption total)

- Items purchased for resale
- Intangible personal property
- Tangible property produced for export
- Ag products for further processing/resale
- Labor Services



Structural Exemptions

Other examples:

- Occasional or isolated sales
- Purchases by governments
- Credit for tax paid to other states

Life's Necessities Exemptions

Examples:

- Groceries
- Prescription Drugs
- Rent for Permanent Residents
- Residential Power and Heating
- Health Services

Economic Development Exemptions

These help Florida business compete

Examples:

- Research and Development
- Co-generated Energy
- Machinery & Equip. for Expanding Businesses
- Electricity Used in Manufacturing



Economic Development – Manufacturing Example

Florida TaxWatch used dynamic modeling (REMI – Regional Economic Models, Inc.) to analyze the effect on state's manufacturing

Industry of three scenarios:

- 1) Maintain current exemptions
- 2) Repeal current exemptions
- 3) Provide a new exemption



Manufacturing – Scenario 1

Maintain Current Exemptions

In 2009, sector is projected to contribute:

- 1.1 million jobs
- \$122 billion in GSP
- \$252 billion increased annual state output

By 2018, sector is projected to contribute:

- 1.4 million jobs
- \$216 billion per year in GSP
- \$424 billion increased annual state output



Manufacturing – Scenario 2

Repeal Current Exemptions

By 2018, this would result in a net loss (after controlling for benefits of increased government spending) of:

- 3,300 Floridian jobs
- \$980 million in GSP
- \$2.3 billion in state output
- \$200 million in reduced exported goods

Manufacturing – Scenario 3

Provide A New Exemptions

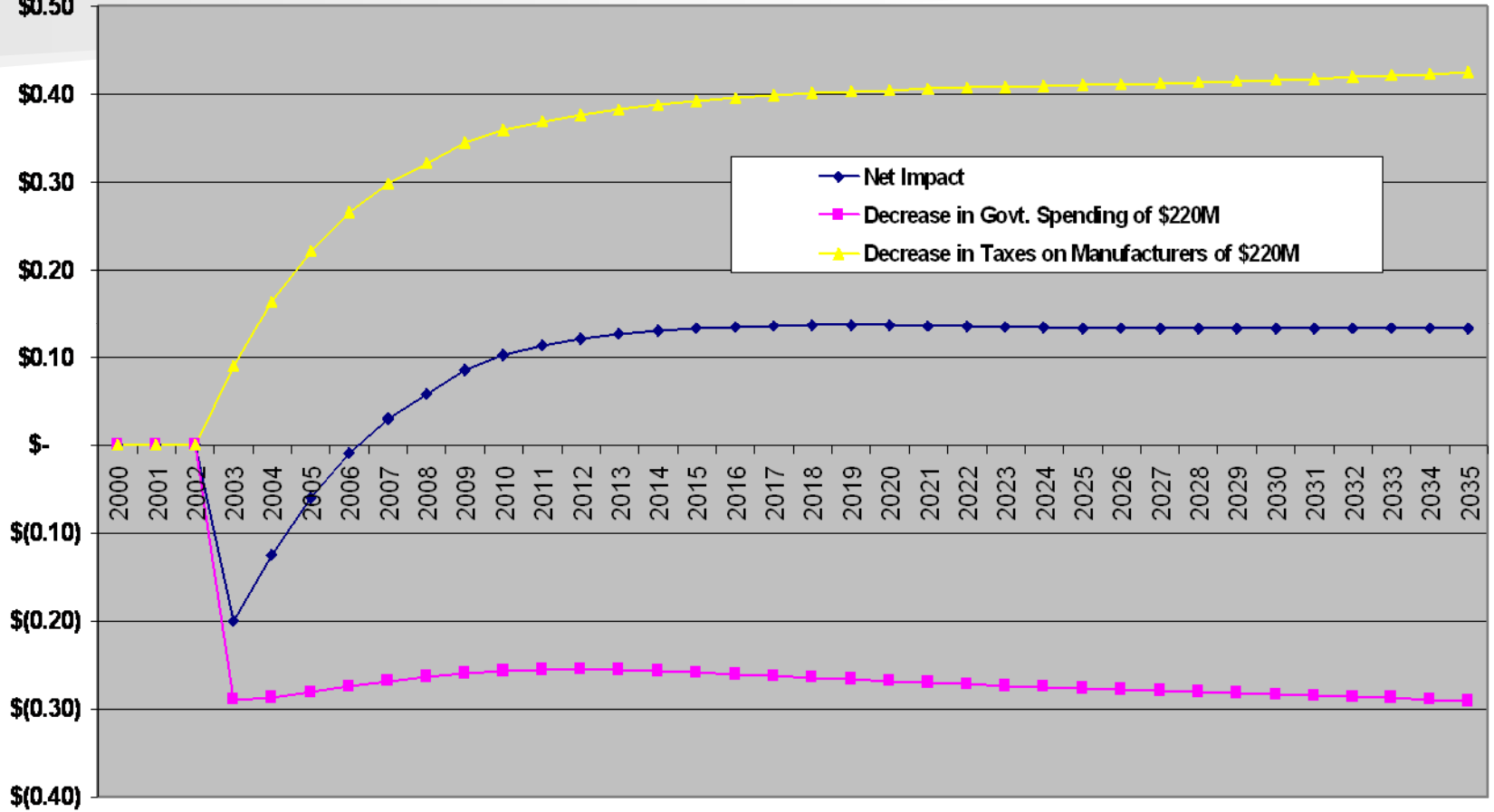
By 2018, a 10 percent Capital Investment Incentive would create a net:

- 5,500 Floridian jobs
- \$1.0 billion in additional GSP
- \$2 billion in additional state output
- \$200 million in additional exported goods



CHANGE IN FLORIDA GROSS STATE PRODUCT FROM THE GRANTING OF A NEW SALES TAX EXEMPTION FOR MANUFACTURING MACHINERY & EQUIPMENT

Billions of
1992\$
\$0.50



The Challenge

Tax Policy Should Encourage Capital
Formation and Job Creation

Florida Should Not Tax Business Inputs

The Economic Impact of an Exemption Must
Be Considered



The Taxation of Services

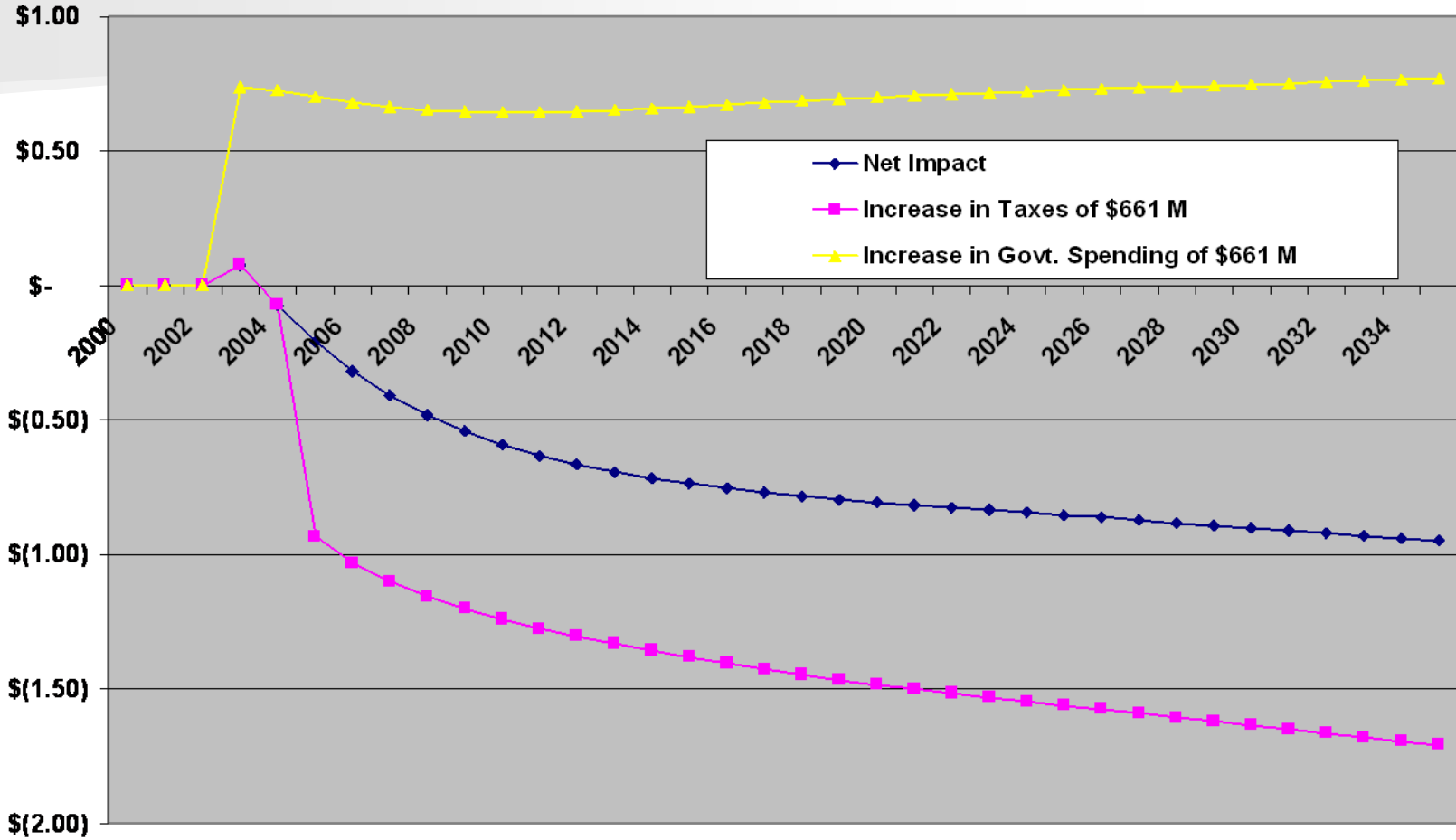
The Task Force also recommended against the major taxation of services:

- Many services fit in the three categories
- Econometric modeling shows significant negative economic impact



CHANGE IN FLORIDA GROSS STATE PRODUCT FROM A NEW SALES TAX ON TRANSPORTATION SERVICES AND AN INCREASE IN GOVERNMENT SPENDING BY \$661 MILLION

BILLIONS
1992\$



Criteria Should be Used That Consider the Following Principles of Taxation

Equity

Compliance/Ease of Administration

Pro-competitiveness

Certainty

Stability

Integration

Public Purpose



Lessons Learned

Be specific about what is to be taxed

Wholesale sunseting of exemptions is dangerous:

- Unintended consequences
- Taxes should not be raised without an affirmative vote of the Legislature
 - Economic uncertainty

Sunset Exemptions?

- Sunset should only be used after the Legislature has approved a list of exemptions or exclusions that do not meet established criteria
- Recurring review of sales taxes should not occur more often than once every ten years
- More frequent review would create too much uncertainty for business and investment planning

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