CROSSROADS

Designing Florida's Tax Structure

FLORIDA CHAMBER
Foundation

MISSION STATEMENT

To provide statewide leadership in formulating public policy alternatives which will best assure a high quality of life for Floridians in the twenty-first century, and to use wisely the contributions given to sustain this mission.

CROSSROADS

Designing Florida's Tax Structure

December 1990

Prepared by:

SRI International

Douglas C. Henton
Kimberly A. Walesh
Steven A. Waldhorn, Director
Center for Economic Competitiveness

With:

W. J. Shelley, Economic Consultant

Sponsored by:

Florida Chamber of Commerce Foundation, Inc.

ABOUT THIS REPORT

Crossroads: Designing Florida's Tax Structure analyzes the current tax structure in Florida from an economic competitiveness perspective and identifies principles that can be used in designing a tax structure that will help Florida prepare for the economic challenges of the 21st century.

The Florida Chamber Foundation sponsored *Crossroads* to help Florida's leaders address fundamental choices about the state's economic future. Florida needs solid fiscal foundations to achieve the high-value-added, competitive economy envisioned in the Chamber's *Cornerstone* study. *Crossroads* finds that Florida's current tax structure is inadequate for achieving that economic vision.

Crossroads documents the problems with the existing tax structure, identifies principles to guide the development of a high-quality tax structure, and provides examples of how changes in the tax structure could help Florida achieve those principles. Several points about the analysis should be highlighted:

- *Crossroads* focuses on improving overall tax structure, not on individual taxes.
- *Crossroads* focuses on linking a higher-quality tax structure to the performance of the economy, not on raising revenues.
- *Crossroads* focuses on providing principles to guide the design of the tax structure, not on recommending a specific tax structure.
- *Crossroads* focuses on examples of tax structure changes as illustrations of how the principles of a high-quality tax system can be met, not as proposals.
- *Crossroads* focuses on educating the public about the need to improve Florida's tax structure, not on advocacy.

Crossroads was prepared by SRI International. It received in depth review by the Research Committee of the Florida Chamber Foundation. SRI wishes to thank the members of the Research Committee and the Foundation for their dedication and support during this project.

FLORIDA CHAMBER OF COMMERCE FOUNDATION, INC.
RESEARCH COMMITTEE

CHAIRMAN:

Cass D. Vickers
Messer, Vickers, Caparello, French, Madsen & Lewis
Tampa

VICE CHAIRMAN:
Malcolm S. Scott
American Resources, Inc.
Bartow

COMMITTEE MEMBERS:

Benjamin Lester Abberger III
Florida Hospital Association
Tallahassee

Dr. Kenneth W. Clarkson
University of Miami
Coral Gables

Robert E. Coker
United States Sugar Corporation
Clewiston

Miles Collier
Collier Enterprises
Naples

John Cordrey
The Beacon Council
Miami

Charles V. Dannewitz
Price Waterhouse
St. Petersburg

Charlie Davis
Gulf Power Company
Pensacola

John C. Evelyn
Florida Power & Light Company
Miami

Courtney L. George
CSX Corporation
Jacksonville

John M. Godfrey
Barnett Bank
Jacksonville

Glenda E. Hood
Glenda Hood & Associates, Inc.
Orlando

Michael L. Jamieson
Holland & Knight
Tampa

Burton Lamont
Greenwich Air Services
Miami

Dr. Robert F. Lanzillotti
University of Florida
Gainesville

Steven Lew
Universal Studios Florida
Orlando

Douglass Michael Mann
A. Duda & Sons
Oviedo

Chick McDowell
Cordis Corporation
Miami Lakes

Thomas R. Moor
Harris Corporation
Melbourne

John Mungenast
NCNB National Bank of Florida
Tampa

Loyd S. Pettegrew
University of South Florida
Tampa

Lawrie Pitcher Platt
Tupperware Worldwide
Orlando

Ted E. Pope
Orlando Utilities Commission
Orlando

Harvey Smalheiser
Ryder System, Inc.
Miami

Richard J. Walsh
General Mills Restaurants
Orlando

George A. Weeks
George A. Weeks & Associates
Tallahassee

TABLE OF CONTENTS

CONTENTS (Concluded)

SUMMARY

Florida Confronts Fiscal Choices

Florida's current tax structure is inadequate for moving Florida toward the 21st Century. Recurrent fiscal crises throughout the 1980s were symptoms of fundamental problems with Florida's tax structure. This weakness of its fiscal foundation is undermining Florida's ability to prepare for the competitive demands of a new economy.

Florida needs new, pro-competitive principles to guide choices about taxes—principles that recognize the new realities of a competitive economy. A good business climate now is about more than simply low taxes. It's about developing critical economic foundations in human resources, technology, physical infrastructure, finance, and quality of life to support value-added businesses and jobs. Florida needs a tax structure that supports the state's new economic development orientation. Such a pro-competitive structure goes beyond low tax rates to include characteristics such as stability, diversity, and neutrality among industries.

Florida must undertake fundamental tax reform. Florida's across-the-board weakness relative to pro-competitive principles stems from the negative qualities of Florida's existing taxes. Marginal "tinkering," however, to close revenue shortfalls, raise rates on existing taxes, or even introduce a new tax cannot sufficiently address basic structural problems. Only comprehensive structural reform can build a fiscal foundation that prepares the state for the 21st century.

Florida's Economic Future

Florida enters the 1990s facing critical choices about its economic future. A previous Florida Chamber study, *Cornerstone: Foundations for Economic Leadership*, articulated a new economic vision of the state, in which Florida industries evolve toward higher value added, supported by public and private investment in economic foundations.

By adding increasing value in the production of goods and services, Florida can sustain increases in its standard of living over time. More value is added to inputs by improving productivity or by creating special goods and services that command a high price relative to their cost of production. By concentrating on value-added activities, the state can protect itself from competitors willing to perform similar tasks for lower wages.

Companies and economic activities with the potential to bring rising standards of living to Floridians cannot thrive simply on the basis of low-cost labor, cheap land, and low taxes. Florida's traditional competitive strengths are failing the state. Relative to competing states and regions worldwide, Florida is at a competitive disadvantage in the economic foundations increasingly vital to a good business climate. These foundations include a skilled workforce and quality education system, access to technology, available seed capital, adequate transportation, appropriate tax and regulatory environment, and a high quality of life.

The Florida Chamber sponsored *Crossroads: Designing Florida's Tax Structure* to help state leaders confront fundamental choices about a key underlying economic foundation: the state's fiscal system. A solid fiscal foundation is a critical prerequisite for reaching the *Cornerstone* vision, because the fiscal system affects private-sector investment decisions and competitiveness and supports public-sector investments in economic foundations.

Characteristics of a Pro-competitive Tax System

A pro-competitive tax system creates an environment conducive to high-value-added economic growth. Such a system has 10 structural characteristics, including both "standard" and specifically "pro-competitive characteristics." "Standard" characteristics are those traditionally used in Florida to discuss tax policy: equity, stability, quality of administration, ease of compliance, and exportability. "Pro-competitive" characteristics are also important for creating a high-value-added tax environment: efficiency, growth, diversity, neutrality, and pro-investment.

When used as criteria, standard and pro-competitive characteristics together can serve as benchmarks for evaluating tax systems and individual taxes (see Exhibit S-A).

Florida's Current Tax System Fails Pro-competitive Test

Intermittent fiscal crises throughout the 1980s brought growing awareness that Florida's fiscal foundation is inadequate for supporting state needs and fostering a stable business environment. When Florida's current tax structure is measured against the criteria for a pro-competitive system, across-the-board weakness suggests that the fiscal crises of the 1980s were merely symptoms of severe structural problems with Florida's tax system.

- *Equity*—Florida's tax system is regressive; households with low income pay proportionately more in taxes than do households with high income.
- *Stability*—Revenue raised by Florida's tax system is extremely volatile, fluctuating widely with changing economic circumstances. This volatility is due to heavy reliance on the sales tax (see Figure S-1).
- *Administration*—Florida fares average on tax administration, though improvements are needed in property tax assessment, sales tax collection, and computerization.
- *Compliance*—Florida fares average on tax compliance, with improvements needed in the collection of mail order sales and the intangibles tax.

Exhibit S-A

STRUCTURAL CHARACTERISTICS OF A PRO-COMPETITIVE TAX SYSTEM

Standard Principles

Equity

Ability to pay—Is the system either proportional or progressive in its incidence among income groups? Are individuals with similar incomes taxed uniformly?

Benefits received—Is the tax burden related to benefits received by individuals and businesses?

Stability

Is the revenue raised by the system stable, or is it highly sensitive to economic fluctuations in the short run?

Administration

Is administration of taxes by the government professional, fair, and cost-effective?

Compliance

Is compliance with tax provisions, on the part of businesses or consumers, simple and inexpensive?

Exportability

To what degree is the tax burden shiftable to "outsiders," such as tourists, the federal government, or out-of-state business?

Pro-competitive Principles

Efficiency

Does the tax system distort decision-making by consumers or businesses?

Growth

Does the tax system generate revenues that grow in proportion to the state's economy over time, eliminating the need for frequent changes in tax rates?

Diversity

Is the base of the tax system as broad as possible, so that tax rates and burdens are as low as possible?

Neutrality

Does the tax system affect competitors uniformly, fostering a "level playing field" for state-based businesses?

Pro-investment

Does the tax system encourage savings and productive investment in plant, equipment, people, and technology, consistent with *Cornerstone's* value-added economic development strategy, which envisions a rising standard of living for Floridians?

FIGURE S-1 GROWTH RATE OF TAXABLE SALES, 1970-1989

- *Exportability*—Florida exports an average amount of its tax burden to out-of-state residents and companies, but shifts little of its burden onto the federal revenue system.
- *Efficiency*—Florida's tax system has significant inefficiencies, because taxes influence economic decisions made by consumers and businesses.
- *Growth*—Over time, Florida's tax revenues do not grow enough with the economy to fund even the most conservative expenditure level—one that includes no real increase in spending per household. Since 1982, over 50 significant tax changes have been made to Florida's tax system to compensate for its inability to grow.
- *Diversity*—Florida's tax structure is narrowly based, tapping some consumption, wealth embodied in property, and corporate income, but not personal income.
- *Neutrality*—Florida's tax structure creates an uneven playing field among Florida businesses by making heavy use of industry-specific taxes and exemptions.
- *Pro-investment*—Florida's tax structure discourages investment in machinery and equipment and does not encourage investment in people and research.

Unmasking the Problem

Structural weaknesses in Florida's overall tax system stem from weaknesses in its major taxes. *Crossroads* assessed the pro-competitive characteristics of 10 of Florida's existing taxes, providing "high," "medium," and "low" rankings for each criterion. These rankings indicate how well each tax meets each criterion for a pro-competitive tax system. The results are summarized in Table S-1.

Crossroads also assessed the pro-competitive characteristics of 4 potentially new sources of revenue for Florida. Results are summarized in Table S-2. On balance, some new revenue sources are strong in areas where Florida's current taxes are weak, including equity, growth, and diversity.

Toward Pro-competitive Solutions

To prepare for a 21st-century economic strategy, Florida's fiscal system needs comprehensive structural reform. Tinkering with the existing system or merely adding one new tax will not resolve fundamental structural problems.

The five examples that follow illustrate how the pro-competitive criteria can be used to evaluate potential tax reform changes. Example 1 examines reforming the existing system. Examples 2, 3, and 4 make a new revenue source the centerpiece of structural reform: the services tax, the Single Business Tax, and the personal income tax, respectively. Drawing on the best features of Examples 1 through 4, Example 5 offers a more comprehensive example of structural reform—one that goes farthest in meeting the pro-competitive criteria.

All examples can be constructed to be revenue neutral—to raise the same amount of revenue in 1990-91 as Florida's existing tax system.

Table S-1

SUMMARY
ASSESSMENT OF FLORIDA'S MAJOR REVENUE SOURCES

Existing Revenue Sources	Standard Criteria						Pro-competitive Criteria				
	Equity*		Stability	Administration	Compliance	Exportability	Efficiency	Growth	Diversity	Neutrality	Pro-investment
Sales Tax											
Property Tax											
Corporate Income Tax											
Intangibles Tax											
Documentary Stamp Tax											
User Fees	N.A.		N.A.					N.A.			
Special Assessments	N.A.		N.A.					N.A.			
Impact Fees			N.A.					N.A.			
Estate Tax										N.A.	
Utilities Taxes											

*Equity is judged on both "ability to pay" (left box) and "benefits received" (right box) principles.

High   Medium   Low   N.A. = Not applicable

Table S-2

SUMMARY
ASSESSMENT OF POTENTIAL NEW REVENUE SOURCES

	Standard Criteria					Pro-competitive Criteria				
New Revenue Sources	Equity*	Stability	Administration	Compliance	Exportability	Efficiency	Growth	Diversity	Neutrality	Pro-investment
Services Tax	Medium / Medium	Medium	Low	Medium	Medium	Medium	Medium	High	Medium	Medium
Personal Income Tax	High / Low	Medium	High	High	High	Medium	High	High	High	Medium
Single Business Tax	Medium / High	High	High	High	High	High	High	High	High	High
Inheritance Tax	High / Low	Low	High	High	High	High	High	Low	N.A.	Medium

*Equity is judged on both "ability to pay" (left box) and "benefits received" (right box) principles.

High Medium Low N.A. = Not applicable

Example 1: Reform the Existing System

To reform Florida's current system so that it better meets pro-competitive criteria would entail making four significant changes to Florida's sales and property taxes, and a host of changes to Florida's other revenue sources.

The four significant changes are:

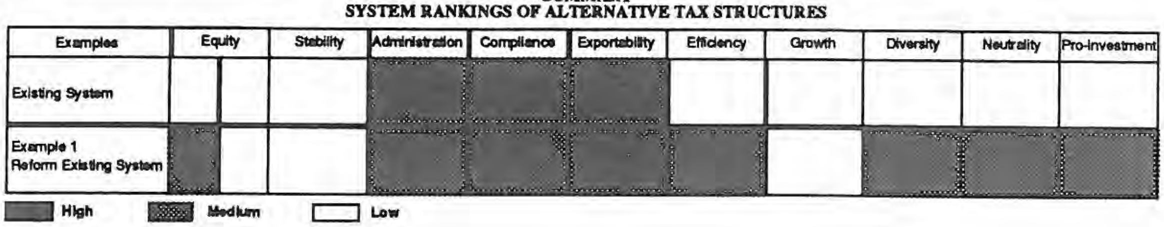
- *Tax goods that currently are exempt from the sales tax*—Broaden the tax base, and improve stability and neutrality by taxing goods currently exempt from the sales tax.
- *Minimize sales tax pyramiding*—Substantially improve efficiency (reduce pyramiding) and pro-investment characteristics by exempting business purchases of machinery and equipment, electricity, and telecommunication services.[1]
- *Assess property at market value*—Broaden the tax base and improve neutrality, equity, and administration by assessing all property at full market value.
- *Eliminate homestead and personal property exemptions*—Broaden the tax base and improve efficiency and neutrality by eliminating the homestead exemption and taxing certain types of personal property currently exempt under the constitution.

In addition to these changes, a variety of less significant changes could be made to each of Florida's existing taxes.

The fundamental problem with this approach is that, after undertaking numerous specific reforms, the effect of the major and minor changes in individual taxes on the pro-competitiveness of the overall system is at best marginal (see Table S-3).

Table S-3

SUMMARY
SYSTEM RANKINGS OF ALTERNATIVE TAX STRUCTURES



---

[1]Pyramiding occurs when the cost of an intermediate good or service is taxed when sold and when the final product the intermediate input is used to produce is also taxed. Since the cost of the intermediate input is embodied in the cost of the final product, the intermediate input is effectively taxed twice. In an intricate chain of economic links, inputs could be taxed many times over in a distorting, inefficient,"pyramiding" effect.

Example 2: Establish a Services Tax Without Pyramiding

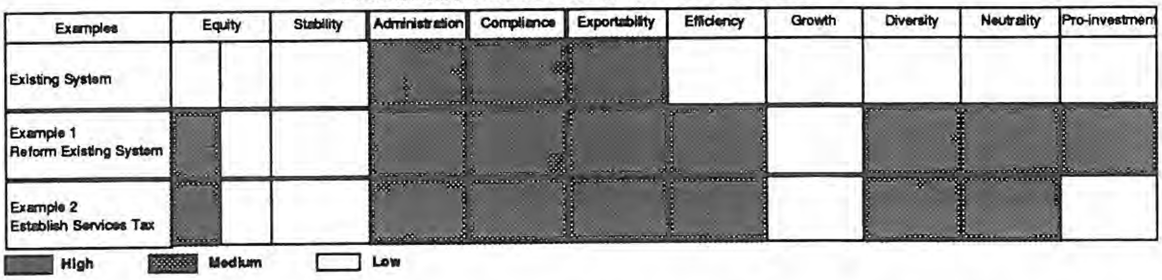
Example 2 establishes a services tax without pyramiding. This example has three key elements:

- *Tax services*—Tax all services currently not subject to the sales tax (except medical services, education services, and employment services). Taxing services improves the current sales tax's neutrality, equity, and diversity.
- *Minimize services tax pyramiding*—Exempt services that are purchased to produce final goods and services subject to the tax. Exempting these services makes the tax efficient (minimizes pyramiding) but decreases the potential scope of the base.
- *Tax insurance and financial services*—Tax insurance and financial services purchased by consumers under the use tax, because these industries do not have "sales" that can be taxed with a sales tax on services. Repeal the insurance premium tax. Taxing insurance and financial services under the use tax improves neutrality.

Simply adding a services tax without pyramiding to Florida's existing system leads to only modest improvements over the existing system (see Table S-4). Compared with other services tax proposals, this version is relatively "pure" because it minimizes pyramiding. Other proposals suggest taxing all services or only those purchased by business. These proposals would increase the inefficiency of the existing system.

Table S-4

SUMMARY
SYSTEM RANKINGS OF ALTERNATIVE TAX STRUCTURES



Yet merely adding this nonpyramiding version of the services tax to the existing system proves to be a "second-best" solution, because pyramiding remains in the sales tax on goods. From a pro-competitive standpoint, the best type of consumption tax would be a broad-based tax on final purchases of both goods and services. Such a tax would encourage savings, foster a level-playing field among goods and services, and be highly efficient.

Example 3: Create a Single Business Tax

Example 3 centers around the establishment of a Single Business Tax (SBT), similar to the one used by Michigan. The key elements of this example are:

- *Impose a Single Business Tax*—Florida would establish a single tax on business activity—an annual tax on the value that businesses add to goods and services purchased from other businesses or government.

- *Eliminate five taxes* —Florida would eliminate the following taxes on businesses:

    - The state corporate income tax
    - The retail sales and use tax paid by business
    - The intangibles tax
    - The documentary stamp tax on documents other than deeds
    - The insurance premium tax.

  Revenues previously raised by these 5 taxes would be raised by a single broadly based, low-rate tax on business.

The SBT is examined because it has several unique characteristics, among them:

- *Grows in proportion to economic activity*—In the long run, SBT revenues grow in proportion to personal income.

- *Promotes investment in capital*—The SBT promotes new capital investment because capital expenditures for real and personal property are excluded from the tax base, effectively reducing tax liability in the year in which they occur.

- *Has minimal fluctuation in revenue from year to year*—With minimal fluctuation from year to year, the SBT is particularly appropriate for states with cyclical economies.

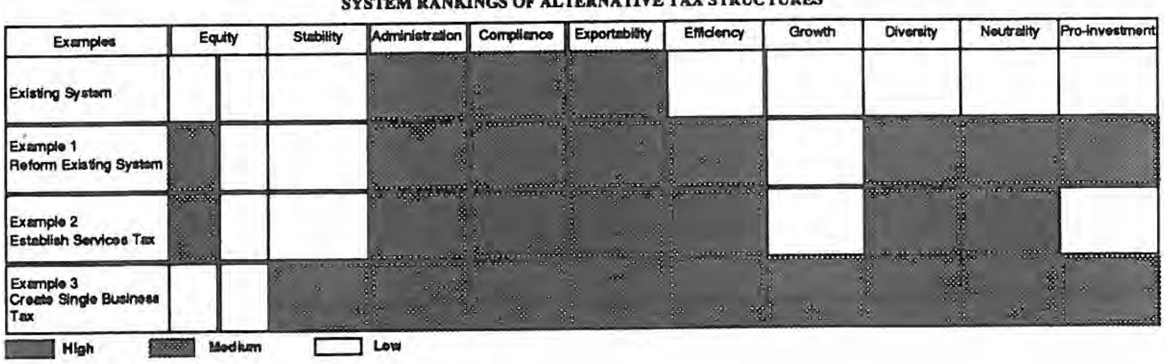
- *Promotes neutrality*—The SBT is neutral in treating firms from different industries equally.

- *Simple compliance and administration*—The broad base of the tax means that the same amount of revenue can be raised from a *low-rate SBT* as from *five existing state taxes on business.*

Although adding an SBT to Florida's existing tax system brings important improvements to six criteria for a pro-competitive tax system, including stability and growth, it does not by itself move any criterion toward a "high" ranking because SBT revenues account for a small share of total revenue relative to the sales and property taxes (see Table S-5).

Table S-5

SUMMARY
SYSTEM RANKINGS OF ALTERNATIVE TAX STRUCTURES



Example 4: Institute a Personal Income Tax

Example 4 centers around the enactment of a personal income tax, provides property tax relief, and includes some provisions to encourage investment.

- *Adopt a personal income tax*—Florida would repeal its constitutional prohibition on the taxation of income and establish a personal income tax.
- *Provide property tax relief*—Funds raised by the income tax could be used to provide property tax relief in the form of "circuit breaker" property tax credits against the personal income tax and/or cuts in property tax millage rates.
- *Encourage investment in economic foundations*—To encourage individuals and industry to invest in Florida's economic capacity, Florida could establish Individual Training Accounts, an Employee Training Tax Credit, and an R&D Tax Credit with a special provision to encourage research collaboration with Florida universities.

Adding a personal income tax would significantly improve the following elements of Florida's current tax system:

- *Decrease the regressivity of the current system*—Whether the personal income tax has proportional or progressive rates, the presence of the tax will decrease the regressivity that characterizes Florida's current tax system.
- *Improve growth*—Increase the ability of the system to grow with the economy.
- *Enhance the short-run stability of the system*—Although the personal income tax is sensitive to short-run swings in the economy, it is less volatile than the sales tax.
- *Enhance exportability*—A personal income tax would allow Florida to exploit another source of exportability: deductibility from federal tax liability.
- *Increase diversity*—By adding income to Florida's wealth and consumption tax bases, a personal income tax would increase the diversity of the state tax base.

To simplify compliance and administration, Florida's personal income tax could "piggyback" off the federal income tax. Federal adjusted gross income would be the most stable base. The tax could be applied either to all taxpayers with federal tax liability or to taxpayers with income above a certain threshold level.

As with the Single Business Tax example, adding a personal income tax to Florida's existing system significantly improves the stability, growth, and pro-investment characteristics. Three strengths are unique to this example: with a personal income tax, Florida could reduce regressivity, export an increased tax burden to the federal government, and tap a truly diverse tax base (see Table S-6).

Table S-6

SUMMARY
SYSTEM RANKINGS OF ALTERNATIVE TAX STRUCTURES

Examples	Equity		Stability	Administration	Compliance	Exportability	Efficiency	Growth	Diversity	Neutrality	Pro-investment
Existing System											
Example 1 Reform Existing System											
Example 2 Establish Services Tax											
Example 3 Create Single Business Tax											
Example 4 Investment-Oriented Personal Income Tax											

High Medium Low

Example 5: A Comprehensive Structural Reform

Drawing on the best features of Examples 1 through 4, this example illustrates how revenue sources with complementary and reinforcing strengths can be combined to create a portfolio of taxes with a highly pro-competitive tax structure.

This example of comprehensive structural reform has the following key elements:

- *A Single Business Tax*—The SBT would be the only major state tax levied on business.
- *A retail sales tax*—Florida would have a pure retail sales tax on the final consumption of goods and services.
- *A broad-based property tax*—A property tax would be levied on a broad base of real and personal property.
- *Personal income tax*—Florida would enact a personal income tax on income earned in Florida, with "circuit breaker" property tax relief for Florida residents.
- *Expanded estate tax*—An estate tax above the credit for other states' taxes would be levied.

This combination of taxes leads to across-the-board improvements over both the existing system and Examples 1 through 4 individually (see Table S-7)

Table S-7

SUMMARY
SYSTEM RANKINGS OF ALTERNATIVE TAX STRUCTURES

Examples	Equity*		Stability	Administration	Compliance	Exportability	Efficiency	Growth	Diversity	Neutrality	Pro-investment
Existing System											
Example 1 Reform Existing System											
Example 2 Establish Services Tax											
Example 3 Create Single Business Tax											
Example 4 Investment-Oriented Personal Income Tax											
Example 5 Comprehensive Structural Reform											

*Equity is judged on both "ability to pay" (left box) and "benefits received" (right box) principles.

High Medium Low

The interplay between the taxes works for the benefit of the whole system.

- *Equity*—Together these taxes work to create a system that is likely to have minimal regressivity or be slightly progressive. The presence of the personal income tax offsets the natural regressivity of the sales tax. The income tax also provides opportunity to decrease the regressivity of the property tax through a "circuit breaker," which would be available to both homeowners and renters. The "benefits received" aspect of equity is enhanced by the SBT.
- *Stability*—On balance, this system has medium stability. The SBT and property taxes are highly stable, countering the estate tax, which has low stability but high growth. The consumption and income taxes have medium stability. Recognizing the trade-off with long-run growth, medium stability over the short run may be the most appropriate target for a pro-competitive system. A system with high stability is likely to be dominated by taxes growing less than the economy over the long run.
- *Administration* —The component taxes add up to a system that is strong on administration. Administering one major tax on business is easier than administering several. The personal income tax, estate tax, and consumption tax all rank high on administration.
- *Compliance*—The system ranks high on compliance. The presence of one tax on business simplifies compliance. The broad-based tax on all consumer consumption simplifies compliance for retailers.
- *Exportability*—The system can take advantage of all opportunities to export tax burden. The state SBT, personal income tax, and property tax can be deducted for federal tax purposes. A broad-based sales tax ensures that tourists will pick up as much of Florida's tax burden as possible.
- *Efficiency*—Overall, the broad base of these taxes could result in rates low enough to minimize the role of taxes as much as possible in business and consumer decision-making. The broad base of the retail sales tax, for example, precludes an effect of taxes on consumption decisions between goods and services. The broad base of the property tax and use of the personal income tax could lead to lower property tax burden, and better targeting of property tax relief to financial need. Finally, there is no inefficient pyramiding in this system.
- *Growth* —The combination of a relatively low-growth tax (retail sales) with some high-growth taxes (personal income, property, estate) and one that grows proportionately with the economy (SBT) results in an overall system that will grow over time with economic activity.
- *Diversity*—This system is diverse in two respects. First, the base of each individual tax is as broad as possible. Second, the system as a whole taps the three major bases: consumption, wealth, and income.
- *Neutrality*—The use of the SBT and a retail sales tax that falls on both goods and services results in a highly level playing field among Florida businesses. Using circuit-breaker property tax relief instead of the homestead exemption results in fair competition between the residential and rental property industries.
- *Pro-investment*—This system encourages investment primarily through the use of the SBT. It lacks the investment-discouraging effects of a tax on business purchases.

Although the criteria rankings for comprehensive structural reform show marked improvement over Florida's existing system, the amount of revenue raised by each tax could be set so that the aggregate share of taxes paid by Florida residents and businesses is approximately the same in both cases.

Results from Designing a Pro-competitive Tax Structure

Designing a pro-competitive tax structure is but one of the steps Florida needs to take to become a competitive, value-added economy. It is, however, a critical step to help build the other elements of Florida's economic foundation: human resources and education, technology, physical infrastructure, finance, regulatory environment, and quality of life.

If Florida designs a pro-competitive tax system, Floridians can expect the following results:

- Florida's public sector will have the stability and revenue growth needed to plan and make long-term investments in other economic foundations: education, human resources, physical infrastructure, technology, finance, quality of life.
- Florida's private sector will have tax-based incentives to invest in people, research, and equipment. Many disincentives to invest will be eliminated.
- The overall competitiveness of Florida's tax environment will be enhanced. Uncertainty regarding tax liability from one year to the next and tax-induced advantages to specific industries will be minimal.

When public sector investments in economic foundations are strengthened, Florida businesses will have the support needed to produce value-added goods and services. A high-quality tax structure will encourage individual businesses to invest in training, R&D, and capital equipment, increasing their opportunities to enter new value-added markets. Reducing the uncertainty in Florida's tax climate will provide a clear signal to existing and potentially new Florida businesses that Florida understands the importance of stability to business planning needs.

The combination of the above will help all Florida industries—from citrus to tourism to aerospace—continually move toward higher value added. When companies produce more value added, they can stay competitive in the global economy and offer high-quality, high-wage jobs. The end result will be rising real standards of living for Floridians.

Finally, structural tax reform of the kind envisioned in this study, coupled with commitments by government to make improvements in areas like education and physical infrastructure, can work to restore public confidence in government. Comprehensive, competent structural tax reform, however, is a necessary but not sufficient step towards building a renewed climate of public trust. Structural tax reform must be accompanied by accountability measures and expenditures which show Florida residents the benefits of revenues they entrust to state and local government.

I PURPOSE OF THE PROJECT

Purpose

Florida enters the 1990s facing critical choices about its economic future. Florida can become a leading competitor in the new global economy, with Floridians enjoying a rising standard of living and widespread economic opportunity, or it could find itself declining in economic status relative to states and regions worldwide. Although economic success is within reach, progress requires that government, businesses, and individual Floridians make hard choices about improving Florida's capacities in critical economic foundations: human resources, technology, physical infrastructure, finance, tax and regulatory environment, and quality of life.

The Florida Chamber Foundation sponsored *Crossroads: Designing Florida's Tax Structure* to help the state confront fundamental choices about a key underlying economic foundation: the state's fiscal system. A previous Florida Chamber study, *Cornerstone: Foundations for Economic Leadership*, conducted by SRI International, DRI/McGraw-Hill, and MGT of America identified reform of Florida's fiscal structure as a critical first step down the path toward economic prosperity. *Cornerstone* articulated a new economic vision for the state, in which Florida industries evolve toward higher-value-added economic activities, supported by public and private investments in economic foundations.

The purpose of *Crossroads* is to determine how Florida's fiscal foundation can better prepare the state to meet economic challenges and to evolve into an advanced, leading economy. To this end, the study has three objectives:

- To determine the essential characteristics of a "pro-competitive" tax structure, one that creates an environment conducive to high-value-added economic growth.
- To evaluate Florida's current tax system in light of these desired characteristics.
- To provide examples of tax changes that bring improvements to Florida's tax structure.

Tax and budgetary reform is clearly not new to Florida. Since 1911, 10 major tax study commissions have grappled with improving the state's tax system. Countless other government, academic, and consultant studies have contributed to debates in Florida about how best to respond to fiscal crises, correct defects, raise additional revenue, and spend government funds.

Crossroads, however, is an "untraditional" fiscal project in several respects.

Unlike prior studies, the project assesses Florida's tax system through the lens of competitiveness. Taking the Chamber's *Cornerstone* report as a stepping-off point, the project examines the role of the state and local tax system as one key aspect of Florida's competitiveness. A solid fiscal foundation is a critical prerequisite for reaching the *Cornerstone* vision, because the fiscal system affects private-sector investment decisions and competitiveness and supports public-sector investment in economic foundations. The operative question of this project is, "What type of tax structure can create an environment conducive to high-value-added economic growth?"

The project focuses on the importance of tax structure, rather than specific taxes or rates. The project identifies specific characteristics that the overall tax structure must have to be pro-competitive, regardless of specific component taxes and their rates. An assumption is that the establishment of a widely accepted framework, or set of objectives for Florida's fiscal foundation, can lead to more productive debate about the merits of proposed tax changes.

The project focuses exclusively on the revenue-raising side of the budgetary equation. No attention is devoted to analyzing or projecting specific expenditure needs, as was the focus of the recent Zwick Commission study. Although the Chamber believes that serious consideration of expenditure patterns—in areas such education, technology, physical infrastructure, crime, and health—is vitally important to Florida's economic future, this project was conducted with only a cursory examination of needs for overall revenue growth. A guiding tenet of this report is that there are more pro-competitive ways to raise revenue than the current system, given any level of expenditures required.

This project is intended to provide input to the Taxation and Budget Reform Commission established by the voters in 1988. The Commission has the responsibility to conduct a comprehensive examination of Florida's tax and budgetary systems and to make recommendations by 1992. This project was initiated and designed to help the Commission focus on one important aspect of the tax reform issue: the impact of tax structure on economic competitiveness.

Organization

Crossroads is organized into seven chapters:

- *I. Introduction*—This chapter outlines the purpose of the project and the organization of the report.
- *II. Florida's Economic Future*—This chapter articulates the vision of Florida's economic future developed in the Chamber's *Cornerstone* report, in which Florida's public and private sectors invest in the economic foundations required for industries to move toward higher-value-added economic activities and for Floridians to enjoy rising standards of

living. A strong fiscal foundation on which to build this new future for Florida is found to be critical.

- *III. Criteria for a Pro-competitive Tax Structure*—This chapter outlines the characteristics of a tax structure that need to be present for it to be "pro-competitive"—to foster an environment conducive to high-value-added economic growth. These characteristics include both "standard" and specifically "pro-competitive" criteria.
- *IV. Problems with Florida's Current Tax Structure*—This chapter examines how well Florida's existing tax structure measures up to the criteria for a pro-competitive tax system, finding Florida's recurrent fiscal crises throughout the 1980s to be symptoms of serious structural flaws. The fact that criteria can be useful for assessing individual taxes, as well as overall tax systems, is noted.
- *V. Assessment of Florida's Major Revenue Sources*—This chapter undertakes an in-depth evaluation of 10 of Florida's major sources of revenue at the state and local levels. Although all taxes have strengths, across-the-board weaknesses are identified, including equity, growth, stability, neutrality, and pro-investment.
- *VI. Assessment of Potential New Revenue Sources*—This chapter analyzes four potential new sources of revenue for Florida that are currently used by other states: the services tax, the personal income tax, the inheritance tax, and Single Business Tax. On balance, these are found to have strengths that Florida's existing revenue sources do not.
- *VII. Examples of Pro-competitive Structural Improvements*—This chapter provides five examples of changes to Florida's existing tax structure that bring improvements to pro-competitive criteria. The first four examples are independent of each other, while the fifth combines the best qualities of the first four to provide the most comprehensive example of structural improvement.
- *Appendices*—The appendices provide information and analysis to support the main document.

II FLORIDA'S ECONOMIC FUTURE

An Economic Vision

Cornerstone examined the competitive strengths and weaknesses of the Florida economy by analyzing industry trends and comparing the status of critical elements of the state's economic infrastructure with those of national and regional competitors. It found that although Florida has the potential to move toward a higher-value-added economy in the 1990s, the state's current competitive disadvantage in education, technology and transportation infrastructure limits Florida's ability to realize its economic potential. The key question is what type of tax structure can promote public-and private-sector investment in these economic foundations while also promoting the growth of competitive businesses.

One of the most significant findings of *Cornerstone* (as well as the follow-up *Enterprise Florida* report also prepared for the Florida Chamber by SRI) was that high-value-added businesses and economic activity, so important to the state's future, cannot be attracted or grown simply on the basis of low taxes and low wages. Increasingly, businesses with the potential to grow and to pay high wages require a strong "economic infrastructure," including a quality workforce, access to technology, available seed capital, adequate transportation, and a high quality of life. To sustain increases in real wages, the basis for economic development in Florida must shift from a focus on low costs (land, labor, and taxes) and population growth to a focus on investing in economic foundations that are critical for productivity growth.

Discussing this vision of Florida's economic future and how to get there requires a clear statement of what constitutes a high-value-added economy and why Florida's rapid population and employment growth does not necessarily by itself lead to high-value-added growth. Furthermore, it is important to identify what benchmarks can be used to help determine whether Florida is, in fact, moving toward a higher-value-added economy.

The Competitive Challenge: Adding Economic Value

Only economies that successfully and continuously add increasing value in the provision of goods and services can sustain increases in their real standard of living over time. Value added is the difference between the price of a good and the cost of its inputs. More value can be added by decreasing the cost of making a product (through better use of resources) and/or by increasing the price that will be paid for the product (e.g., through creating special technical attributes, providing special services, or otherwise affecting its uniqueness).

All industries, whether computers, chemicals, or textiles, have within them relatively low-value-added and relatively high-value-added product segments or economic activities. Low-value-added segments (e.g., commodity chemicals, beginner tennis rackets, personal computers) face constraints to the amount of value that can be added because competition in these market segments is driven by *price*. These segments typically have several characteristics in common: they require low-skill, low-cost labor and use relatively standard, easily accessible technology.

Opportunities to add increasingly higher amounts of value to other goods and services (e.g., designer fashions, luxury autos, deluxe tennis rackets, computer workstations) are limited only by imagination, ingenuity, and what the market will bear. Differentiating the product through *qualities*, such as aesthetic design, technical performance, servicing, or marketing, allows the product to command a price that is high relative to its costs of production. In general, high-value-added economic activities require more highly skilled workers, more technical knowledge, sophisticated inputs, and sometimes heavy investment in specialized design and production equipment. The number of places where high-value-added activities can successfully take place is therefore more limited.

Individual states and regions improve by having the overall orientation of their economies constantly evolve toward higher-value-added activities. Only by adding more and more value to inputs can companies increase workers' wages. Investments in economic infrastructure lead to higher productivity of labor, capital, and material resources, and thus higher value added. (Since productivity statistics measure unit of output per unit of input, they are a measure of value added.) Only by constantly increasing productivity can economies protect themselves from competitors willing to perform similar tasks for lower wages.

How Florida Rates in Value Added

The findings of *Cornerstone* concerning Florida's value added can be summarized as follows:

- Although Florida succeeded in the 1980s in diversifying its economy by increasing employment in high-value-added manufacturing and business and financial services, Florida's economic structure remains oriented toward low-value-added businesses, especially those in its large retail sector.
    - Florida remains underrepresented in high-value-added, high-wage manufacturing (with only 11% of employed persons, compared with 19% nationally).

- Over 50% of Florida's workers are employed in low-wage service and retail sectors.
- Florida leads the nation in the proportion of gross state product contributed by retail trade.

- The economic consequences of Florida's current low-value-added economy can be seen in the following statistics:
  - Real gross state product per employee (the best overall measure of labor productivity) is 13% below the national average. Florida ranks in the bottom 20% of the 50 states.
  - Florida's value added per worker in manufacturing is 14% below the national average.
  - Florida ranks 34th in the nation in real wages per employee.

The reality of Florida's low-value-added economic structure has been masked by the growth of passive income. Florida's dividend and interest income is 8 percentage points higher than the national average, while wage and salary income is 7 percentage points below the national average. Whereas Florida's real per capita income has grown relative to other states (and is now equal to the national average), much of this remarkable growth stems from passive rather than earned income.

While Florida has begun to shift its industrial structure toward higher value added (and high wages) through the attraction and growth of high-value-added manufacturing and traded services, more has to be done if Florida is to earn its living on the basis of higher productivity.

Closing Florida's Value-Added Gap

Florida continues to face a value-added gap relative to its competitors that threatens improvements in the standard of living of its workers. Without continually shifting to higher-value-added economic activity, Florida's people will fail to gain the economic benefits of growth in the state.

The value-added gap can be illustrated by comparing the value added per production worker in Florida, California, and the United States:

	Value Added/Production Worker
Florida	$73,000
United States average	82,000
California	93,000

If Florida were able to attain the value added/production worker ratio of a leading state such as California, it could add approximately 11% to its gross state product and Florida's standard of living could increase by $2,000 per worker.

Yet moving toward high value added requires investment in economic foundations, such as education, technology, and physical infrastructure. Would Floridians be willing to invest more in economic foundations if such investments promoted a shift to a higher-value-added economy, leading to better-paying jobs and a higher real income? For example, would people be willing to pay $200 a year more now if it would pay off in $2,000 in higher income 8 years from now? With questions such as these, the link between economic foundations, value added, and standard of living becomes clear.

Measuring Florida's Performance

Rather than traditional measures like population or employment growth, which are often viewed as the same as economic health, *Cornerstone* suggests some new measures for determining whether Florida's economy is improving. *Economic health* results from a competitive economy that generates rising real wages, increasing employment, and growing business profits.

Population growth is not a good measure of economic health. It can be an important stimulus for economic growth if increasing consumer demand leads to growing businesses. If population grows faster than the economy, however, unemployment will increase.

Employment growth, although important, is also not a true measure of economic health. It is possible to have increasing employment and declining per capita real income if the economy is not creating high-paying jobs.

Cornerstone suggests that *a better measure of economic health is rising real wages per employee,* which reflect an increasing standard of living. Rising real wages stem from increasing employment opportunities in higher-paying jobs based on a continuing shift in economic structure toward higher-value-added. More productive use of workers and other resources leads to a higher standard of living. Thus, *the most important intermediate measure of economic health is real gross state product per employee,* an overall measure of productivity.

During the 1990s, Florida will know it is moving toward a higher-value-added economy if real wages and real gross state product (GSP) improve in both absolute terms and relative to national competitors. Real GSP per employee will need to improve from its current 13% deficit relative to the nation, and real wages per employee will need to move closer to the national average from its current 34th rank. This improvement will occur only if Florida's economic structure shifts toward high value added over the decade.

A computer simulation in *Cornerstone,* prepared by DRI/McGraw-Hill using an economic model of the Florida economy, shows that a growth rate in high-value-added manufacturing and business service industries 3 percentage points higher than the national average between 1988 and 2000 would result in a 6% increase in real personal income and employment.

Implications for Florida's Tax Structure

Florida's tax structure was created for an earlier era when low taxes were an important basis for attracting people and business to the state. Between the 1950s and the 1980s, the major impetus for Florida's economic growth was migration based on the state's high quality of life and low-cost environment. Florida's status as a low-tax state was a fundamental part of the strategy that brought jobs for a burgeoning population.

Times have changed. Florida is no longer a sparsely populated, resource-dependent economy, geographically isolated from national markets, that has to rely on a low cost of living to attract people and industry to the state. As the state's economy has diversified and dynamic clusters have grown in its major regions, the prior focus on attraction has shifted toward homegrown enterprise development.

Global competition is reality. Attempting to compete primarily on the basis of low costs has become a losing game, since many Third World countries have much lower land costs, wages, and taxes than Florida. Florida cannot match these low-cost environments while maintaining a high standard of living.

Cornerstone offers an alternative vision for Florida based on adding value to economic activities through investments in strong economic foundations of skills, knowledge, and infrastructure. Such an economy is not only more appropriate for Florida today, it offers promise for a rising standard of living for Florida's people.

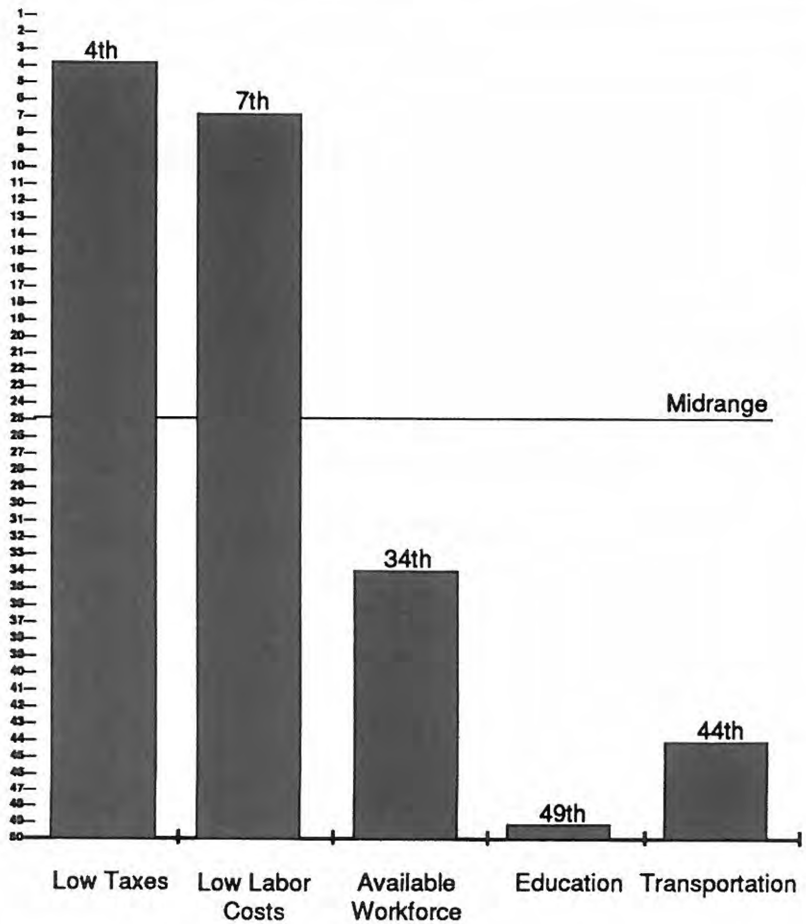
Redefining the Business Climate

A basic challenge is redefining what constitutes a good business climate in the context of the new global economy. The traditional definition of a good business climate focused on the cost of doing business (labor costs, taxes, regulations). Although these factors are still important, now they must be balanced with new value-adding factors such as labor force quality, technology, education, and transportation. The challenge of the 1990s is to be competitive in both cost and quality. If a state is good only on the cost dimension, it will tend to attract and grow low-cost businesses and thus lose value-added, higher-wage businesses.

Florida's problem is that its overall business climate is not balanced. Whereas it ranks 4th lowest in taxes and 7th lowest in low labor costs, it ranks 34th in available workforce, 49th in education, and 44th in transportation (see Figure II-1). In short, Florida's good rankings on the cost side are at the expense of investments in the quality side.

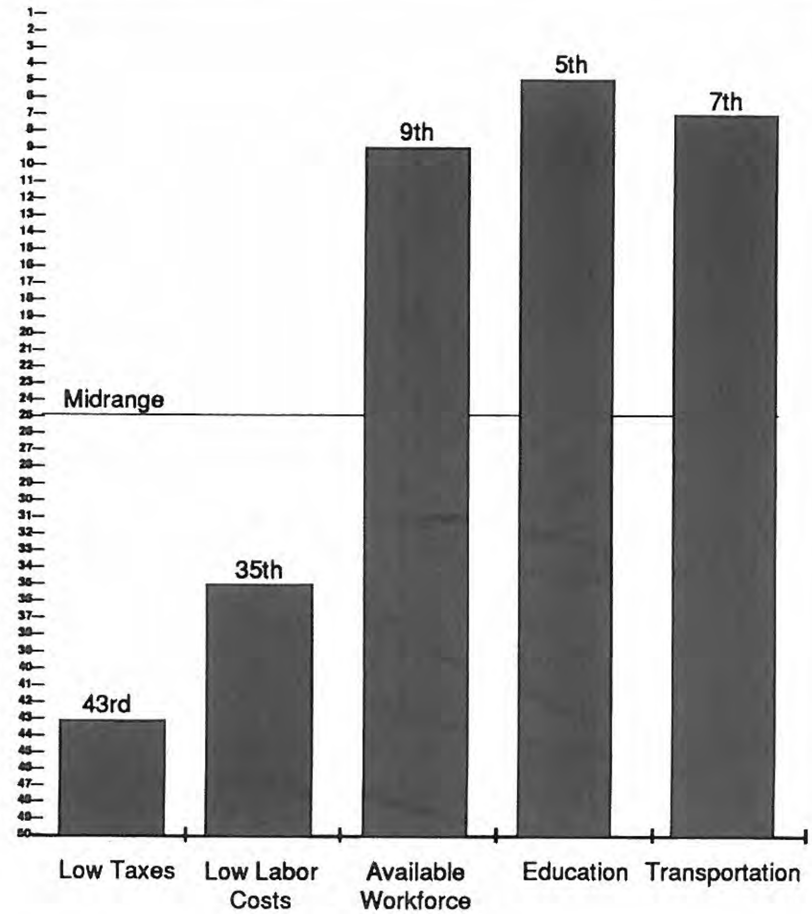
Every state grapples with this balance. Minnesota represents an interesting contrast to Florida (see Figure II-2). This "Frostbelt" state has been able to grow a significant portion of high-value-added industries, largely because of the quality of its workforce (ranking 9th), education (5th), and transportation (7th). On the other hand, its tax burden is high (7th highest). Another example is Maryland (see Figure II-3), which has experienced significant economic growth in the past decade with a moderate tax burden (35th), a high available workforce (7th), and moderate education (21st), but low transportation (46th). A third comparison state is Colorado (see Figure II-4), which combines a relatively low tax burden (12th) and average labor costs (28th) with a high available workforce (5th) and relatively high education (16th) and transportation (16th).

Using this new definition of a competitive business climate as one that is neither too high nor too low on a range of both cost and quality measures, it is clear that a low tax burden, by itself, cannot constitute a good business climate.



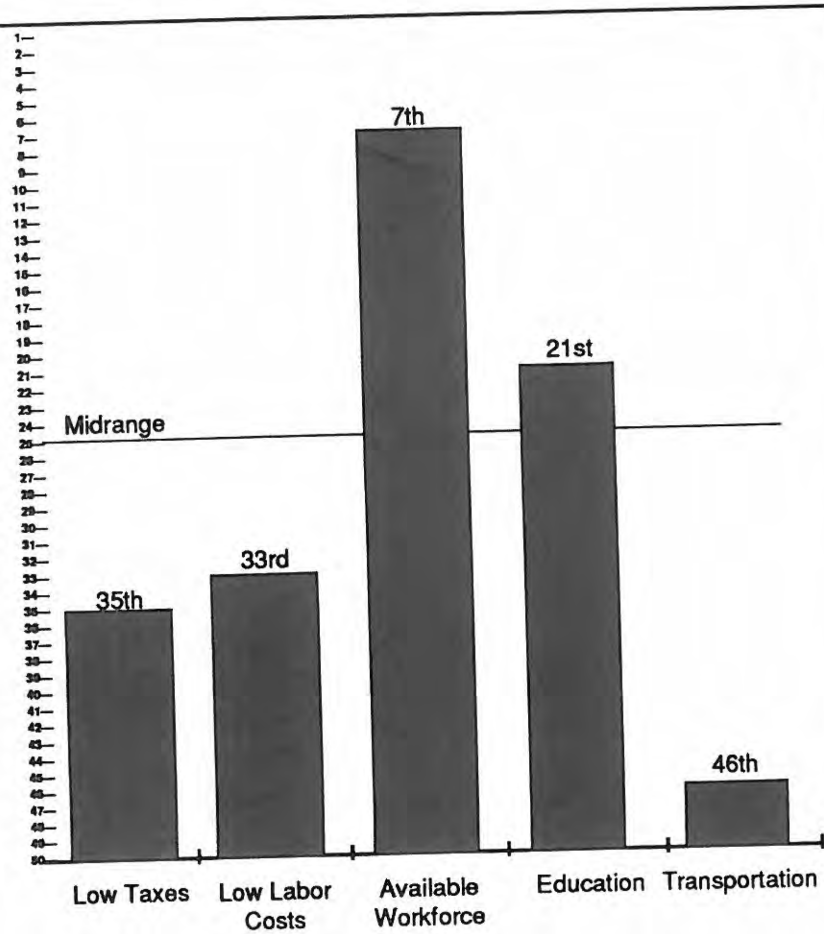
Source: Grant Thornton, 1989.

FIGURE II-1 NATIONAL RANKINGS OF KEY FLORIDA BUSINESS CLIMATE INDICATORS



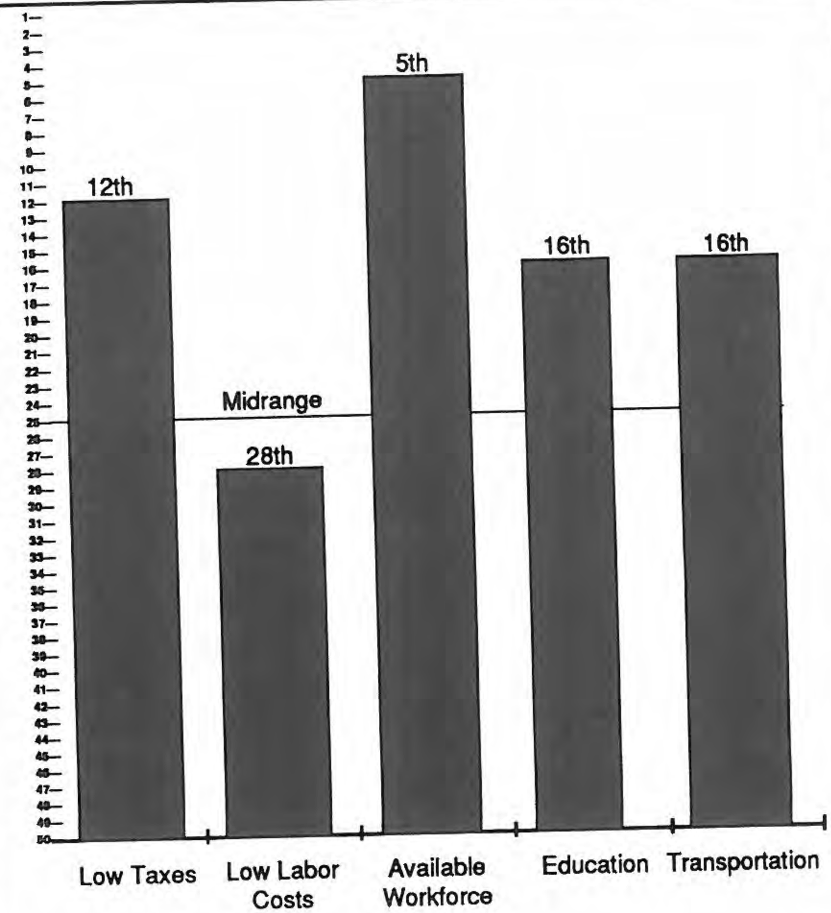
Source: Grant Thornton, 1989.

FIGURE II-2 NATIONAL RANKINGS OF KEY MINNESOTA BUSINESS CLIMATE INDICATORS



Source: Grant Thornton, 1989.

FIGURE II-3 NATIONAL RANKINGS OF KEY MARYLAND BUSINESS CLIMATE INDICATORS



Source: Grant Thornton, 1989.

FIGURE II-4 NATIONAL RANKINGS OF KEY COLORADO BUSINESS CLIMATE INDICATORS

III CRITERIA FOR A PRO-COMPETITIVE TAX STRUCTURE

Criteria serve as objectives for creating a high-quality revenue system. This chapter identifies criteria that should be considered in analyzing Florida's tax structure, combining standard criteria with a new set of criteria appropriate for developing a pro-competitive tax structure.

The criteria are not necessarily compatible, for it may prove impossible to meet all criteria of a good tax system at once. In this sense, the criteria can be useful for identifying trade-offs among alternative policy goals.

Standard Criteria for High-Quality Tax Structure

Five major objectives have dominated discussions about Florida's tax system.

- *Equity*—In a high-quality tax structure, all taxpayers should pay their "fair share." One approach to fairness states that taxpayers should be taxed according to their ability to pay. *Horizontal equity* implies that taxpayers with equal ability to pay should have similar tax burdens. *Vertical equity* requires that taxpayers with greater ability to pay contribute more than those with less ability. Determining how to measure "ability to pay" for individuals and businesses is an ongoing challenge to policymakers.

  A second approach to equity focuses on the link between taxes paid and benefits received. The *benefits received* principle implies that taxpayers should contribute in line with benefits they receive from public goods and services.

- *Stability*—Revenues raised by the fiscal system should be stable and predictable, with a minimum of unplanned fluctuation from one year to the next.

  Short-run revenue stability is a prerequisite for effective fiscal and budgetary planning for the public sector. Governments that are preoccupied with patching up unexpected budget shortfalls from one year to the next often lack the ability to make longer-term investment and policy decisions. Frequent changes in tax rates and bases to make up for budget shortfalls frustrate the planning activities of businesses and individuals and undermines their confidence in government.

- *Quality of administration*—Tax systems should not be extremely difficult or expensive for governments to administer, relative to the revenue they produce. Administration of tax provisions should be nonarbitrary.

- *Ease of compliance*—The tax system should be understandable to the taxpayer. Compliance costs, including the filing of forms and keeping of records, should be low.

- *Exportability*—Like other states, Florida has been concerned about passing the burden of taxation and support for public services on to nonresidents. Public service burdens are passed on when taxes are paid directly by nonresidents, when residents deduct state taxes for purposes of federal tax liability, or when the federal government shares revenues.

New Criteria for a Pro-competitive Tax Structure

Beyond this traditional base, other criteria can be developed that promote a *pro-competitive* revenue structure—one that helps move the state toward higher-value-added business activity and higher per capita income. Although a revenue system is but one of the tools government and business have for building regional competitive advantage, a pro-competitive revenue system provides a critical foundation for success in other initiatives.

A pro-competitive system would have the following characteristics:

- *Promote efficiency*—A high-quality tax system should not interfere with the economic choices made by individuals and businesses in otherwise efficient markets. The tax itself, in other words, should not be the major factor that sways decisions about how to allocate resources.

  The efficiency principle implies, for example, that taxes should not significantly influence individuals' decisions about which goods and services to purchase or which investments to make. For businesses, taxes should not influence decisions about how to organize or which capital goods to buy.

- *Grow in proportion to the economy*—Over time, revenues should grow in proportion to the economy. In most states, history has shown that government spending on public services parallels growth in the economy, as measured by growth in state personal income. The reason is that, over the long run, growth in the economy is tied to population growth and new business investment, which make demands on a variety of public services: schools, roads, human services.

  If revenues grow less than the economy over time, frequent changes in tax policy will be needed. Alternatively, long-run revenue growth that outpaces the economy could foster unnecessary government spending.

- *Diversification of sources over a broad base*—The revenue system should have substantial diversification of revenue sources over broad bases. Diversification makes it possible to keep tax rates low, minimizing each tax's undesirable effects on the taxpayer and the overall system. Diversification over broad bases also fosters stability in the revenue system. Heavy reliance on a single tax can increase the difficulty of raising additional revenue and induce unintended behavioral distortions. An excessively high sales tax, for example, may lead residents to shop out-of-state; excessively high property taxes may curtail in-state investment. Last, diversification of tax burden between consumers and business promotes a sense of fairness.

  Diversification is pro-competitive because it fosters stability in government's resource base, minimizes the negative effects of taxation on business and consumer activity by keeping rates low, and can spread the cost of government across all who benefit from government services.

- *Provide economic neutrality*—To be fair, the revenue system should treat all industries in a similar fashion. The system should not provide industry-specific tax incentives or special taxes on selected industries, in hopes of targeting statewide "winners" or providing relief to industries that are otherwise uncompetitive (see Exhibit III-A). The system should minimize the use of tax incentives to attract individual firms or industries.

  Maintaining a "level playing field" is important for fostering fair competition among competing industries. Also important is the fact that the economic neutrality principle leads to the broadest possible revenue base and the lowest possible rates. Last, by minimizing rewards for tax-break lobbying, economic neutrality saves resources and raises public and business confidence in the integrity of the revenue-raising process. As a corollary, economic neutrality also means that tax policy itself should not substantially harm the ability of the state's businesses to compete with out-of-state competitors, both in and outside the state.

Economic neutrality is pro-competitive because it puts all firms on an equal footing. Since all types of companies in all different industries benefit from public provision of goods and services, all companies should foot the bill. The principle also ensures, however, that a state will not risk hurting its economy by imposing an overall tax burden far out of line with those of neighboring states. Finally, it ensures that the state will not deplete resources unwisely through tax concessions.

- *Promote private investment in value-added activities*—The tax structure should encourage, or at least not discourage, investments that can move the state toward higher-value-added activities and income growth. Such investments might include business investment in R&D, equipment, and employee training and individual investments in education and savings instruments.

  A pro-competitive tax system encourages these behaviors to improve competitiveness across industries, rather than for specific industries.

These pro-competitive criteria in combination with standard criteria can be powerful tools for creating a tax environment conducive to high-value-added economic growth.

Exhibit III-A
THE ROLE OF TAXES IN ECONOMIC DEVELOPMENT: INDUSTRIAL TARGETING VS. ECONOMIC NEUTRALITY

Two opposing views have long characterized debate about the appropriate role of tax policy in encouraging economic development. One view, emphasizing *industrial targeting*, asserts that tax policy should favor those companies and industries with potential for employment growth in the state. The other view, emphasizing *economic neutrality*, asserts that good tax policy should result in uniform effective rates across industries.

A series of recent studies have undermined the view that tax exemptions and rates play an important role in stimulating investment and employment growth. Rather, the overall structure, burden, and use of public revenues are proving more relevant for economic growth. Such evidence supports a move away from industrial targeting toward more economically neutral revenue systems.

Tax policy is often used for industrial targeting—the awarding of tax concessions to certain firms or entire industries. To encourage firms to locate or expand within state borders, some governments offer tax abatements as the centerpiece of their industrial finance programs. To stimulate the development of specific industries, governments exempt them from the sales tax or property tax.

States offer tax concessions because they believe these measures will affect economic growth and job creation by influencing corporate decisions to expand, relocate, or establish branch firms. Yet studies on the effects of financial incentives reveal no statistical evidence that tax incentives influence business location decisions or affect employment growth. Why not?

- *Other factors carry more weight when businesses make decisions about where to locate or whether to expand.* These factors include market proximity, the availability of skilled labor, quality of life, technical expertise, and government attitude toward business.
- *As one of many business costs, state taxes can be marginal.* Relative to payroll, federal taxes, and other operating costs, state taxes are often a small cost of doing business. For many companies, for example, a few pennies difference in hourly wage rates or marginal improvements in productivity can reduce production costs by more than any conceivable tax savings from relocating or seeking a tax concession.
- *By forgoing taxes, companies may actually be increasing their costs.* Low tax revenue relative to demand for services may jeopardize a variety of factors affecting bottom lines, including the quality of the workforce, the pricing of municipal services such as water, the speed of the regulatory process, and the maintenance of roads.

If tax concessions and rates are not a significant factor in stimulating economic growth, do taxes matter? They do. The old belief, however, that low taxes improve competitiveness is giving way to a more sophisticated understanding of the importance of taxes in economic development, one that focuses on overall tax structure, tax burden, and expenditure policy.

Taxes matter if their overall burden is significantly out of line with those of other states. States may weaken their economic growth opportunities relative to other states if their overall tax effort is exceptionally high.

Taxes matter if their overall burden is out of line with benefits received. Companies, especially high-value-added ones, don't want low taxes as much as value for their tax dollar. As global competition intensifies, companies have rediscovered the economic importance of traditional government services, such as education and transportation, and the strategic advantages of untraditional ones, such as technology, export, and small-business assistance. Taxes can actually reduce a company's cost of operations if without them companies would need to supply basic infrastructure at their own expense or would suffer productivity losses.

Taxes matter if the tax system creates an environment of fiscal uncertainty. Uncertainty about tax rates from year to year impedes companies' ability to plan investment, employment, and anticipated sales. Although corporate decision-making rarely hinges on the tax factor alone, uncertainty unnecessarily clouds the planning process. Equally important, uncertainty undermines corporate confidence in state leadership.

Despite this new thinking, the temptation to use the tax code to induce specific types of behavior is likely to remain strong. Rather than targeting specific industries or types of firms, states should use tax policy to encourage certain types of economic activity (e.g., investment in people and technology) across a broad range of industries. Such incentives are particularly appropriate when they are designed to address market failure, such as underinvestment in human resources or misuse of environmental resources. Tax systems that are "neutral" across industries will be more efficient, more likely to encourage productive use of resources, more closely linked to generally accepted economic objectives, and less susceptible to political influence.

IV PROBLEMS WITH FLORIDA'S CURRENT TAX STRUCTURE

Overview

Intermittent fiscal crises throughout the 1980s brought growing awareness that Florida's fiscal foundation is inadequate for supporting the state's needs and fostering a productive planning environment. Year after year, patching up budget gaps consumed more and more of state policymakers' time. Business became increasingly frustrated by Florida's highly uncertain tax planning environment, and residents began to sense a rapid growth in tax burden.

When Florida's current tax structure is measured against the pro-competitive criteria, across-the-board weakness suggests that the fiscal crises of the 1980s were merely symptoms of severe structural problems with Florida's tax structure.

- *Equity*—Florida's tax system is regressive; households with low income pay proportionately more in taxes than do households with high income.
- *Stability*—Revenue raised by Florida's tax system is extremely volatile, fluctuating widely with changing economic circumstances.
- *Administration*—Florida fares average on tax administration, though improvements are needed in property tax assessment, sales tax collection, and computerization.
- *Compliance*—Florida fares average on tax compliance, with improvements needed in the collection of sales tax on mail order sales and the intangibles tax.
- *Exportability*—Florida exports an average amount of its tax burden to out-of-state residents and companies, but shifts little of its burden onto the federal revenue system.
- *Efficiency*—Florida's tax system has significant inefficiencies, because taxes influence economic decisions made by consumers and businesses.
- *Diversity*—Florida's tax structure is narrowly-based, tapping some consumption, wealth embodied in property, and corporate income, but not personal income.
- *Growth*—Over time, Florida's tax revenues cannot grow enough with the economy to fund even the most conservative expenditure level—one that includes no real increase in spending per household.
- *Neutrality*—Florida's tax structure creates an uneven playing field among Florida businesses by making heavy use of industry-specific taxes and exemptions.
- *Pro-investment*—Florida's tax structure discourages investment in machinery and equipment and does not encourage investment in people and research.

Assessing Florida's Tax Structure

This section describes the findings about Florida's existing tax structure.

Equity—Florida's tax system is regressive; persons with low incomes pay proportionately more in taxes than do people with high incomes. Although many state and local tax systems are regressive, Florida's ranked 40th in a comparison of the 50 states.[1] The regressivity stems from Florida's heavy reliance on property, sales, and excise taxes, and the state's lack of a personal income tax—the only major source of progressivity in state and local tax systems.

Stability—Florida's tax revenue is extremely volatile, fluctuating widely with changing economic circumstances. Florida's extreme, often unpredictable fluctuations in revenue from one year to the next stem directly from its heavy reliance on the sales tax, the tax most tied to cyclical swings in the economy and population growth. Movement in sales tax collections is more volatile than movement in the economy as a whole; revenue collected from the sales tax plummets when personal income growth slows and increases faster than personal income when growth recovers (see Figure IV-1).

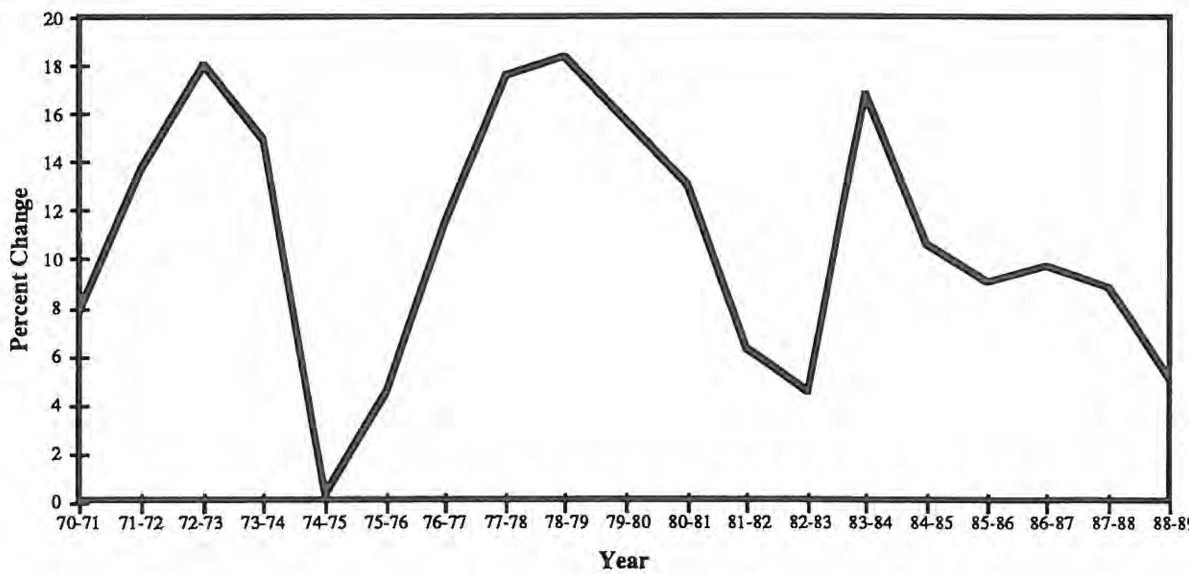


FIGURE IV-1 GROWTH RATE OF TAXABLE SALES, 1970-1989

Such volatility clearly wreaks havoc on even the most sophisticated public planning processes. For example, unanticipated revenue shortfalls early in 1990-91 led to a $160 million reduction in funds for education. Since October 1990, revenues are still coming in below estimate, setting the stage for more general revenue cuts in December. Florida anticipates a shortfall of $1 billion to $1.5 billion in 1991-92 from revenues needed to continue programs existing in 1990-91.

---

[1] See Donald Phares, "The Role of Tax Burden Studies in State Tax Policy," in *Reforming State Tax Systems*, Stephen D. Gold, ed., National Conference of State Legislatures, 1986.

Administration—Florida fares average on tax administration, although improvements are needed in property tax assessment, sales tax collection, and computerization. Like other states, Florida faces administration problems, particularly with the sales tax and assessment of property. Over the course of the 1980s, however, both have seen improvement. In the future, Florida needs to move toward assessing property at full value, collecting sales tax on mail-order purchases, computerizing Department of Revenue records and procedures, and simplifying tax forms.

Compliance—Florida fares average on tax compliance, with improvements needed in compliance with the sales tax on mail order sales and the intangibles tax. Like public sector administration, private sector compliance is improving. Compliance with the Florida legislature's mandate to fax mail order sales remains weak. Compliance with the intangibles tax is not as strong as it could be due to inadequate taxpayer awareness of the tax and weak penalties.

Exportability—Florida exports an average amount of its tax burden to out-of-state residents and companies, but shifts little of its burden onto the federal revenue system. In 1980, Florida exported 9.28% of its tax burden to out-of-state residents, roughly equaling the national average of 9.58%. The main tool for export is the sales and tourist taxes paid by visitors.

Florida does less well in shifting taxes to the federal government through the itemization of personal and real property and personal income taxes on federal tax returns. In 1980, Florida exported 4.73% of taxes via federal offset, compared with a national average of 7.12%. This low level of export stems largely from Florida's lack of a personal income tax. The elimination of the deduction for state sales tax in 1986 further undermined the ability of Florida's current tax system to export to the federal level.

Efficiency—Florida's tax system has significant inefficiencies, because taxes influence economic decisions made by consumers and businesses. The sales tax, for example, favors the purchase of services over the purchase of goods. The corporate income tax, combined with the lack of a personal income tax, encourages businesses to organize as noncorporate entities for tax purposes. The property tax encourages consumers to buy homes rather than rent, and businesses to invest in land rather than in structures and equipment. The fact that businesses pay sales tax on purchases and then charge consumers sales tax on the price of final goods (i.e., tax pyramiding) distorts prices throughout the production and sales chain.

Growth—Over time, Florida's tax revenues do not grow enough with the economy to fund even the most conservative expenditure level—one that includes no real increase in spending per household. Ideally, revenues raised through a tax system would grow in line with state income. State income is correlated with population-induced demand for government services. A system with this characteristic would be able to keep rates fairly stable, unless it wanted to finance significant increases in public expenditures.

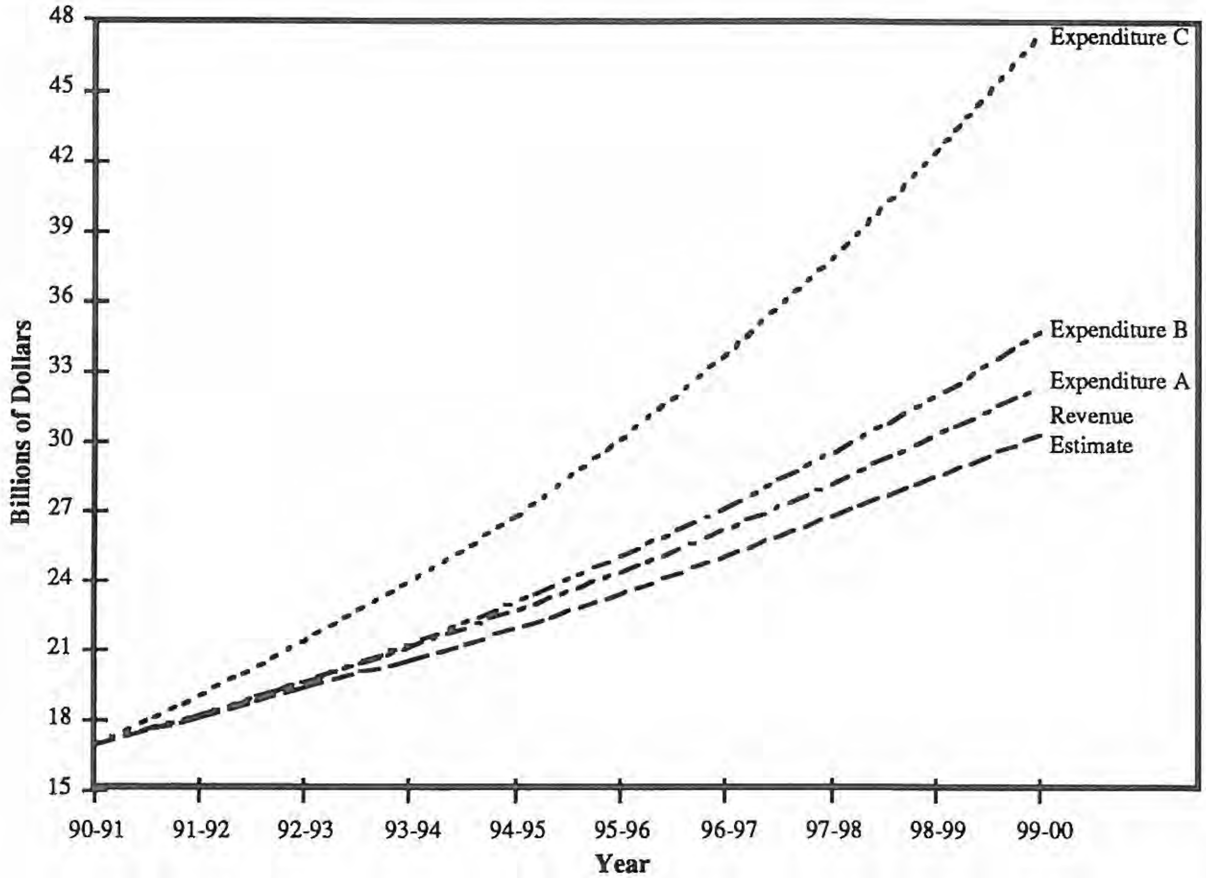
Over the next 10 years, Florida's current tax structure cannot raise sufficient revenues to fund even the most conservative expenditure level. The bottom line in Figure IV-2 shows the amount of tax revenue projected by the Florida Consensus Estimating Conference to be raised by the current tax structure over the next 10 years.[2] As early as 1991-92, outlays required to finance public services at three alternative expenditure levels begin to diverge from projected revenues. Expenditure A, the most conservative estimate, assumes no real increase in per household expenditure over the 1990-91 budget. Expenditure B assumes that spending as a share of state personal income is maintained at its 1990-91 ratio, 6.72%. Expenditure C assumes that increases in expenditures grow each year in the 1990s at the average growth rate of the 1980s, 12.10% annually.

Probing the question of which expenditure level is most appropriate —A, B, C, or some alternative—is vitally important for Florida's future and deserves further analysis. Since this project focuses exclusively on the characteristics of Florida's current tax system, *the key finding on growth needs is that Florida's tax structure cannot grow enough to maintain existing expenditure levels, whether defined as A, B, or C, much less make Florida's level of government spending and investment as a share of state income more on par with that of other states* (see Exhibit IV-A).

Why doesn't Florida's current tax structure grow? Florida's tax structure cannot grow with Florida's economy because the tax bases tapped by major taxes are inelastic; that is, they do not grow with personal income over time. Revenues from the retail sales tax, which excludes Florida's fast-growing service sector, cannot accurately track the state's economic growth. Florida also makes extensive use of excise taxes that are based on quantities rather than values (e.g., cigarette taxes that are X cents per pack, rather than X cents per dollar of sale). Florida's property tax revenues have grown slightly faster than personal income, but not enough to substantially offset the slow-growth effects of the sales and excise taxes. Florida's corporate income tax has grown roughly with the economy.

To compensate for its inelastic tax base, Florida has had to resort to increasing tax rates frequently and substantially to raise needed revenue. Repeated increases on low-growth bases moreover, tend to yield less-than-proportionate increases in revenue. Exhibit IV-B provides a timeline of significant tax changes through the 1980s.

[2]The Florida Consensus Estimating Conference is the official revenue-estimating body for the state. The members of the Conference include representatives from the House and Senate and the Governor's Office.



Revenue Estimate—Revenues projected to be raised by Florida's current tax system, according to the Florida Consensus Estimating Conference. To provide a more accurate figure of total state revenues, medical and hospital fees have been subtracted and one-half of the lottery has been added.

Expenditure A: No Real Increase—Projected expenditure level limiting real expenditures per household to the 1990-91 level of $3,137 per household (allowing increases only for inflation).

Expenditure B: 6.72% of Personal Income—Projected expenditure level limiting government spending as a share of personal income to its 1990-91 rate, 6.72%.

Expenditure C: Compounded at 12.10%—Projected expenditure level if expenditures grow each year of the 1990s at the average annual growth rate of the 1980s, 12.10%.

Source: *Florida Consensus Estimating Conference, Book 6, Revenue Analysis, FY 1970-71 Through FY 1998-99*, Florida Legislative Division of Economic and Demographic Research, September 1990.

FIGURE IV-2 FLORIDA'S REVENUE SYSTEM CANNOT MEET EVEN THE MOST CONSERVATIVE EXPENDITURE ESTIMATE, FY 1990-91 TO FY 1999-2000

Exhibit IV-A
FLORIDA'S RELATIVE TAX EFFORT AND EXPENDITURE LEVELS

Increases in sales, alcohol, cigarette tax, and property tax rates in the 1980s fueled a perception that Floridians are increasingly paying more of their income to state and local governments. *Although tax burdens on Floridians have increased slightly in the last 5 years, the tax burden felt by Floridians is still light relative to those in other states.*

Florida's level of tax effort remains very low relative to neighboring states and the U.S. average, although its tax capacity is high. Of all states, Florida ranks high (16th) in tax capacity and low (48th) in tax effort. Tax capacity is the ability of the state to raise revenue by taxing consumption, income, and wealth. Tax effort is the degree to which the state actually exploits that ability. All of Florida's regional competitors have higher tax effort and lower tax capacity. Among Florida's key national competitors, all have higher tax effort.

INDICES OF STATE TAX CAPACITY AND EFFORT, 1988

	Tax Capacity Index*	Tax Effort Index
Florida	104	82
National competitors		
California	116	94
Colorado	107	89
Texas	96	88
Massachusetts	129	94
Arizona	99	96
New York	109	152
Regional competitors		
Alabama	76	84
Georgia	94	89
North Carolina	91	93
South Carolina	79	96
Tennessee	84	83

*Indices are based on per capita capacity and effort calculations, compared to a national average of 100.
Source: Advisory Commission on Intergovernmental Relations.

One reason Florida receives less in federal government revenues than other states is that measures of tax effort are used to allocate federal grants for certain health, welfare, and social service programs. In general, more assistance goes to states with less ability to raise revenues to support their service needs with a given tax effort.

In 1987, Florida's state and local tax systems raised revenues equaling $9.60 per $100 of personal income—the third-lowest amount of the 50 states. Florida's state tax raised revenues equaling 5.76% of personal income (44th), while the local revenue system raised 3.84% of personal income (30th). From 1978 to 1987, state and local tax revenue as a share of personal income actually fell 2.6%.

Exhibit IV-B
SIGNIFICANT TAX CHANGES IN FLORIDA, 1980-1990

1980	Homestead exemption increased to $25,000 for all homeowners over a three-year period. The increased exemption offsets an increase in property assessments of 50% or more.
1981	Documentary stamp tax on deeds increased from 40 cents to 45 cents per $100 of value.
1982	Sales tax rate increased from 4% to 5%. One-half of the increase shared with local governments.
	A corporate emergency excise tax of 2% on accelerated depreciation enacted with a future corporate tax credit. The tax is in response to federal tax legislation accelerating the depreciation of property.
1983	Businesses collecting the sales tax have to pay an estimated tax with their regular tax payment. Sales tax collections advanced by 20 days only for the first month of implementation.
	The 4 cent per gallon state gas tax converted to a 5% sales tax on a statutory price of $1.148 per gallon. The effective state gas tax at this price is 5.7 cents per gallon.
	Counties given a 4 cent optional gas tax to be levied by an extraordinary vote of the county commission.
	Corporate income tax converted to its worldwide unitary form with foreign-source profits and dividends subjected to Florida taxation. Other changes enacted that increase Florida's tax base.
	Unitary Tax Study Commission appointed to study the unitary tax. The Commission recommends the repeal of the unitary tax. The unitary tax repealed in a December 1984 special session. Corporate income tax increased from 5.0% to 5.5% at this time.
	Taxes on alcoholic beverages increased: 20% for beer and 37% for spirits.
1984	Net operating income of hospitals taxed at a 1% rate with an increase to 1-1/2% the following year. Proceeds from tax are to fund indigent health care programs (PMATF).
1985	The tax base of the utilities gross receipts tax and sales tax expanded to include several telecommunication services. Both taxes apply to interstate telecommunication services that originate in Florida and are billed to a Florida number. Services that compete with regulated telecommunication services are also taxed.
	Local option gas tax increased from 4 cents to 6 cents per gallon.
	Aviation gasoline exempted from the sales tax and subjected to a 5.7 cent per gallon tax.
	Documentary stamp tax on deeds raised from 45 cents to 50 cents per $100.
	Payment of estimated sales tax collections repealed in stages, with complete repeal set for 1991.
1986	State sales tax amended to tax services and other previously exempted transactions, effective July 1, 1987.
	Tax on cigarettes increased from 21 cents to 24 cents per pack. Other tobacco products taxed at 25% of wholesale price. Cigars are exempt from the tax.
1987	Documentary stamp tax increased by 5 cents to 55 cents per $100. Proceeds of the tax increase deposited in the State Infrastructure Trust Fund (SIF).
	The state lottery begins in the spring of 1988 after approval by voters in November 1986.
	Sales tax on services repealed, effective January 1988. In its place the sales tax is increased from 5% to 6%.
	Five hundred million dollars of the increase in sales tax revenues earmarked for SIF.
	Legislation enacted to tax mail-order sales.
	Local governments given the authority to levy a 1 cent sales tax for infrastructure purposes by referendum.

Exhibit IV-B (Concluded)

1988 Several attempts made to change the alcoholic beverage tax to protect Florida producers. The courts hold that the changes are illegal.

Changes made in the insurance premium tax to treat foreign insurers and Florida-based insurers on the same basis. State revenues adversely affected, although the legislation intended to be "revenue neutral."

Cap on the SIF reduced to $500 million from $550 million. One hundred fifty million dollars transferred to PECO.

Retail dealers' collection allowance reduced and a dealer registration fee of $25-$50 imposed to help fund the Solid Waste Management Trust Fund.

Additional auditors given to the Department of Revenue (DOR) to recover unpaid taxes.

Sales tax extended to motor vehicle service agreements.

1989 Insurance premium tax changed to recover 1988 revenue shortfall. Changes do not resolve the problem.

Additional DOR auditors expected to produce $43 million in additional revenue annually.

Collection period for the utilities gross receipts tax changed from quarterly to monthly. The additional two months of collections, which are nonrecurring, are earmarked for PECO.

One hundred and fifty million dollars transferred from SIF to the General Revenue Fund for operating purposes.

It's announced that lottery funds are not being used to "enhance" education. Instead, the funds are replacing general revenue funds previously used for education.

December special legislative session on transportation fails to provide funds for a state transportation program.

PMATF program has a $200 million plus deficit for 1990-91 and $250 million more for 1991-92.

1990 Cigarette tax increased 9.9 cents per pack.

Drink tax imposed for alcoholic beverages consumed on premises.

Motor vehicle impact fee imposed on new residents.

Gross receipts tax increased from 1.5% to 2.5%.

Highway safety fees increased.

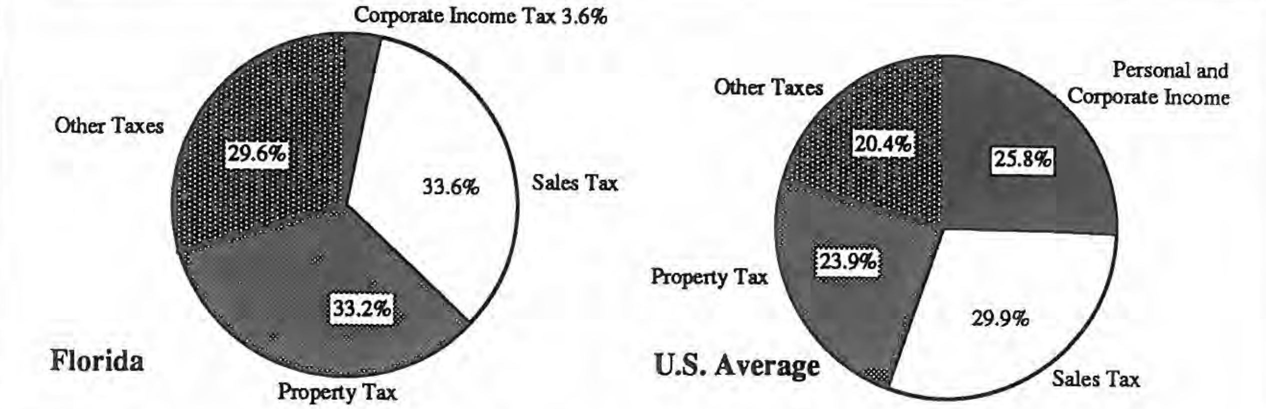
Documentary stamp and intangible taxes increased.

Service charges on selected trust funds increased to 7%.

Corporate filing fees increased.

Insurance premium tax increased.

Diversity—Florida's tax structure is narrowly based, tapping consumption, wealth embodied in property, and corporate income, but not personal income. Most states use a combination of major taxes to achieve balance in their tax structures. Balance can be desirable because it makes it possible to avoid high rates on any particular tax base, minimizes the negative characteristics of each individual tax, and enhances stability and growth. Figure IV-3 shows that Florida's state tax structure is highly dependent on the sales tax and property tax, relative to the U.S. average.



Other taxes include energy taxes, business taxes other than corporate income tax, excise taxes, and licenses.
Source: State Local Fiscal Indicators, National Conference of State Legislatures, 1990.

FIGURE IV-3 BALANCE OF STATE-LOCAL TAX REVENUE, 1987

A conservative definition of balance, one used by the National Conference of State Legislatures, calls for none of the three major taxes—sales, income (personal and corporate), and property—to raise more than twice as much as any other. Although Florida and 22 other states have "unbalanced" systems, Florida is one of 5 that are "unbalanced" because of underreliance on the personal income tax. The imbalance in Florida's tax structure contributes to high sales and property tax rates and to instability, and undermines the ability of the system to grow with the economy.

Neutrality—Florida's tax structure creates an uneven playing field among Florida businesses by making heavy use of industry-specific taxes and exemptions. Florida's tax code provides special treatment to previously regulated industries that are increasingly competing with never-regulated companies (e.g., banks competing with nonbank lending institutions). Florida also has more state and local taxes specifically on electric and telecommunication service industries than any other state. Florida's lack of a personal income tax puts incorporated companies at a disadvantage with unincorporated companies, whose net income escapes taxation entirely. Exemptions of certain types of machinery and equipment from the sales tax or property tax sometimes give one industry an advantage over competing industries.

Pro-investment—Florida's tax structure discourages investment in machinery and equipment and does not encourage investment in people and research. Unlike in many other states, companies in Florida pay sales tax when they purchase machinery and equipment. Florida businesses also are assuming a growing share of Florida's property tax burden because of the large homestead exemption. In general, Florida has above-average reliance on taxes that affect business. State taxes paid only by businesses or by both businesses and individuals account for 86% of total state tax revenues; the average for all states is 64%, primarily because 45 other states have personal income taxes. Although Florida does have an R&D credit, it is narrowly defined and little used.

From Evaluation of Tax Structure to Analysis of Specific Taxes

The overall characteristics of Florida's tax system stem from the characteristics of the system's individual revenue sources. Just as the pro-competitive criteria can be used to assess tax systems, they can also be used to assess the contribution that individual revenue sources make to the overall system. Exhibit IV-C provides a checklist for evaluating individual revenue sources. The following two chapters assess existing revenue sources in Florida and potential new ones for their compatibility with the pro-competitive criteria.

Exhibit IV-C
CHECKLIST FOR EVALUATING INDIVIDUAL TAXES

Standard Principles

Equity

Ability to pay—Is the tax either proportional or progressive in its incidence among income groups? Are individuals with similar incomes taxed uniformly?

Benefits received—Is the tax burden related to benefits received by individuals and businesses?

Stability

Is the revenue raised by the tax stable, or is it highly sensitive to economic fluctuations in the short run?

Administration

Is administration of this tax by the government professional, fair, and cost-effective?

Compliance

Is compliance with this tax, on the part of businesses or consumers, simple and inexpensive?

Exportability

To what degree is the burden of the tax shiftable to "outsiders," such as tourists, the federal government, or out-of-state business?

Pro-competitive Principles

Efficiency

Does the tax distort decision-making by consumers or businesses?

Growth

Does this tax generate revenues that grow in proportion to the State's economy over time, eliminating the need for frequent changes in tax rates?

Diversity

Is the base of the tax as broad as possible, so that rates and tax burdens can be as low as possible?

Neutrality

Does the tax affect competitors uniformly, fostering a "level playing field" for state-based businesses?

Pro-investment

Does the tax encourage savings and productive investment in plant, equipment, people, and technology, consistent with *Cornerstone's* value-added economic development strategy, which envisions a rising standard of living for Floridians?

V ASSESSMENT OF FLORIDA'S MAJOR REVENUE SOURCES

Overview

This chapter examines ten of Florida's existing revenue sources according to the 10 criteria for a pro-competitive tax system outlined in Exhibit IV-C.

Revenue sources include the following: retail sales tax, property tax, corporate income tax, intangible tax, documentary stamp tax, user charges, special assessments, impact fees, estate tax, and utilities taxes. Each tax, as it is currently being used in Florida, is ranked "high," "medium," or "low" for how well it meets each of the criteria in comparison with the other taxes.

The ten taxes were chosen because they are among Florida's most significant revenue raisers, affect a broad segment of Florida's consumers or businesses, and/or are commonly used by other states. Other Florida taxes were not subjected to thorough analysis. Some were eliminated because they have an extremely narrow base (e.g., alcoholic beverage tax, gas tax). Others affected only a very narrow segment of Florida businesses or consumers (e.g., insurance premium tax). Table V-1 provides a summary of the evaluation. Key findings regarding each tax are summarized below.

Retail Sales Tax

- Florida's retail sales tax is not a pure retail sales tax because it includes business purchases.
- The sales tax ranks low on equity because it is regressive.
- Administrative difficulty is moderate; problem areas include mail order businesses, Department of Revenue turnover, and nonmarket transactions.
- Compliance is routine for many firms, but problem areas include new businesses, the cost of collection, and training personnel about exempt and nonexempt goods.
- The tax is inefficient because of pyramiding (multiple taxation throughout the production process).
- Sales tax revenues are highly unstable. With frequent changes, the tax has shown average growth relative to Florida's other revenue sources.
- The tax ranks low on diversity, because its base is very narrow: many consumer and business goods are exempt and services are not taxed.
- The tax ranks low on neutrality because it distorts consumers' choices between goods and services and even between different types of goods. Often, closely related and substitute goods are not taxed uniformly.
- The tax discourages investment in machinery, equipment, and structures.

Property Tax

- The property tax is the largest single source of tax revenues for local governments.
- Florida's property tax ranks low on equity because it taxes identical properties at different rates, depending on the type of ownership. To the degree that property is a reflection of wealth, the property tax can introduce an element of progressivity.
- The property tax is the state's most stable and growth-oriented source of tax revenue.
- Compliance with the tax is straightforward for most individuals, but more difficult for owners of tangible personal property. Administration can be difficult because of the assessment process.
- The property tax is inefficient because it distorts economic decisions by consumers and businesses, and can lead to pyramiding.
- Even with exemptions, the property tax base can be considered diverse because it is levied on both personal property and real estate. The base could be increased dramatically if the homestead exemption were repealed.
- The tax ranks low in neutrality and pro-investment because it favors investment in owner-occupied housing over capital investments.

Corporate Income Tax

- The corporate income tax rates low in stability, efficiency, diversity, and neutrality, while being strong in administration, compliance, and exportability. It rates average in equity and growth.
- The potential base of the corporate income tax is narrowed by the fact that it excludes noncorporate entities. The tax is not neutral as it applies across industries.
- Most fundamentally, the corporate income tax can provide a disincentive to invest by reducing net after-tax profits on new investments.
- The major plus for the corporate income tax is that it is relatively easy to administer because it follows federal definitions of corporate taxable income.
- Major questions remain about who really bears the burden of the corporate income tax: shareholders, employees, or consumers. Nevertheless, the tax is viewed as equitable based on the belief that if people are taxed, corporations should be too.

Intangibles Tax

- The tax has both progressive (stocks and bonds) and regressive (mortgages) components.
- Compliance and administration are average; the self-reporting system is problematic.
- The tax ranks low on efficiency, since it distorts portfolio decisions.
- The tax has moderate growth potential, with the stocks, bonds, and accounts receivable component growing steadily and the mortgage component adding volatility.
- Diversity is medium; although mortgages and bank loans are narrowly tied to the construction industry, the remaining base is quite broad.
- The tax is low on neutrality, since industries with high accounts receivable and those that hold large portfolios of securities are disadvantaged.

Documentary Stamp Tax

- Although the tax is moderately regressive because it taxes consumer credit, it is not as regressive as the sales tax.
- The low rate makes the tax highly efficient, that is, unlikely to affect decision-making of businesses or consumers.
- The quality and cost-effectiveness of compliance and administration are average.
- The tax ranks low on stability and diversity, because revenues are highly dependent on Florida's volatile real estate market.
- Although the tax is not entirely neutral across industries, neutrality is not undermined significantly because the tax rate is so low.
- The tax ranks medium on pro-investment because it likely has a neutral effect on capital accumulation.

User Charges, Special Assessments, and Impact Fees

- When administered correctly, user fees and special assessments rank high on "benefits received" equity. Impact fees rank lower, because of their more tenuous link between fees levied and benefits from services funded.
- User fees can be highly efficient, if they reflect the incremental cost of providing the goods. Special assessments are more efficient than impact fees.
- All three charges are among the easiest revenue sources to comply with and administer.
- Stability and growth considerations are not applicable because all 3 charges are used to fund specific activities.

Estate Tax

- Florida imposes a tax on the net estates of deceased residents and on the Florida property of nonresidents.
- The estate tax ranks high on equity because it can be progressive.
- Administration and compliance with the tax are easy. The tax also ranks high on exportability, efficiency, and growth.
- The estate tax is unstable, however, because of its narrow, unpredictable base.
- The tax has a neutral effect on investment.

Utilities Taxes

- There are four main types of utilities taxes: state utilities gross receipts tax, state and local option sales tax, municipal public services tax, and local franchise tax.
- The taxes rank low on equity because they are regressive.
- The taxes are easy to administer and compliance is easy.
- They have average exportability, stability, and growth.
- The taxes rank low in diversity, neutrality, effiency, and pro-investment.

Table V-1

SUMMARY
ASSESSMENT OF FLORIDA'S MAJOR REVENUE SOURCES

Existing Revenue Sources	Standard Criteria						Pro-competitive Criteria				
	Equity*		Stability	Administration	Compliance	Exportability	Efficiency	Growth	Diversity	Neutrality	Pro-investment
Sales Tax	Low	Low	Low	Medium	Medium	Medium	Low	Medium	Low	Low	Low
Property Tax	Low	Low	High	Low	Medium	High	Low	High	Medium	Low	Low
Corporate Income Tax	Medium	Low	Low	High	High	High	Low	Medium	Low	Low	Low
Intangibles Tax	Medium	Low	High	Low	Medium	High	Low	Medium	Medium	Low	Medium
Documentary Stamp Tax	Medium	Low	Low	Medium	Medium	Medium	High	Low	Low	Medium	Medium
User Fees	N.A.	High	N.A.	High	High	Low	High	N.A.	Medium	Medium	Medium
Special Assessments	N.A.	High	N.A.	High	High	Low	High	N.A.	Medium	Medium	Medium
Impact Fees	Medium	Medium	N.A.	Medium	High	Low	Medium	N.A.	Low	Medium	Low
Estate Tax	High	Low	Low	High	High	High	High	High	Low	N.A.	Medium
Utilities Taxes	Low	Low	Medium	High	High	Medium	Low	Medium	Low	Low	Low

*Equity is judged on both "ability to pay" (left box) and "benefits received" (right box) principles.

High   Medium   Low   N.A. = Not applicable

Retail Sales Tax

The retail sales tax is the largest producer of state tax revenue. Forty-five states and the District of Columbia impose retail sales taxes. A "pure" retail sales tax would tax *all purchases by consumers* at the point of sale.

Like those in other states, Florida's sales tax is not a pure retail sales tax. First, rather than falling on all expenditures, the tax excludes most services and goods that are household necessities. The state estimates that the value of these exclusions and exemptions totals $9.1 billion (see Table V-2). Second, Florida's sales tax falls on some business purchases, creating tax pyramiding.

Table V-2

VALUE OF SALES TAX EXEMPTIONS AND EXCLUSIONS

Exemptions and Exclusions	Millions of Dollars
Household Necessities	$2,300
Business Exemptions	515
Business Services	594
Construction Services	676
Entertainment and Sports	91
Financial Services	1,792
Health Services	881
Institutional Services	224
Media Services	444
Personal Services	453
Professional Services	921
Transportation Services	278
Miscellaneous Exemptions	316
Net export of services	(348)
Total	$9,137

Source: Florida Tax Sources: Fiscal Impact of Potential Changes, 1989-1990, 1990-1991, State of Florida, 1989. Many of the above are not sales tax exemptions but are excluded from the sales tax.

As now constituted, Florida's sales tax is inherently unstable, regressive, and unable to grow with the economy in the long run. On the other hand, the tax is easily exportable to out-of-state visitors.

Florida's state sales tax rate is 6%. Counties may levy up to an additional 1% sales tax, to be spent for infrastructure. The tax base for the local sales tax is the same as the state's, except that the tax applies to only the first $5,000 of a transaction. Only 24 of Florida's 67 counties levy the sales tax.

The sales tax generates approximately $1.5 billion for each percentage point levied. Next year (FY 1990-91) the sales tax is expected to produce $8.7 billion, making it Florida's largest revenue raiser. In fact, only two states—Tennessee and Arizona—are more dependent on the sales tax than Florida. Florida shares 8.7% of its sales tax collections with local governments and earmarks $500 million for state infrastructure purposes. Almost half of the funds are now used for operating purposes.

Equity

Ability to pay (Low)

Like those in other states, Florida's retail sales tax is regressive: low-income Floridians pay a larger share of their income in sales tax than higher-income Floridians. Five Florida tax studies have documented this regressivity (see Table V-3). To reduce the natural regressivity of the sales tax, Florida exempts food, utilities, and other household necessities (totaling $2.3 billion in value) from the tax base. Even with exemptions, the tax remains regressive because lower-income households simply spend more of their incomes than higher-income households.

Table V-4 shows the problems inherent with attempts to make the sales tax less regressive. The regressivity of the sales tax stems from lower-income groups spending more than their income. For some lower-income households, this situation is only temporary. Students, retirees, and others draw on savings, loans, and gifts to maintain a certain standard of living.

None of the tax studies done for Florida measure horizontal equity—the degree to which persons who are equally well off face similar tax liabilities. Sales taxes can have considerable horizontal inequity, because the value and types of goods and services purchased by consumers in the same income class often differ. Size of household, age of household members, savings rates, and consumption habits will cause each household's consumption of taxable items to be different.

Benefits received (Low)

There is no relationship between sales tax paid and benefits received from government services.

Table V-3

REGRESSIVITY OF THE SALES TAX

Study "A"		Study "B"		Study "C"		Study "D"		Study "E"		
Income Group	Percent of Income	Income Group	Percent of Income	Home Owners Percent of Income	Renters Percent of Income	Income Group	Percent of Income	Income Group	Under 65	65 and Over
Under $1,000	3.9	$Under $1,000	4.77	7.14	7.22	Under $3,000	2.66	Under $4,999	4.4	3.8
$1,000-$1,999	2.3	$1,000-$1,999	3.08	4.13	3.49	$3,000-$4,999	2.62	$5,000-$9,999	2.2	2.6
$2,000-$2,999	2.5	$2,000-$2,999	2.84	3.86	3.35	$5,000-$6,999	2.55	$10,000-$14,999	1.8	2.0
$3,000-$3,999	2.6	$3,000-$3,999	2.83	4.04	3.69	$7,000-$9,999	2.67	$15,000-$19,999	1.8	1.3
$4,000-$4,999	2.5	$4,000-$4,999	2.53	3.43	3.27	$10,000-$11,999	2.63	$20,000-$24,999	1.7	1.6
$5,000-$6,999	2.7	$5,000-$5,999	2.51	3.27	3.27	$12,000-$14,999	2.48	$25,000-$34,999	1.6	1.5
$7,000-$9,999	2.4	$6,000-$7,499	2.38	3.02	2.98	$15,000-$24,999	2.25	$35,000-$49,999	1.3	1.5
$10,000-$14,999	2.1	$7,500-$9,999	2.24	2.91	2.82	Over $25,000	2.05	Over $5,0000	1.2	1.1
Over $15,000	1.8	$10,000-$14,999	2.09	2.46	2.43					
		Over $15,000	1.33	1.90	1.83					

Study "A": Henry Cain and Howard Tuckman, Untitled.

Study "B": Stephen Pajcic, An Estimate of the Incidence of Florida Taxes 1968-69, 1970.

Study "C": Chester John Trow, An Estimate of the Incidence of State and Local Taxation by Income Class in Florida 1969-70, 1971.

Study "D": Florida Finance and Taxation Committee, The Burden of Florida Taxes by Income Class: 1974-75, June 1978.

Study "E": William Shelley, William Bell, William Serow, Measuring the State's Impact on an Elderly Population, 1986.

Note: All studies except "E" allocate all state sales taxes collected to nonresidents and residents after the initial allocation to businesses. Study "E" is a tax simulation model that estimates only sales taxes directly paid by Florida consumers.

Table V-4

CONSUMER EXPENDITURES BY HOUSEHOLDS (FIRST QUARTER 1989)

Quintiles of Income	Percent of Income Spent	Tax (6%) as a Percent of Income
Highest 20%	66	4.0
Fourth 20%	83	5.0
Third 20%	92	5.5
Second 20%	111	6.7
Lowest 20%	206	12.4
All Groups	83	5.0

Source: Consumer Expenditure Survey: Quarterly Data from the Interview Survey, U.S. Department of Labor, Bureau of Labor Statistics, 1990.

Stability (Low)

The sales tax is a highly unstable source of revenue from one year to the next (Figure V-1). Tied to cyclical swings in the economy and population growth, Florida's sales tax collections fluctuate widely, often unpredictably, around changes in the state's personal income. Collections can plummet when personal income growth slows, and show dramatic increases when income growth heats up.

FIGURE V-1 GROWTH RATE OF TAXABLE SALES, 1970-1989

Although the average annual growth rate in taxable sales has been 10.8% since 1970, the rate has fluctuated from year to year. The recession of 1974-75 saw taxable sales increase by only .3%. Slowdowns in 1981-82 and 1982-83 brought taxable sales growth down to 6.3% and 4.5% respectively. Since 1982-83, the rate of growth of taxable sales has remained low, ending up at 5.1% in FY 1988-89.

Durable goods, construction, and business equipment are the most turbulent components of the sales tax base. Consumer nondurables and tourism and recreation sales have shown more consistent annual growth rates. Although the average annual growth rates for each major component of the sales tax base are similar, their behavior from year to year is different (see Figure V-2).

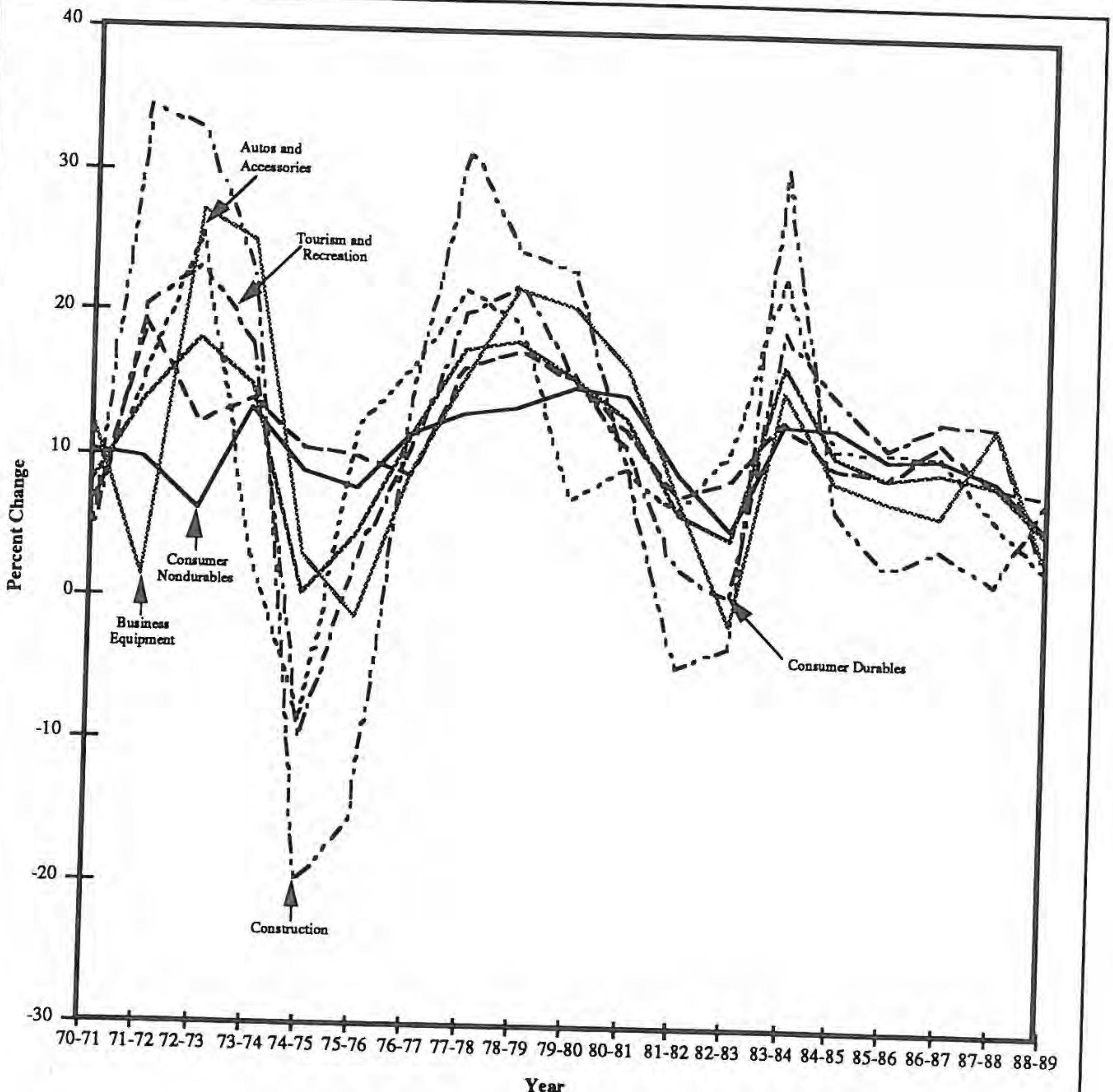


FIGURE V-2 ANNUAL RATE OF GROWTH OF COMPONENTS OF TAXABLE SALES, 1970-88

The sales tax may be becoming more stable, since the most unstable elements of the sales tax base, construction and business equipment, have declined in importance since 1983-84. They accounted for 27.6% of taxable sales that year, compared with 25.2% in 1988-89 (see Table V-5).

Table V-5

SHARES OF TAXABLE SALES, 1970-88
(percent)

Year	Consumer Nondurables	Tourism and Recreation	Autos and Accessories	Consumer Durables	Construction	Equipment and Business Supplies
70-71	32.7	17.1	17.6	6.1	8.5	18.0
71-72	31.6	17.9	17.9	6.5	10.1	16.1
72-73	28.5	17.0	19.0	6.8	11.4	17.4
73-74	28.0	16.9	17.1	6.9	12.2	18.9
74-75	30.4	18.6	15.5	6.2	9.7	19.5
75-76	31.4	19.6	16.6	6.1	7.8	18.4
76-77	31.4	19.1	17.4	6.1	8.0	18.0
77-78	30.2	18.9	18.0	6.2	9.0	17.6
78-79	29.0	18.8	18.1	6.4	9.5	18.2
79-80	28.9	18.8	16.8	6.4	10.1	19.0
80-81	29.3	18.7	16.3	6.3	9.8	19.6
81-82	30.0	18.9	16.3	6.1	8.8	19.8
82-83	30.2	19.7	17.3	5.8	8.2	18.7
83-84	29.1	19.0	18.3	6.0	9.2	18.4
84-85	29.6	18.9	18.3	6.2	8.9	18.1
85-86	30.0	18.9	18.6	6.3	8.3	17.8
86-87	30.2	19.2	18.8	6.5	7.9	17.3
87-88	30.3	19.2	18.4	6.7	7.4	18.0
88-89	30.5	19.7	18.0	6.6	7.6	17.6

Source: Economic & Demographic Research Division, Joint Legislative Management Committee. Computation by William J. Shelley, Economic Consultant.

Administration (Medium)

The administration of the sales tax requires each seller (dealer) of a product or service to collect the tax from the purchaser. Also, dealers purchasing items for their own use from out-of-state sources must pay the state's use tax.

The tax is difficult to administer for mail order businesses—a source of increasing competition for Florida retailers located outside the state. Florida purchasers are required to pay a use tax on these purchases if they are taxable. Many mail order businesses are refusing to collect the use tax from Florida customers, setting the stage for a court challenge. The state has joined efforts with other states to identify mail order sales made to Florida customers. When identified, the businesses are encouraged to collect Florida's use tax. Meanwhile the state is forgoing over $100 million in use taxes yearly.

Auditing is an essential ingredient of a tax administration system. The turnover rate for beginning auditors is high because of the state's low starting salary. Retaining auditors is important because new auditors generally bring in $250,000 a year, whereas experienced auditors produce more than $650,000 a year. Auditors also play important roles in educating taxpayers that have deficiencies in their collection and accounting systems.

Compliance (Medium)

Florida has had a sales tax since 1949, long enough that most older businesses comply satisfactorily with the law. Several problems do exist, however. The owners of new businesses, especially if they are small, often have little knowledge of the sales and use tax law and its complexity. It can be difficult to train personnel to know which items are taxable.

Compliance can be costly. Businesses that collect sales taxes for the state receive an average of 1% of the tax collected to compensate them for their collection costs. Retailers have conducted studies that show the actual cost of collecting the tax as closer to 5%. The state itself levies a 6% service charge on revenues it collects for many trust funds.

The large numbers of small businesses, especially in services and construction, may lead to nonmarket transactions that are difficult to monitor. The large number of taxable and nontaxable transactions makes it difficult for retailers and other businesses to comply fully with the law. Increased compliance will require the Department of Revenue to commit more funds for taxpayer education.

Exportability (Medium)

Many policymakers are drawn to the sales tax because of its perceived ability to be "exported" to nonresidents. True, sales tax revenues from tourists can be used to provide public services to Floridians. A recent legislative study on the impact of tourism found that tourists pay 14.7% of the state's sales tax.[3] Policymakers, however, often overlook the fact that tourists place demands on Florida government (e.g., police, fire) that have real costs. Once this secondary effect is considered, the sales tax has less exportability than property, personal income, and corporate income taxes, which can be exported to the federal government through their federal deductibility.

The exportability of Florida's tax burden to the federal government was undermined when the federal deduction for state sales tax payments was eliminated in 1986. Lacking a personal income tax, Florida is unable to exploit this large source of exportability.

[3] "The Impact of Fiscal Year 1988-89 Out-of-state Tourism on the Florida Economy," Joint Legislative Management Committee, Economic and Demographic Research Division, Florida Legislature, April 1990.

Efficiency (Low)

Florida's sales tax is inefficient because it affects the choices consumers and businesses make about which goods and services to buy. Purchasers often face different tax liabilities for two goods, or for a good and a service, that are close substitutes (e.g., business accounting equipment vs. accounting services; frozen home dinners vs. take-out prepared foods). Table V-6 provides a more complete description of the taxation of consumer expenditures under the sales tax and other taxes.

Table V-6

MAJOR STATE AND LOCAL TAXES LEVIED ON HOUSEHOLD CONSUMERS WHEN PURCHASING GOODS AND SERVICES

Goods and Services	Sales and Use Tax	State Utility Tax	Local Utility Tax	Property Tax	Intangible/Documentary Stamp Tax
Food at Home	N				
Food Away From Home	Y				
Alcoholic Beverages	Y				
Cigarettes	Y				
Soft Drinks	Y				
Vending Machine Sales	Y				
Owner Occupied Homes	N			Y	Y
Rented Dwellings	P			P	N
Mobile Homes	Y			P	Y
Mobile Home Park Space	Y			P	N
Hotels/Motels	Y			Y	N
Real Estate Agents	N				
Electricity	N	Y	Y		
Natural Gas	N	Y	Y		
Local Telephone	N	Y	Y		
Long Distance Telephone	Y	Y	Y		
Water and Sewer Services	N		P		
Newspapers	Y				
Magazines	Y				
Books	Y				
Television & Radio	N				
CATV	Y				
VCR - Movie Rentals	Y				
Repair Services	P				
Apparel	Y				
Furniture	Y			N	Y
Household Appliances	Y			N	Y
Electronic Equipment	Y			N	Y
Motor Vehicles	Y			N	Y
Gasoline	N				
Motor Oil	Y				
Auto Equipment	Y				
Railroad (Pass)	N				

Table V-6 (Concluded)

Goods and Services	Sales and Use Tax	State Utility Tax	Local Utility Tax	Property Tax	Intangible/Documentary Stamp Tax
Bus (Pass)	N				
Airline (Pass)	N				
Cruise Lines	N				
Health Care					
Hospital Care	N				
Nursing Homes	N				
Medical Service	N				
Prescribed Drugs	N				
Nonprescription Drugs	N				
Movie Theaters	Y				
Amusement Parks	Y				
Sporting Events	Y				
Amusement Machines	N				
Education	N				
Personal Care Products	Y				
Insurance	N				
Banking Services	N				Y
Financial Services	N				Y
Legal Services	N				
Accounting Services	N				
Miscellaneous Services	N				

Key: Y= Yes, N=No, P = Partially exempt.

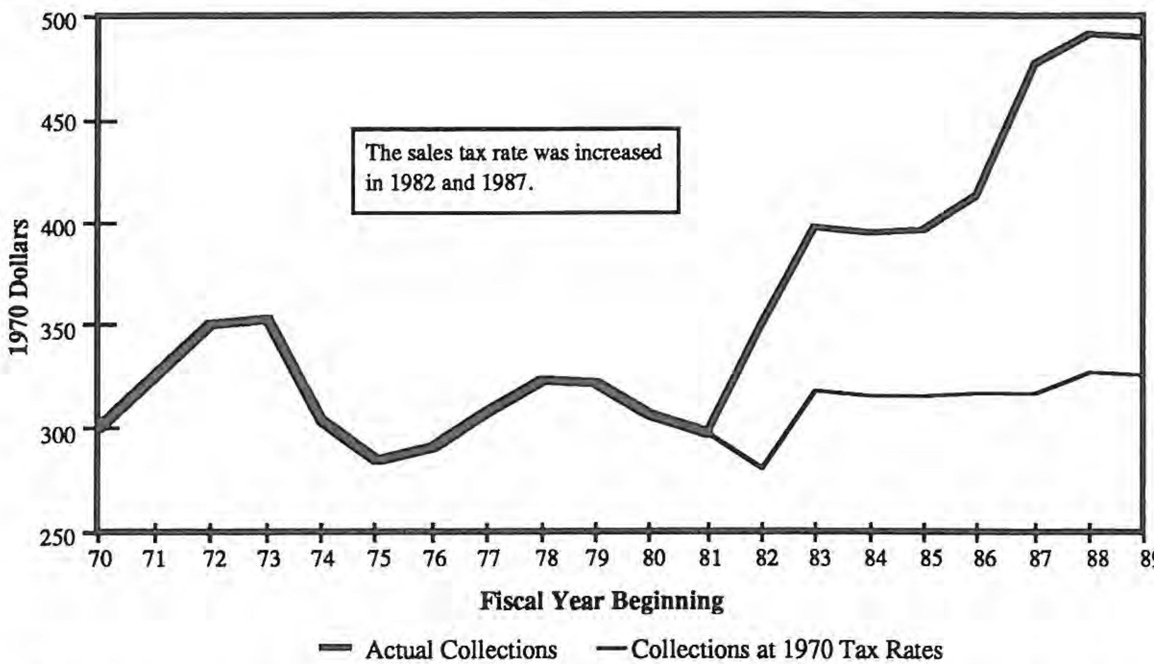
The tax is also inefficient because business purchases are subject to taxation. The major business purchases subject to taxation include equipment, store fixtures, structures, telephone and electric services, natural gas, and all supplies. Materials and component parts of produced goods, and many business services are exempt. Substantial "tax pyramiding" occurs when taxes are levied on business inputs and also on the value of the final product.

Growth (Medium)

As currently constituted, Florida's sales tax lacks the ability to keep pace with growth in the state's personal income—a measure of the state's economic performance and demand for government services. The reason is that services and necessity goods are not taxed. Taxing either or both of these would bring the natural elasticity of the tax closer to 1—tax revenues would grow in proportion to the economy.

Since 1970, the average annual growth rate of taxable sales has been 10.8%. Over the same period, the average annual growth rate of state personal income was 11.7%. On a household basis, after adjusting for inflation, taxable sales in 1988-89 were actually less than they were in 1970.

Rate increases alone have brought revenue growth in line with personal income over certain periods. Figure V-3 shows the unstable, slightly declining value of sales tax revenue at 1970 rates. The 1982 and 1987 sales tax rate increases actually caused sales tax collections to temporarily exceed the growth in state personal income. The benefits of the 1987 tax increase, however, were particularly short-lived as the slowdown in the state's economy adversely affected sales tax collections but not personal income. (Sharp drops in construction, auto sales, and business investments undermined sales tax growth; personal income growth remained constant because of heavy reliance on transfer payments.)



Source: Florida Consensus Estimating Conference, Book 6, Revenue Analysis, FY 1970-71 Through FY 1998-1999, Florida Legislative Division of Economic and Demographic Research, September 1990.

FIGURE V-3 SALES AND USE TAX COLLECTIONS PER HOUSEHOLD, ADJUSTED FOR INFLATION

Two long-term trends point to continued problems in financing Florida's future with the sales tax. First, the ratio of taxable sales to gross sales has been declining over the last 20 years, largely because of the gradual slowdown in the state's population growth rate and construction spending (see Table V-7). Second, the types of personal income that directly affect current spending—wages and salaries, and transfer payments—are becoming smaller components of personal income. In 1970-71 both totaled 71.2% of personal income. By 1988-89, their share of personal income had declined to 66.9%.

Table V-7

TAXABLE SALES AS A PERCENT OF GROSS SALES, 1970-88

Year	Consumer Nondurables	Tourism and Recreation	Autos and Accessories	Consumer Durables	Construction	Equipment and Business Supplies	Total
70-71	54.5	81.2	62.2	62.0	50.4	32.9	52.4
71-72	53.7	85.0	56.7	63.9	54.9	27.4	50.3
72-73	48.9	90.2	59.0	63.2	55.8	29.0	50.0
73-74	47.3	90.2	54.2	64.1	55.4	29.9	48.7
74-75	46.0	90.9	50.3	61.7	53.8	29.0	47.0
75-76	45.3	91.0	49.1	59.3	51.9	27.4	46.0
76-77	46.0	90.2	50.8	60.6	53.9	27.4	46.7
77-78	46.1	88.6	52.7	56.1	55.0	27.8	47.2
78-79	44.8	87.7	52.3	56.0	56.5	27.9	46.7
79-80	42.8	85.6	47.6	58.6	56.1	29.0	45.6
80-81	42.0	83.9	45.2	55.2	55.7	29.1	44.5
81-82	41.7	77.4	44.8	50.3	52.9	29.1	43.5
82-83	42.3	83.0	47.4	51.4	54.1	28.6	44.7
83-84	45.8	79.0	49.2	51.8	56.5	30.0	46.8
84-85	45.2	84.6	51.0	52.4	55.7	28.2	46.3
85-86	45.6	84.8	54.9	51.2	57.6	29.1	47.6
86-87	46.6	82.4	58.0	50.9	57.8	27.8	47.8
87-88	44.7	81.7	56.2	49.9	52.6	28.2	46.4
88-89	43.1	83.8	55.0	48.7	51.3	28.7	46.2

Source: Economic & Demographic Research Division, Joint Legislative Management Committee. Computation by William J. Shelley, Economic Consultant.

Diversity (Low)

The tax base of Florida's sales tax is not diverse as possible, because it excludes services, necessity goods, and some items purchased by business. In fact, the value of sales tax exemptions exceeds current sales tax revenues. There are strong rationales for not taxing business purchases or goods and services (avoid "pyramiding") and necessity goods (minimize regressivity). There is no plausible economic rationale for not taxing consumer services. In addition to raising more revenue, a tax base broadened to include consumer services would eliminate the tax bias between goods and services that are close substitutes and may make the sales tax less regressive.

Although Florida's consumer sales tax base is narrow, data in Table V-8 shows that it is very productive. The table adjusts each state's tax collections for any difference in sales tax rates from Florida's rate. Florida ranks second to California in the generation of sales tax revenue to supply governmental services to Florida households. At least two reasons can be given for the high productivity of the state's sales tax:

Table V-8

STATE SALES TAX COLLECTION ADJUSTED TO FLORIDA'S TAX RATE, 1988

State	Tax Collections (Millions)	1988 Tax Rate	Collections Per 1 Percentage Point (Millions)	Tax Collections at Florida's Tax Rate (6%)		
				Amount (Millions)	Per Household	As a Percent of Personal Income
Florida	$ 6,863	6.0%	$ 1,144	$ 6,863	$ 1,394	3.4%
California	11,515	4.75	2,424	14,546	1,409	2.7
Colorado	724	3	241	1,449	1,144	2.7
Connecticut	1,984	7.5	265	1,587	1,318	2.1
Maine	492	5	98	590	1,283	3.2
Minnesota	1,677	6	279	1,677	1,036	2.3
Nevada	546	5.75	95	570	1,367	3.1
New Jersey	3,137	6	523	3,137	1,103	1.8
New York	5,511	4	1,378	8,266	1,216	2.4
North Dakota	205	5.5	37	223	901	2.6
Ohio	3,219	5	644	3,863	941	2.3
Rhode Island	383	6	64	383	1,027	2.3
Texas	6,271	6	1,045	6,271	1,042	2.6
Vermont	123	4	31	185	882	2.2
Wisconsin	1,769	5	354	2,123	1,167	2.8
Alabama	928	4	232	1392	927	2.6
Alaska	0					
Arizona	1,706	5	341	2,048	1,598	3.9
Arkansas	777	4	194	1,166	1,291	4.0
Delaware	0					
Georgia	1,857	3	619	3,713	1,605	3.8
Hawaii	920	4	230	1,380	3,908	7.5
Idaho	328	5	66	394	1,086	3.1
Illinois	3,677	5	735	4,413	1,021	2.2
Indiana	2,362	5	472	2,834	1,365	3.4
Iowa	859	4	215	1,289	1,185	3.1
Kansas	776	4	194	1,163	1,217	3.0
Kentucky	952	5	190	1,142	826	2.4
Louisiana	1,301	4	325	1,951	1,253	3.6
Maryland	1,424	5	285	1,708	1,007	1.9
Massachusetts	2,021	5	404	2,425	1,092	2.0
Michigan	2,919	4	730	4,379	1,290	2.9
Mississippi	1,007	6	168	1,007	1,096	3.5
Missouri	1,683	4.225	398	2,391	1,215	3.0
Montana	0					
Nebraska	448	4	112	672	1,092	2.8
New Hampshire	0					
New Mexico	40	4.75	156	935	1,737	5.0
North Carolina	1,628	3	543	3,255	1,332	3.5
Oklahoma	757	4	189	1,135	916	2.6
Oregon	0					
Pennsylvania	3,847	6	641	3,847	854	2.0
South Carolina	1,249	5	250	1,499	1,224	3.3
South Dakota	262	4	66	394	1,468	4.3
Tennessee	2,142	5.5	390	2,337	1,262	3.4

Table V-8 (Concluded)

State	Tax Collections (Millions)	1988 Tax Rate	Collections Per 1 Percentage Point (Millions)	Tax Collections at Florida's Tax Rate (6%) Amount (Millions)	Per Household	As a Percent of Personal Income
Utah	589	5.1	116	694	1,325	3.4
Virginia	1,189	3.5	340	2,038	915	1.9
Washington	3,554	6.5	547	3,280	1,805	4.3
West Virginia	537	6	90	537	759	2.4
Wyoming	151	3	50	302	1,716	4.6
District of Columbia	391	6	65	391	1,575	3.0
U.S. Average	1,714	5.68	302	2,344	1,178	2.7

Note: States in boldface exempt food and utilities.

Sources: Current Population Reports, Population Estimates and Projections, P-25 Series, No. 1044, U.S. Bureau of the Census, 1989.
Survey of Current Business, U.S. Department of Commerce, August 1989.
State Tax Collections 1988, U.S. Bureau of the Census, 1990.

- The high proportion (14.7%) of sales taxes paid by nonresidents (tourists) who place a small demand on services *funded directly by the sales tax,* such as education, welfare services, and corrections.
- Lump sum sales tax payments on durable goods, business equipment, and structures, purchased and produced to accommodate a growing population. The sales tax is collected on these long-life assets when purchased; together they account for 50% of Florida's sales tax base.

Neutrality (Low)

The sales tax is not neutral because industries, including many that compete directly with each other, are not taxed uniformly. The exemptions and exclusions from the sales tax influence consumer and business purchasing decisions. In some cases, certain goods and services are exempt from taxation, while close substitutes are taxable. In others, industries drawing on the same input resources are taxed differently. The following are some examples of nonneutrality in the current system:

- Factory-built housing is taxable at its sale price: housing on-site is taxable only on materials and supplies.
- Frozen home dinners are exempt from taxation, take-out prepared foods are taxable.
- Rental cars are subject to the sales tax; other modes of public transportation are not.
- Movie admissions are taxable; amusement machines are exempt.
- Movie rentals and cable television are taxable; television and radio broadcast are exempt.
- Business accounting equipment is taxable, business services are not.
- Rental housing is subject to taxation if not leased for 6 months or more: owner-occupied housing is not taxable.

- Leased commercial space is subject to taxation, whereas owner-occupied space is not.
- All leased land, except agricultural property, is subject to the sales tax.
- The tax rate on farm equipment is 3%; the tax rate for all other equipment is 6%.

Pro-investment (Low)

The sales tax on business equipment and structures is a tax on capital investment that has the immediate effect of reducing the return on invested capital. This creates an incentive to substitute greater levels of employment for capital. Since capital equipment embodies new technology, a tax on capital can be construed as a tax on technology—an increasingly vital source of productivity gains.

Property Tax

The property tax is the largest single source of tax revenues for local governments. In 1989, property taxes levied totaled $8.5 billion, distributed as follows:

County Governments (millions)	$3,237
Municipalities	1,074
School Districts	3,599
Independent Special Districts	590
Total (millions)	$8,500

The property tax is the only source of tax revenues for school districts and most special districts.

The property tax rate that local governments may levy is limited by the state's constitution. The tax limit is $10 per thousand dollars of taxable value (10 mills) for school districts, counties, and municipalities. Tax limits for special districts are specified in the law creating them. The tax rarely exceeds 2 mills. Local governments may levy a debt service millage outside of the 10 mill cap and may levy an additional tax of up to 2 mills by referendum.

The average millage levied by municipalities is 5.3 mills, by counties 7.9 mills, and by school districts 8.8 mills. If property is located within a municipality, all three millages apply. If it is located in an unincorporated area, only the county and school district taxes are paid unless a special district levy also applies. Counties may also establish Municipal Service Taxing Units (MSTUs) within unincorporated areas and levy the municipal-purposes millages in those area. Many counties have established MSTUs but levy low tax rates.

All property subject to the property tax is supposed to be assessed at its market value. In practice, most properties are assessed at less than 80% of their market value.

Equity

Ability to pay (Low)

In its impact on individuals, Florida's property tax has both vertical and horizontal inequities. (For an evaluation of fairness across different industries, see *Neutrality*.) Even with the homestead exemption, the property tax is very regressive for homeowners and renters, as shown in Table V-9.

Table V-9

INCIDENCE OF PROPERTY TAX (TAX AS PERCENT OF HOUSEHOLD INCOME)

Income Class	Homeowner 65 or Over	Homeowner Under 65	Renter 65 or Over
$0-$4,999	3.0	5.4	5.6
$5,000-$7,499	1.9	2.4	4.2
$7,500-$9,999	2.0	2.2	3.1
$10,000-$12,499	1.6	1.7	2.5
$12,500-$14,999	1.4	1.3	2.2
$15,000-$19,999	1.5	1.4	1.9
$20,000-$24,999	1.5	1.3	1.6
$25,000-$34,999	1.4	1.4	1.4
$35,000-$49,999	1.5	1.4	1.0
$50,000+	1.3	1.5	0.5

Income Class	Renter Under 65	65 or Over Total	Under 65 Total
$0-$4,999	7.6	4.0	6.8
$5,000-$7,499	4.3	2.5	3.5
$7,500-$9,999	3.0	2.3	2.6
$10,000-$12,499	2.6	1.8	2.1
$12,500-$14,999	2.3	1.5	1.7
$15,000-$19,999	1.9	1.5	1.6
$20,000-$24,999	1.6	1.5	1.4
$25,000-$34,999	1.4	1.4	1.4
$35,000-$49,999	1.1	1.4	1.3
$50,000+	0.7	1.2	1.5

Source: William J. Shelley, W. G. Bell, and W. J. Serow, Measuring the Impact of a State's Tax Structure on an Elderly Population, Tallahassee, 1986.

Florida's property tax also has horizontal inequities, because it taxes identical properties at different rates, depending on the type of ownership. Homeowners receive a $25,000 homestead exemption. Renters receive no exemption even if they occupy a dwelling unit identical to that of a homeowner.

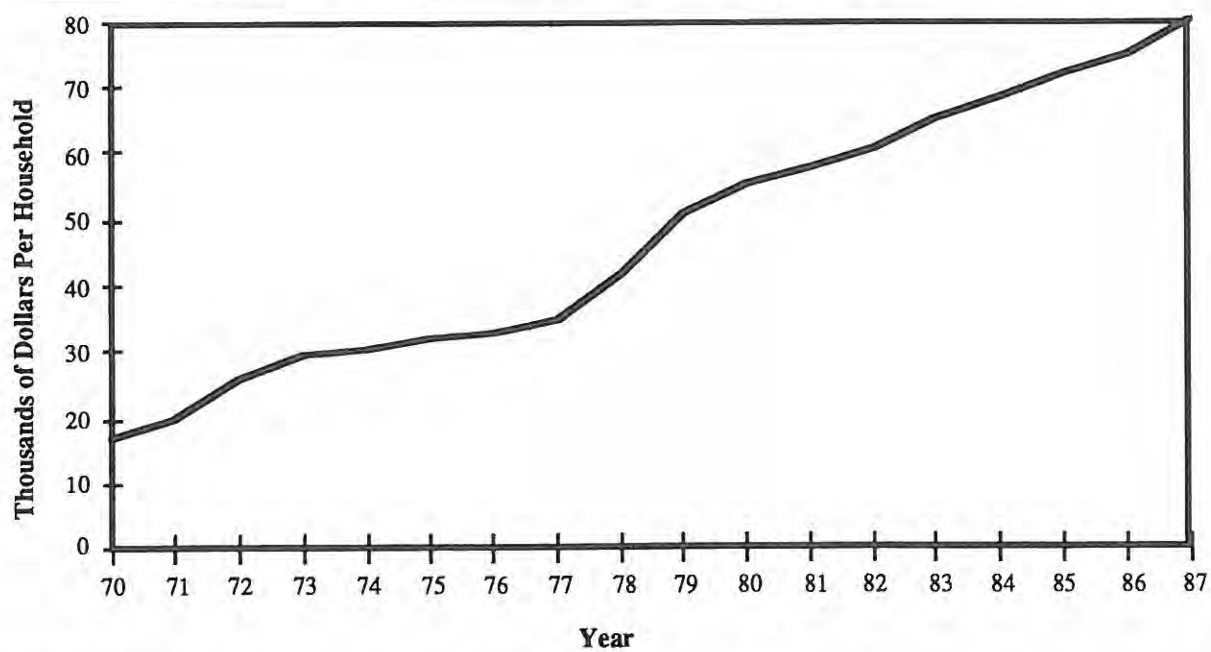
The property tax has long been considered a wealth tax. This is not the case if wealth is determined by net asset value. A substantial portion of the value of property is reduced by liabilities in the form of mortgages, corporate bonds, and notes.

Benefits received (Low)

The property tax has no relationship to benefits received.

Stability (High)

The property tax is the state's most reliable and predictable source of tax revenue, demonstrating only minimal cyclical instability. Since 1972, the taxable value of property has increased steadily each year (see Figure V-4), ranging from 7.5% to 37% per year.



Sources: Florida Ad Valorem Valuations and Tax Data, Department of Revenue, various issues. Florida Consensus Estimating Conference, Legislative Division of Economic and Demographic Research, Spring 1987.
Computation by William J. Shelley, Economic Consultant.

FIGURE V-4 TAXABLE PROPERTY VALUE INCREASES, 1970-1987

The reliability of the property tax is based on the value of the current tax base with additions from new construction, increase in values due to inflation, and the reassessment of property. With the state's population continuing to grow, property values should continue to increase at a faster rate than the sales tax base. Even if new construction slows, the tax base will continue to grow because the tax-saving value of the homestead exemption will decline with inflation.

Administration (Low)

The administration of the property tax is difficult because the property appraiser must be able to defend his appraisal of all parcels of property and tangible personal property. Since property appraisers are elected constitutional officers, they have an automatic incentive to "underassess" property. This incentive is offset by the state Department of Revenue's (DOR) responsibility to review each property tax roll. If assessments are not close to market value, less 15%, they have the power to require the property appraiser to correct the tax roll.

Local governments cannot levy property taxes until a tax roll is approved by DOR. DOR has been criticized lately for approving deficient tax rolls. The new director of DOR has promised to correct this deficiency.

Since business property may be assessed on the basis of its income, replacement cost, or market value, there is plenty of room for disagreements over assessments. This is especially true when property appraisers do not have to disclose how they arrived at the assessed value.

Compliance (Medium)

The property tax on real estate is easy to comply with, since property is assessed by the county property appraiser. The tax is then paid based on his assessment. Little conflict arises between most property owners and property appraisers, since property is assessed substantially below market value. The property owner thinks he is getting a tax break and is unlikely to complain. The most common complaint that does arise concerns disparate assessments of properties that would appear to have similar values.

Since the value of property may have little relation to a person's ability to pay, Florida has established a program that allows homeowners to defer taxes in excess of 5% of their income.

Owners of tangible personal property have more difficulty complying with the assessment law, since they are on a self-assessment basis. They must tell the property appraiser the market value of their personal property. Most businesses probably report the depreciated value of property as used for federal income tax purposes.

Exportability (High)

The property tax has a relatively high degree of exportability because it is deductible for federal tax purposes. Property tax increases thus are partially offset by reduced federal income tax payments. The actual degree of exportability will depend on the degree to which taxpayers itemize and their marginal tax bracket. A 1967 study estimated the long-run export rate for

Florida's property tax to be 14.3% to the federal government.[4] (Although the study is old, its approximation is probably still valid, since the property tax remains deductible and, although marginal income tax rates have declined, property values have risen.)

Efficiency (Low)

The residential property tax causes a number of distortions in the way consumers and businesses allocate resources. The property tax distorts economic decisions by consumers, since owner-occupied housing receives the homestead exemption and rental housing does not. The location of housing and business activity is influenced by lower tax rates in unincorporated areas when municipal services are not essential or can be provided cheaper through special districts or property tax sources.

By increasing the cost of physical capital, the tax creates an incentive to substitute labor for capital. The tax also reduces the efficient allocation of capital across industries, drawing resources away from industries with significant amounts of taxable property.

Growth (High)

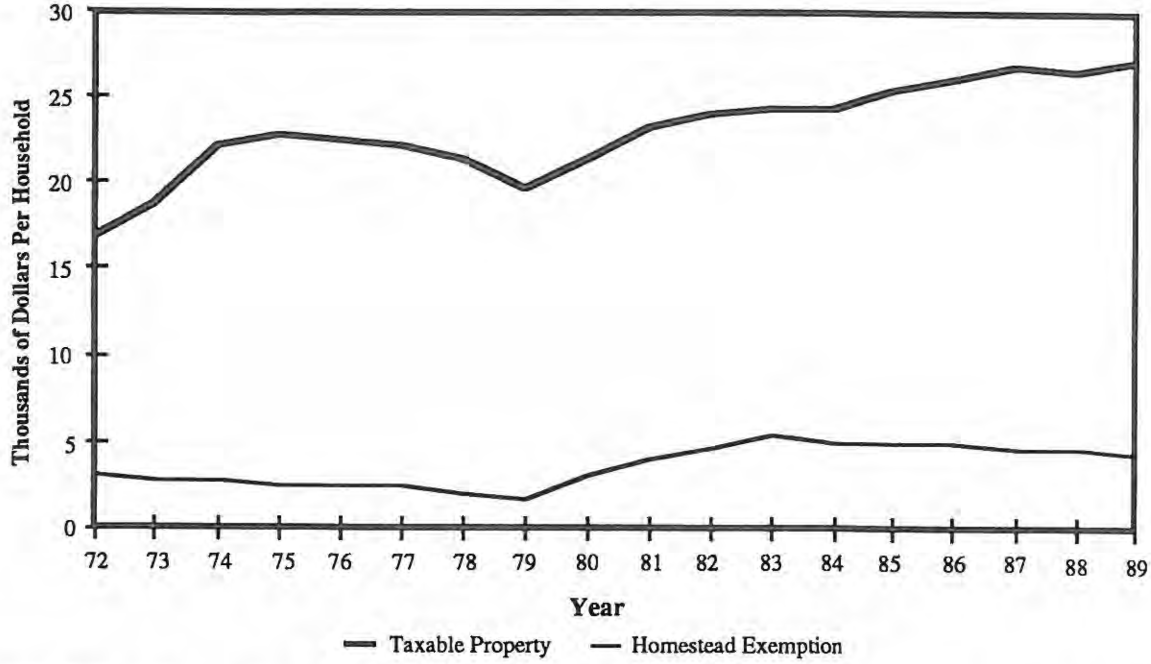
Over the long run, property tax revenues grow slightly faster than state income, and much faster than sales tax revenues. Since 1972, taxable property values increased by 704%, whereas taxable sales increased by 335%. The taxable value of property per household exhibits a continuous upward trend, even though the homestead exemption was increased to $25,000 over 3 years beginning in 1980. After correcting for inflation, taxable values per household have increased from $17,000 in 1972 to $26,500 in 1989 (see Figure V-5). Real taxable sales (for sales tax purposes) have declined by 1.1% since 1970.

Diversity (Medium)

Although the tax is levied on both tangible personal property (movable property owned by business) and real estate, the property tax base does not include all potentially taxable property. Florida has many business exemptions (see *Neutrality*), has a large homestead exemption, and does not tax household goods and personal effects.

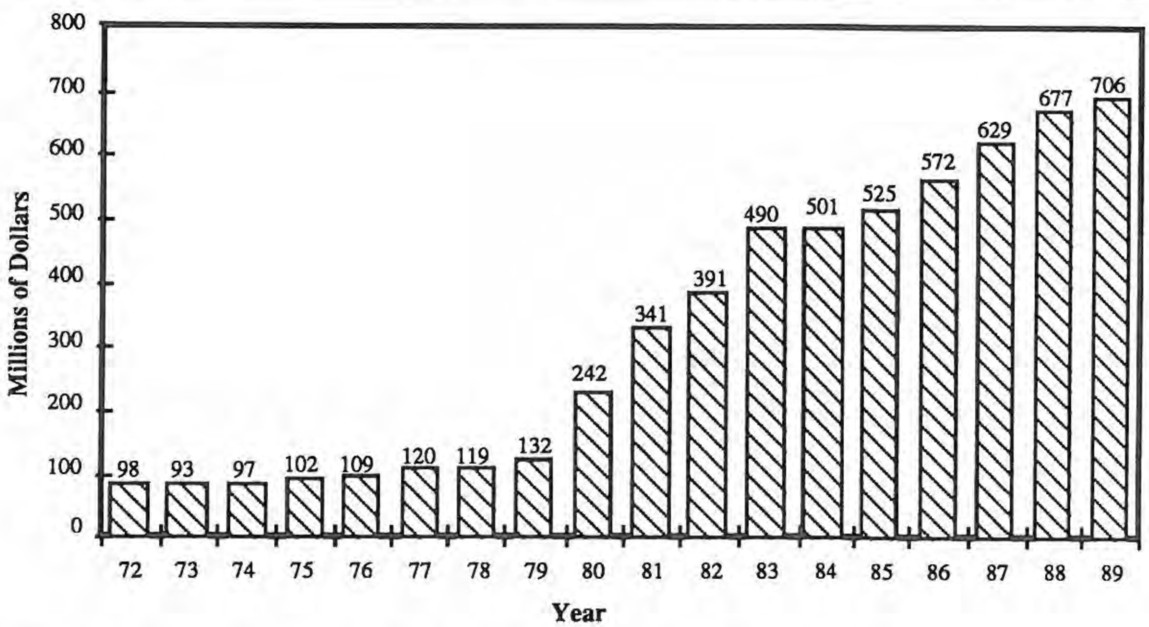
The property tax could produce more revenue if the homestead exemption were repealed (Figure V-6) or replaced by a less costly "circuit breaker'" form of property tax relief. The homestead exemption results in higher taxes on other properties, causing their owners to subsidize home ownership.

[4] Charles E. McClure, Jr., "The Interstate Exporting of State and Local Taxes: Estimates for 1962," *National Tax Journal*, 1967.



Sources: Florida Ad Valorem Valuations and Tax Data, Department of Revenue, various issues. Florida Consensus Estimating Conference, Legislative Division of Economic and Demographic Research, Spring 1987.
Computation by William J. Shelley, Economic Consultant.

FIGURE V-5 TAXABLE PROPERTY AND HOMESTEAD EXEMPTION VALUE PER HOUSEHOLD, ADJUSTED FOR INFLATION, 1972-1989



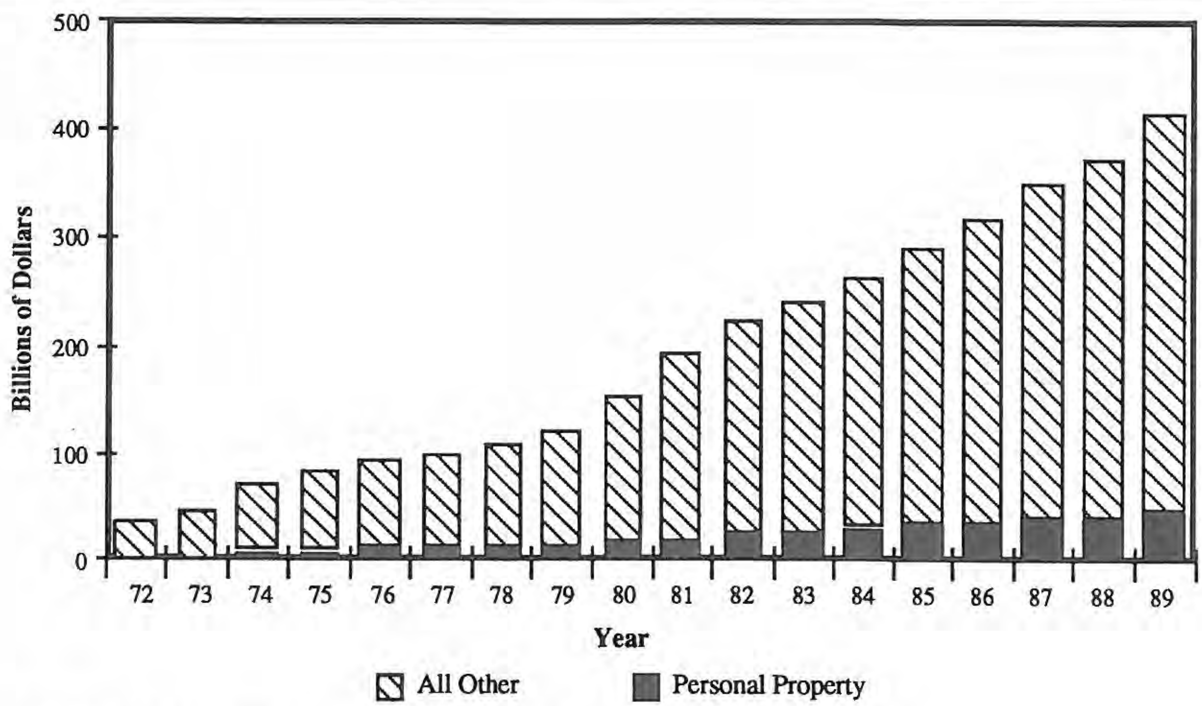
Sources: Florida Ad Valorem Valuations and Tax Data, Department of Revenue, various issues.
Computation by William J. Shelley, Economic Consultant.

FIGURE V-6 LOSS IN PROPERTY TAXES DUE TO HOMESTEAD EXEMPTION, 1972-1989

The value of the personal property part of the tax base (machinery, equipment, fixtures) has declined since 1977, placing a greater share of the property tax burden on real estate owners (see Figure V-7). The decreasing share of personal property may be due to several factors:

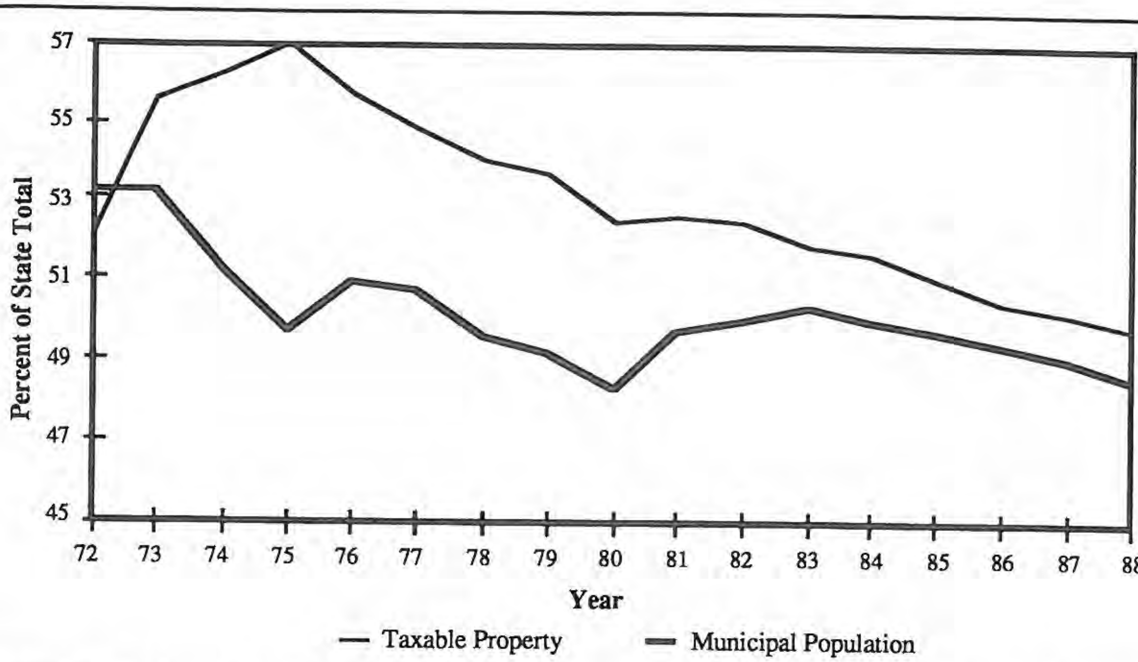
- More rapid depreciation of business equipment.
- More productive use of business equipment and greater economies of scale.
- A relative decline in businesses with higher-than-average ratios of equipment to real estate.
- A general decline in the number and size of businesses in the state.
- Underreporting of tangible personal property.

Another form of diversity is geographic diversity. In 1975, municipalities accounted for 49.5% of the state's population and 57% of the state's tax property base (see Figure V-8). By 1988, the share of the state's population living in municipalities was just below 49% with 50% of total taxable values. This decline in the tax base relative to the population of municipalities will make it increasingly difficult for municipalities to meet their growing responsibilities only from property taxes.



Sources: Florida Ad Valorem Valuations and Tax Data, Department of Revenue, various issues.
Computation by William J. Shelley, Economic Consultant.

FIGURE V-7 VALUE OF PERSONAL PROPERTY AS SHARE OF TOTAL TAXABLE PROPERTY, 1972-1989



Sources: Florida Ad Valorem Valuations and Tax Data, Department of Revenue, various issues. Florida Statistical Abstract, Bureau of Economic and Business Research, various issues.
Computation by William J. Shelley, Economic Consultant.

FIGURE V-8 PERCENT OF POPULATION AND TAXABLE PROPERTY IN MUNICIPALITIES, 1972-1988

Neutrality (Low)

The property tax is not at all neutral in its impact on different Florida industries.

- The tax creates an uneven playing field among transportation industries. Whereas railroads pay property taxes, other modes of transportation are exempt in lieu of paying a license fee. These license fees on other transportation equipment do not match a comparable property tax. And aircraft do not pay license fees. Railroad roadbeds are taxable, whereas roads for trucks, harbors for vessels, and airports for aircraft are not taxable.

  The tax is not neutral between reproducible assets and land. New construction completed after January 1 of each year is not subject to taxation for up to 18 months and may not pay any tax for an additional 10 months. All during this time, it will be the recipient of government services.

- Certain types of business personal property (e.g., aircraft, trucks) are exempt from taxation or assessed at lower rates (e.g., inventories, dairy cattle) than most business property.
- Agricultural land is taxed based on its value as agricultural land. All other land is taxed based on its market value, not the value for which it is currently being used.
- When the property tax has no relationship to benefits received, property investments are penalized, especially improvements to property. This is one reason many have advocated taxing land values more heavily than improvement to land and tangible personal property.
- Industries that use above-average amounts of property are penalized compared with industries that use little property relative to costs and final sales.

Pro-investment (Low)

The property tax discourages business investment in physical capital by increasing its cost, while encouraging investment in owner-occupied housing. Business investment creates employment and income, and leads to increased productivity. Investment in owner-occupied housing results in the purchase of a consumption good, which does little to increase labor productivity.

Productive capital investments would be encouraged by lower tax rates on reproducible capital and greater use of user fees and special assessments to pay for government services. A higher tax on land value would also be beneficial.

The property tax is a poor way to pay for income transfer programs such as the homestead exemption.

Corporate Income Tax

Forty-four states impose some type of tax on corporate net income, though the taxes differ considerably in terms of tax rates, apportionment methods, definition of taxable income, and definition of taxable units. Nationally, the tax raises less than 7% of total state tax collections.

Reversing a trend, the Federal Tax Reform Act of 1986 resulted in a broader corporate tax base, lower and fewer rates, and fewer special provisions. Although many states have adopted the federal IRS code, some remain hampered by the complexities of a corporate tax code that caters to selected industries and businesses. Corporations can deduct all payments of state corporate income taxes when computing their net income for federal tax purposes.

Corporations in Florida are assessed at 5.5% of adjusted federal income apportioned to the state, less a $5,000 exemption. Apportionment is based on three weighted factors: sales (50%), property (25%), and payroll (25%). In 1990-91, the tax is anticipated to raise $825 million.

Equity

There is great disagreement about whether businesses should be taxed at all, because businesses, per se, do not bear the ultimate economic burden of business taxes, people do. The corporate income tax can be viewed as an indirect way of taxing individuals—the shareholders, consumers, and workers who bear the burden of the tax.

Only an argument focusing on the *nontaxation of undistributed profits* provides an economic rationale for a separate corporate income tax. Without a corporate income tax, and with a personal income tax, undistributed corporate profits (retained earnings) would escape income taxation. Absent a corporate income tax, individuals could avoid taxation by accumulating income within corporations. At the state level, this argument loses its validity in states like Florida that lack a personal income tax.

Nevertheless, states tax corporations mostly out of a sense of popular justice, that if people (and their unincorporated small businesses) are taxed, major corporations should be also. As entities, corporations benefit from government services. All the states with a personal income tax, except one, also tax corporate profits.

Given the belief that businesses should be taxed, should businesses be taxed on the basis of their ability to pay or the benefits they receive from the public sector? Although there is disagreement, the corporate income tax is structured around ability to pay.

Ability to pay (Medium)

One approach to fairness argues that entities should be taxed in line with their ability to pay. The corporate income tax uses net income as an indicator of ability to pay.

Vertical equity —A corporate income tax, with either a single or an increasing rate, is an uncertain tool to increase the progressivity of state tax systems. The rationale underlying a progressive rate structure for the individual income tax, that people with greater incomes should be taxed at a higher rate than people with lower incomes, is difficult to apply to the corporate sector. The corporation does not have a tax-paying ability of its own, in the sense that individuals do. All taxes paid by corporations in excess of the value received are ultimately paid by individuals as consumers, employees, and stockholders.

Some view the corporate income tax as being progressive, even if the tax is proportional (a single rate). The tax is assumed to fall on profits, and profit income (ownership of corporate shares) as a share of adjusted gross income is higher among the wealthy.

It could also be argued that progressive taxation of corporations (i.e., taxing more profitable firms at higher rates) is a means to progressive taxation of shareholders. Yet there is no positive relationship between the size of the corporation and the net income of its owners. (Wealthy people can own parts of both large and small companies.)

In reality, the ultimate burden of the corporate tax is shifted and shared by several groups: by owners as a reduced return on investment, by consumers in higher prices, and by workers in lower wages. The degree to which the tax falls on shareholders, workers, or consumers is impossible to determine.

Horizontal equity—Horizontal equity results when the effective tax rate among people with similar ability to pay is the same. Horizontal equity is undermined by the double taxation of dividend income. Dividend income is taxed by the corporate income tax as profit and by the personal income tax as income. The result is that taxpayers in similar income situations could pay considerably different amounts of tax. Horizontal inequity among individuals is not a problem in states like Florida that lack a personal income tax.

Benefits received (Low)

The most common rationale for taxing corporations is that, because they benefit from government services, they should support their provision. Yet business's "fair share" of taxes to support these services is difficult to quantify and in practice never enters the tax decision-making process. The corporate income tax does not adhere to the benefits-received principle, because there is no evidence to suggest that profit is correlated with benefits received from government services.

Stability (Low)

In times of recession, experience has shown that the corporate income tax is extremely volatile because its base, profit, is extremely volatile. Forecasting corporate income tax revenue can be difficult because of the use of net operating loss carry-back and loss carry-forward provisions. States can solve this problem by not following the Internal Revenue Code.

Administration (High)

Most states follow the federal definition of corporate taxable income to ease administration and enforcement.

Compliance (High)

Since most states follow the federal definition of corporate taxable income, complying with state corporate income tax law is not excessively burdensome.

Exportability (High)

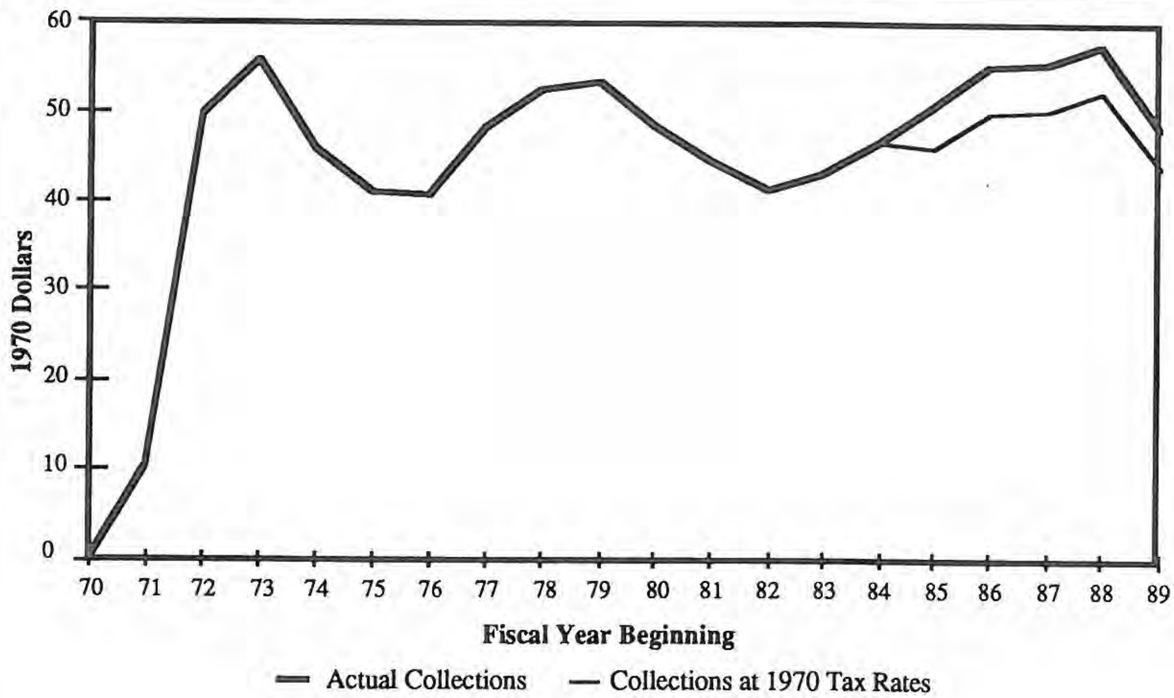
The corporate income tax is exportable because it is deductible in computing net income for federal tax purposes.

Efficiency (Low)

An efficient tax should not alter consumer and business choices unintentionally while raising revenue. For most companies, there is a moderate tax advantage to financing by debt, rather than by equity. The cost of debt is tax deductible, whereas the cost of equity capital is higher because it is taxed twice, when earned and when distributed to stockholders or reflected as capital gains.[5]

Growth (Medium)

State corporate income taxes have an elasticity slightly less than 1. In the long run, the tax will grow slightly less than the economy's personal income. Figure V-9 shows that, after adjusting for inflation, corporate tax collections per household have remained steady, rather than grown over time.



Source: Florida Consensus Estimating Conference, Book 6, Revenue Analysis, FY 1970-71 Through FY 1998-1999, Florida Legislative Division of Economic and Demographic Research, September 1990.

FIGURE V-9 CORPORATION TAX COLLECTIONS PER HOUSEHOLD, ADJUSTED FOR INFLATION

[5] A *partnership method* of income taxation, which fully integrates the two income taxes, could overcome this double taxation problem *for states that have personal income taxes.* Under this plan, undistributed corporate profits would be assigned to the personal income tax base of shareholders on the basis of the number of shares owned by the stockholder (pro rata). The shareholder would then pay taxes on this portion of undistributed profits as well as on dividends received.

Diversity (Low)

The potential base of the corporate income tax is narrowed by the fact that it excludes non-corporate entities. This is a particular problem in states like Florida that lack a personal income tax to pick up income earned by proprietorships, partnerships, and S Corporations. The presence of special tax provisions for certain industries, companies, or economic activities can also undermine the base of the corporate income tax. The narrower the tax base, the higher the tax rate has to be on remaining payers. The tax has been particularly prone to lobbying by special corporate interests and use by economic development professionals as a plant attraction tool.

Neutrality (Low)

For the corporate income tax to be economically neutral, effective tax rates *across industries* have to be uniform. In practice, the corporate income tax is seldom applied neutrally across a range of industries. Although each state is different, companies that historically have faced regulation are treated differently (e.g., telecommunications, financial services, transportation, insurance). They pay gross receipts or special excise taxes. These industries, now unregulated and often competing with never-regulated companies (e.g., banks competing with nonbank lending institutions), should be included and face the same tax treatment as general, mercantile corporations.

In Florida, the insurance and banking industries receive special treatment under the corporate income tax. Banks pay all of their intangibles tax or 40% of their corporate income tax, whichever is less. Insurance companies offset their income tax with their insurance premium tax. Other industries, such as utilities, pay special tax (gross receipts), but do not have offset provisions. Table V-10 shows the value of special exemptions and credits in the Florida corporate income tax code.

The tax is also not neutral as it applies to *different types of business entities*. Only companies legally organized as corporations are subject to the corporate income tax. S corporations, limited partnerships, partnerships, and sole proprietorships are not. In states with no personal income tax, such as Florida, these business entities escape taxation. Having a corporate income tax and no personal income tax, or having divergent top marginal rates for the two types of taxes, can distort businesses' decisions about how to organize.

Many states tax S corporations. These corporations have a limited number of stockholders and a cap on revenue. Like corporations, they benefit from limited liability. There is no strong argument for taxing corporations and exempting S corporations.

Table V-10

VALUE OF EXEMPTIONS AND CREDITS

	1989-90 (millions)	1990-91 (millions)
Exemptions		
Chapter S corporations*	$30.6	$31.2
Foreign source dividend	41.3	45.8
Standard $5,000 exemption	24.8	27.5
Credits		
Banks—either all of intangible tax liability or 40% of corporate income tax liability, whichever is less	13.4	14.8
Economic revitalization jobs	8.1	9.0
Emergency excise tax	67.8	89.7

*Department of Revenue misreported the value of this exemption, which should be close to $80 million each year.

Although partnerships and sole proprietorships pay no corporate or personal income tax in Florida, they pay state sales tax on commercial rents and leases. Few other states tax rents and leases to the degree that Florida does.

Pro-investment (Low)

The corporate income tax can provide a disincentive to invest. An unshifted tax reduces net after-tax profits on new investments, which tends to reduce investment incentives. The profit reduction occurs whether investments are to expand a present capacity or to replace existing facilities. Many factors could help mitigate this effect (depreciation, rate structures), and no definite conclusions can be reached about the degree of disincentive caused by the corporate income tax.

Corporate income taxes have little impact on the location decisions of firms, unless they are significantly out of line with those of other states. This conclusion has been substantiated by an extensive body of literature. All but a few states tax corporate profits earned within their borders, and rates fall in a remarkably narrow range.

Intangibles Tax

The intangibles tax is a two-part tax. Mortgages are taxed when they are first recorded. Stocks, bonds, accounts receivable, and certain other intangibles are subject to taxation annually.

Florida's tax is different from those of other states because it is independent of the general property tax. Only a few other states have separate laws taxing intangibles. Most treat intangibles as a class of property under their general property tax, although intangibles may be assessed and taxed in a different manner than other property.

Florida's tax exempts many intangibles from taxation, including cash, savings accounts, certificates of deposit, life insurance policies, annuities, retirement accounts, federal debt obligation, and debt instruments issued by the state of Florida and its local governments.

For 1989-90, stocks, bonds, notes, accounts receivable, etc., are taxed at 1 mill annually. Mortgages are taxed at 2 mills at recordation. Obligations secured by liens on Florida realty are taxed at 2 mills. There is an exemption of $20,000 for each person and $40,000 for each married couple. Total tax collections for 1989-90 were $418 million, including $108 million from the tax on mortgages.

In July 1990, the Florida Legislature increased the annual intangibles tax on stocks, bonds, notes, and accounts receivable from .01% to .015%, beginning 1990-91. The current $20,000/ $40,000 exemption for persons was raised to $100,000/$200,000 for the .005% additional tax.

The increased tax will produce $150 million a year, bringing total intangibles tax collections to $543 million per year. Of that amount, county governments will receive 40% as part of the County Revenue Sharing Program. The remainder will be allocated to the General Revenue Fund.

Equity

Both businesses and individuals pay the intangibles tax. The new, larger exemption for individual taxpayers creates substantial divergence between the effective tax rates faced by businesses and individuals.[7] As a consequence, most of the burden for the new tax will be placed on businesses with substantial amounts of taxable intangibles.

[7]If a court were to address Florida's new intangibles tax exemption structure, it might declare it unconstitutional. The new exemption structure creates different effective tax rates for owners of the same intangible property. The constitution says that mortgages can be taxed at a different rate than stocks and bonds. There is no mention of different tax rates for different owners of intangible property.
A married couple owning taxable intangibles of $300,000 will pay a tax of $310 for an effective rate of .103%. A couple with $250,000 of intangibles pays $210 for an effective rate of .084%. The greater the amount of intangibles, the higher the tax rate; less in intangibles means lower tax rates.

Ability to pay (Medium)

Vertical equity—The annual intangibles tax on stocks and bonds owned by individuals is progressive because it is a tax on wealth and provides an exemption for small investors. The tax on the value of stocks is essentially a hidden income tax (because the current value of stock depends on dividends paid and the expected value of future net income).

The tax on residential mortgages is the regressive component of the intangibles tax. This tax is borne by property owners and renters. Low-income people spend a greater proportion of their income on rent and housing than high-income people. The fact that cash purchases, typically made by wealthy individuals, are not taxable also contributes to the regressivity. Cash purchasers may have greater "ability to pay."

Taxes on business intangibles are likely to be shifted to consumers in the long run as businesses attempt to restore their profit margin.

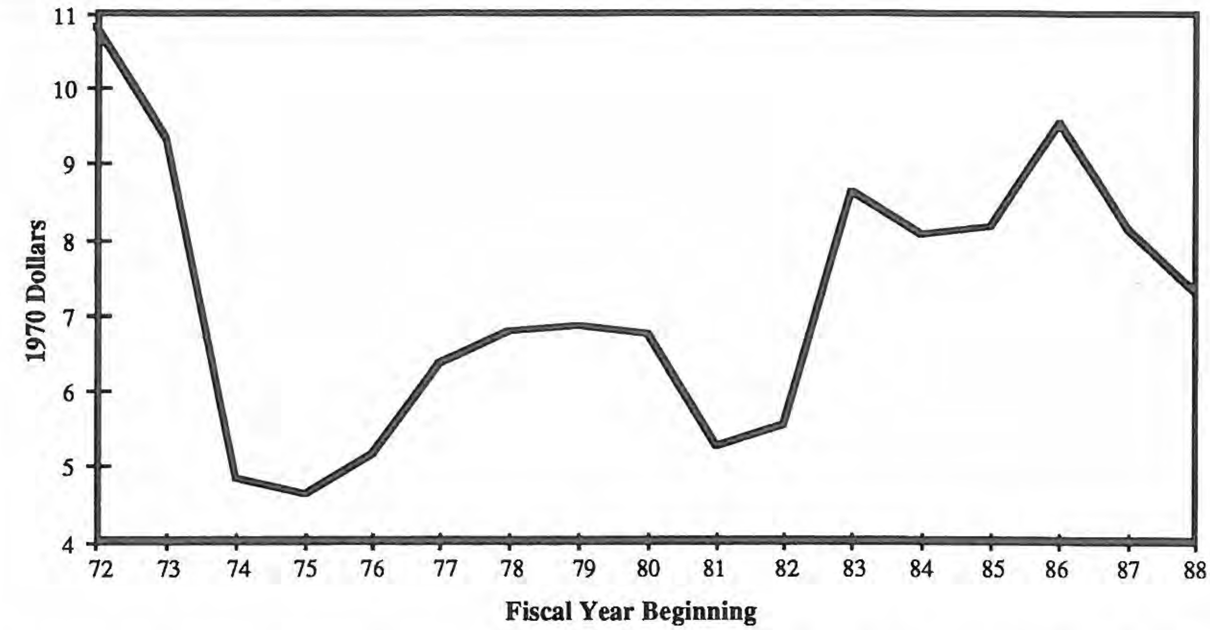
Horizontal equity—Exemptions for certain types of intangibles undermine the tax's horizontal equity. Two individuals with the same value of intangibles can be treated differently. A portfolio of corporate stocks and bonds held by one person is taxable. The other person's portfolio, composed of government bonds and monies in a savings account, would not be subject to taxation. Also, securities held in a retirement account are not taxable, nor are annuities and life insurance policies.

Benefits received (Low)

The intangibles tax has no relationship to benefits received from government services.

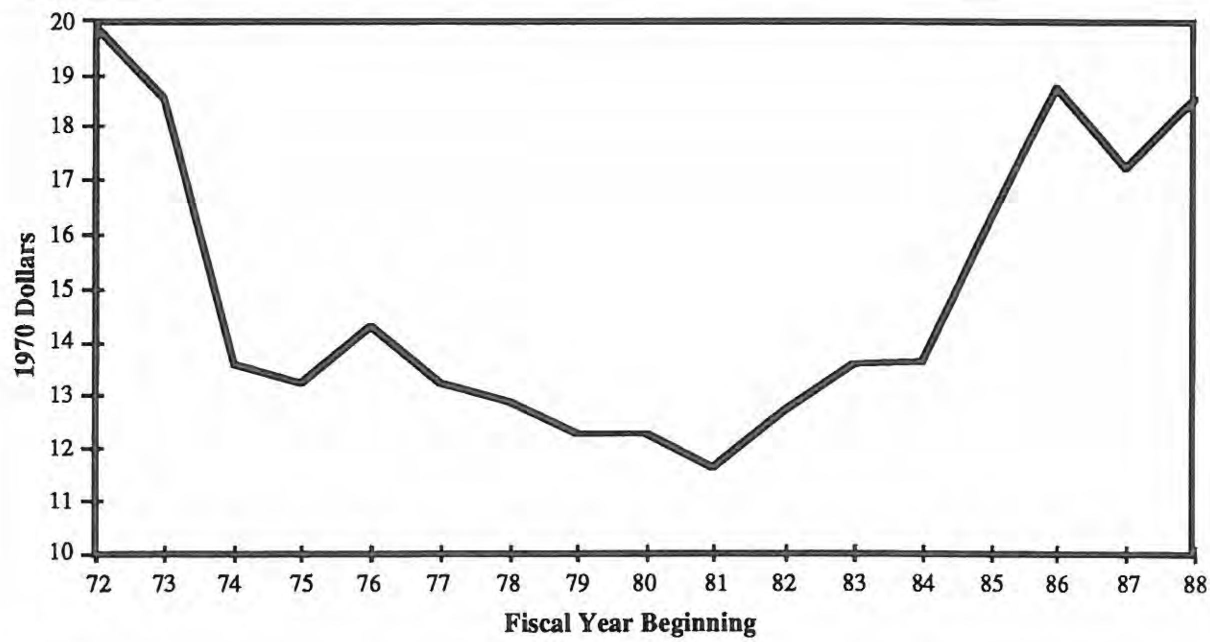
Stability (Medium)

The intangibles tax has proven to be moderately stable in the short run. The mortgage component, comprising 25% of intangibles tax revenues, is slightly more volatile than the annual tax on other intangibles, such as stocks, bonds, and accounts receivable (see Figures V-10 and V-11). Mortgages and a significant share of bank loans are tied to activity in the unstable and declining construction industry. The annual tax on other intangibles acts as a stabilizing force for the volatile tax on mortgages.



Source: Florida Consensus Estimating Conference, Book 6, Revenue Analysis, FY 1970-71 Through FY 1998-1999, Florida Legislative Division of Economic and Demographic Research, September 1990.

FIGURE V-10 MORTGAGE TAX COLLECTIONS PER HOUSEHOLD, ADJUSTED FOR INFLATION 1972-1988



Source: Florida Consensus Estimating Conference, Book 6, Revenue Analysis, FY 1970-71 Through FY 1998-1999 Florida Legislative Division of Economic and Demographic Research, September 1990.

FIGURE V-11 ANNUAL INTANGIBLES TAX COLLECTIONS PER HOUSEHOLD, ADJUSTED FOR INFLATION 1972-1988

Administration (Low)

The Department of Revenue administers and audits the intangibles tax. Its main audit tool is copies of federal personal income tax returns that were filed from Florida. This process is inefficient because the returns include those filed by nonresidents and exclude returns filed by Florida residents in other states. Florida does not have the complete taxpayer data base that full compliance requires. The DOR knows that its audit efforts need to be improved and is hiring additional auditors and assigning them to this tax.

Compliance (Medium)

The tax on mortgages is easy to comply with, like the documentary stamp tax. But the same problems plaguing that tax also apply to the intangibles tax. The self-reporting of annual intangibles means that some intangibles and taxpayers will not be taxed.

Exportability (High)

The intangibles tax is highly exportable. It is considered a tax on property and deductible for federal tax purposes.

Efficiency (Low)

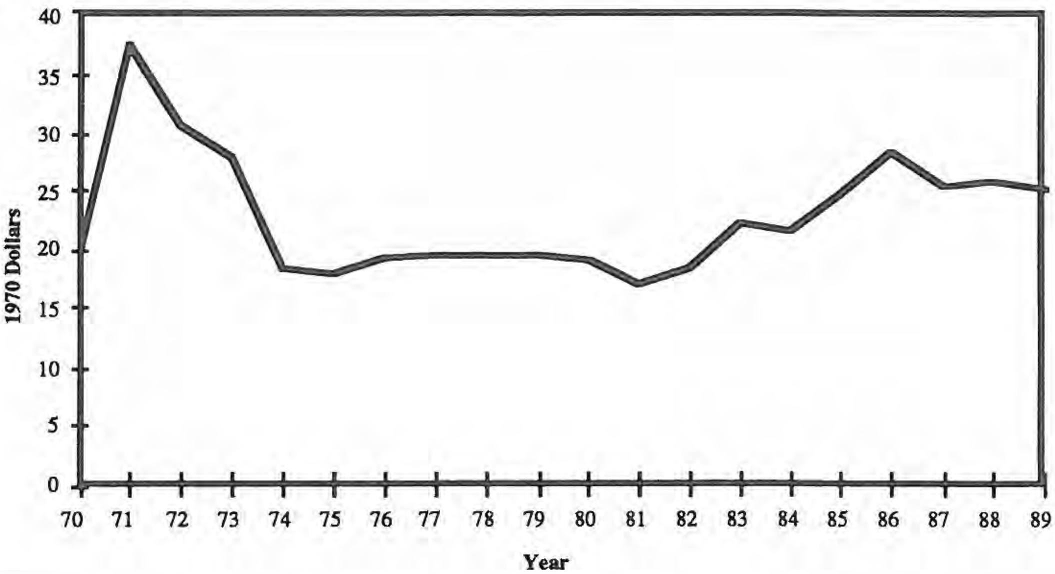
The intangibles tax distorts decision-making by consumers. Consumers have an incentive to purchase securities that are not taxable or are covered by exemptions. This may direct investments into government, rather than the private sector. To the extent that government debt issues are used to service debt, rather than to invest in physical infrastructure or human resources, capital resources are diverted to unproductive areas.

Taxing stocks and bonds increases the after-tax return necessary to maintain a targeted return on equity. This may encourage greater leverage though the use of debt. Bond interest is tax deductible, but dividends, the cost of equity capital, are not.

Consumers have an incentive to purchase property with cash to avoid the intangibles tax on mortgages. In Florida, the persons most likely to benefit from this advantage are new residents who recently sold their homes in other states.

Growth (Medium)

The intangibles tax has only moderate long-term growth potential. After adjusting for inflation, intangibles tax collections per household have increased since 1970 by $6, or 4% (Figure V-12). Real tax collections peaked in the early 1970s, and began to increase again in the late 1980s.



Sources: Florida Consensus Estimating Conference, Book 6, Revenue Analysis, FY 1970-71 Through FY 1998-99, Florida Legislative Division of Economic and Demographic Research, September 1990.

FIGURE V-12 INTANGIBLES TAX COLLECTIONS PER HOUSEHOLD, ADJUSTED FOR INFLATION 1970-1989

The growth component of the intangibles tax is the annual tax on stocks, bonds, and accounts receivable. Tax revenues from this source have been increasing each year since 1981 because of increased stock and bond prices.

Diversity (Medium)

The intangibles tax has medium diversity. Two significant bases of the tax, mortgages and bank loans, are narrowly dependent on activity in the construction industry. The annual tax on stock, bonds, accounts receivable, however, is a more diverse tax base, even with all its exemptions.

Neutrality (Low)

By its very nature, the intangibles tax does not have a neutral effect on industries. The two main industries that are disadvantaged by this tax are industries with high accounts receivables and those that hold large portfolios of securities.

Intangible assets are not the same across all industries. Financial institutions hold and manage intangibles as their main line of business. To prevent an excessive tax burden on financial institutions, they receive a corporate tax credit for a portion of the intangibles tax that they pay.

Industries with large amounts of accounts receivable, such as wholesalers, essentially make short-term loans to purchasers, in a fashion similar to financial institutions. These industries, however, receive no special tax benefits.

The tax treatment of accounts receivable penalizes Florida-based multistate businesses and increases their selling costs compared with those of their out-of-state competitors. The total value of accounts receivable of a Florida-based businesses is subject to taxation, regardless of the location of purchasers.[8] The accounts receivable of out-of-state businesses are apportioned to Florida based on their sales in Florida.

Pro-investment (Medium)

The intangibles tax is not an important tax for most business firms. Financial firms are in the intangibles business, and any tax on the product they sell can influence their behavior. This is true now that financial services are an international business.

The intangibles tax is more likely to affect the behavior of financial firms than the construction industry, since the purchasers of new homes or buildings consider the tax on mortgages to be a closing cost less important than interest rates.

Documentary Stamp Tax

Florida's documentary stamp tax is levied on the recording or transfer of deeds and other instruments related to the transfer of interests in real property. Thirty-six states and the District of Columbia levy such a tax. The taxation of documents in the United States predates the 1765 Stamp Tax Act, when the English Parliament imposed its first direct tax on the colonies. Most states with stamp taxes levy a separate document recording taxes only on real estate. Florida, along with several others, has a more general tax on the transfer of deeds, including other forms of intangibles.

Florida's documentary stamp tax levies 55 cents per $100 of value on deeds and other documents related to real estate, and 32 cents per $100 of value on other documents (the issuance of stocks and bonds, notes, charge accounts, installment loans, and other financial documents). The latter tax was increased from 15 cents by the 1990 legislature (effective July 1, 1990) to help fund the 1990-91 budget. The documentary stamp tax will raise $548 million this year. The General Revenue Fund receives 60% of the stamp tax revenue. The remaining revenue goes to

[8] The section of the law dealing with the taxation of accounts receivable is now before the Florida Supreme Court, where it is alleged that Florida's law causes Florida taxpayers doing business in other states to pay combined taxes on more than 100% of the value of their receivables.

four trust funds: the State Infrastructure Fund, the Land Acquisition Trust Fund, the Water Management Lands Trust Fund, and the Conservation and Recreation Lands Trust Fund.

Equity

Ability to pay (Medium)

Both businesses and individuals pay the documentary stamp tax. For individuals the tax on *deeds* is proportional to their income, except the lowest income group.[9] The tax on *installment loans and charge accounts* is moderately regressive. Medium- and lower-income households use these credit devices for purchases more than higher-income households.

Although the documentary stamp tax has a regressive component, it is less regressive than taxes on consumption goods, because goods in a consumption tax base (e.g., cigarettes, beverages, utilities) make up a larger proportion of low-income people's income than do products purchased on credit (e.g., higher-priced durables).

Taxes on developed property, by convention, are paid by the purchaser. The ultimate incidence of the tax is most likely to be borne by the seller in the form of reduced prices if there is competition among sellers.

Benefits received (Low)

There is no relationship between documentary stamp taxes paid and benefits received.

Stability (Low)

The documentary stamp tax is *highly volatile* in the short run, since it is dependent on the real estate market and general economic conditions. For every slowdown in Florida's economy since 1970, tax collections per household have declined.

Administration (Medium)

County clerks administer the documentary stamp tax. The Department of Revenue is responsible for collecting the tax from the clerks and administering the law. The state is responsible for auditing the amount of tax collected by financial institutions. This division of responsibilities can cause problems. County clerks have not always been diligent in collecting this tax, since it is a state tax and they receive only a collection fee.

---

[9] *Consumer Expenditure Survey: Quarterly Data from the Interview Survey, fourth quarter 1987*, Bureau of Labor Statistics, U.S. Department of Labor, 1989).

Compliance (Medium)

The cost of complying with the documentary stamp tax is minimal, because it is collected when recording a document or executing a financial transaction. The primary compliance problem, from the taxpayer's side, focuses on the correct reporting of the value of the deeds. The value reported for deeds must not include items other than the property itself or be recorded at less than its sales price.

Another problem focuses on the correct taxation of loan agreements and charge card balances. In these cases, the institutions involved are large enough so that compliance should not be a long-term problem.

Exportability (Moderate)

The documentary stamp tax has moderate ability to be exported out of Florida. It is partially exportable through out-of-state property owners and through businesses if the tax is passed forward to tourists and other out-of-state residents.

Efficiency (High)

The documentary stamp tax is a low, nonannual tax for most businesses and is unlikely to distort economic efficiency by modifying business behavior. The tax on a deed of $20 million, for example, would total $110,000—less than a 10% real estate commission.

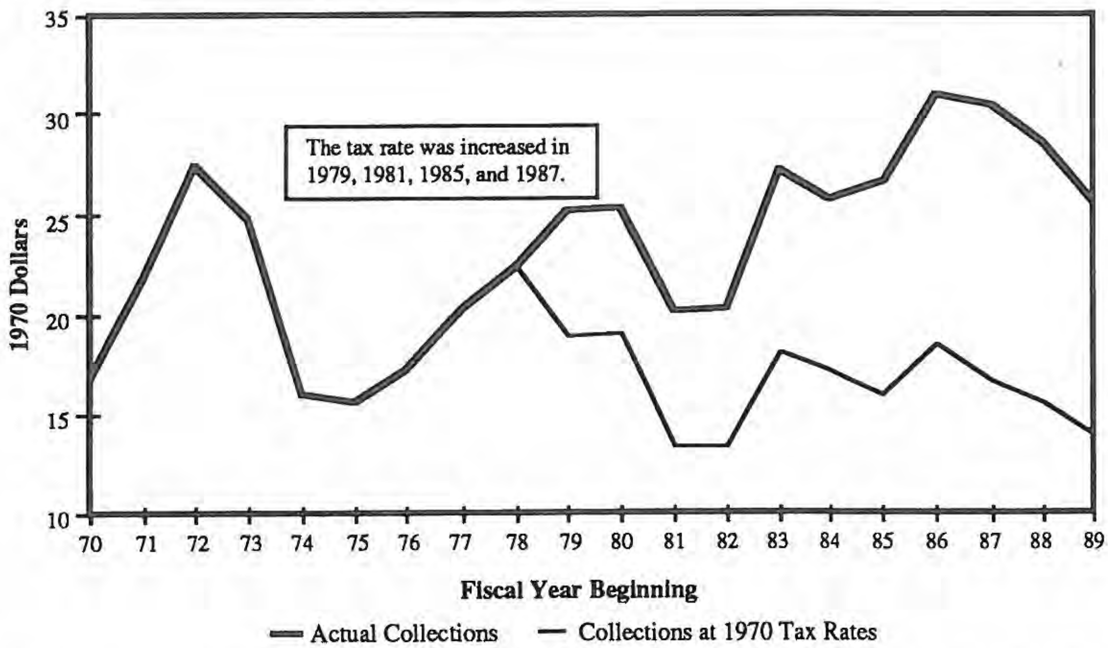
At first, it may seem that the tax on deeds could be avoided simply by using long-term leases. Commercial leases, however, are subject to a monthly sales tax whose cost greatly exceeds the tax on deeds. If anything, the difference in tax treatment provides an incentive to purchase.

The tax on installment loans and charge accounts arguably could alter consumers' choice between the use of credit or cash/saving. Most consumers remain unaware of the documentary tax, since the lender frequently pays it and recoups the cost through higher interest rates or fees. Again, however, the tax is so low (32 cents for every $100 of outstanding balance) that it is likely to have no effect on decision-making.

Growth (Low)

Tax revenues from the documentary stamp tax have low ability to grow over time, chiefly because the construction industry is becoming a smaller component of Florida's economy. The value of deeds filed confirms this trend, which is not likely to be reversed.

The only reason that Florida's documentary stamp tax revenues have increased over time, after adjustment for inflation, is that the tax rate on deeds has increased by 83%, from 30 cents to 55 cents (Figure V-13). Without the tax rate increases, tax collection in 1988 would have been less than in any year between 1970 and 1980.



Source: Florida Consensus Estimating Conference, Book 6, Revenue Analysis, FY 1970-71 Through FY 1998-1999, Florida Legislative Division of Economic and Demographic Research, September 1990.

FIGURE V-13 DOCUMENTARY STAMP TAX COLLECTIONS PER HOUSEHOLD, ADJUSTED FOR INFLATION 1970-1989

Diversity (Low)

The tax on deeds is narrowly focused on the construction industry. Forty-five percent of documentary tax collections come from deeds. That percentage will fall to about 30% when this year's tax increase on other documents takes effect. Even with the decline in the share of taxes from deeds, the combined tax will still be highly dependent on the construction industry.

Although the tax on notes, charge cards, and installment loans has a broader "product" base, that base is highly cyclical. Credit instruments are used to purchase postponable durable goods; when the economy looks weak, the use of credit purchases declines.

Neutrality (Medium)

Although the tax may not be neutral across industries, it is low enough not to raise serious problems.

Since the documentary stamp tax applies to deeds, it increases the cost of land and buildings, but not that of equipment and other liquid assets (e.g., inventory, cash). Industries whose assets are concentrated in highly valued buildings and land, such as retailing, will pay relatively more tax on deeds than others, such as manufacturing, where equipment is a more important asset.

Since the tax increases the cost of credit transactions relative to cash transactions, there may be a slight negative effect on the financial services industry and industries that sell goods to credit users.

The tax on the issuance of stocks and bonds discriminates against companies issuing bonds. The issuance of bonds costs more than the issuance of stock of the same value, because the tax on bonds is based on their face value, while that on stocks is based on their par value. Florida's tax on the issuance of bonds could encourage a utility, for example, to place large bond issues out-of-state.

Pro-investment (Medium)

Although the documentary stamp tax is a tax on capital and credit, its rates are low enough not to deter capital accumulation. To the extent that the tax reduces the use of credit to purchase consumer goods, it may have a positive effect on savings and interest rates. (The use of credit, however, could be replaced by a reduction in savings/use of cash.)

User Fees

User fees are paid by users of public services to cover their cost. User fees are typically charged for services such as utilities, mass transportation, parking, recreation facilities, and solid waste services.

Equity

Ability to pay (Not Applicable)

The ability to pay approach is not applicable because user fees are designed implicitly to link to benefits received.

Benefits received (High)

In theory, user fees are an ideal way to link the costs of government services to those who receive benefits. This potential is undermined whenever user fees do not fully cover the costs of providing the service. There may be strong equity reasons why government may want to use a combination of user fees and direct subsidy to cover the full cost of the service. Public hospitals and transportation are good examples.

A less excusable divergence from theory is the pricing of services on average cost, rather than marginal cost. If user fees reflect the true cost of providing a service, they can serve the same function as private-sector prices and ration the use of government services. Users will purchase as much of the service as they want at a price that reflects the cost of providing the service to each additional user (the marginal cost).

Unfortunately, most user fee schedules do not reflect the true cost of providing services. A typical problem with user fees is that they reflect the average cost of providing a service and neglect other important cost factors. Utility systems, for example, expand over time, as does the cost per unit to be served. Instead of charging new users for the cost of expanding the system, typically the cost is added to the charges for supporting the existing plant and averaged across all users. Average-cost pricing is popular because it is easy to calculate, and because bond firms require a certain amount of utility revenue to support a bond issue. This pricing policy subsidizes growth by placing an excess burden on current residents.

It is also rare to find user charges for water that contain separate distance and capacity charges. The charge for a water user is often the same per gallon whether he is 10 miles from the water supply or next door. Reserve capacity is not charged to those who may use water only part of the year, yet the capacity to serve them is built into the system.

Another inequity and divergence from user fee theory is the practice by some governments of setting rates to return a "profit." Revenues are collected in excess of real costs. These additional revenues, raised more easily than through property tax increases, are then used to fund general-purpose programs.

Stability (Not Applicable)

Stability concerns are not important for user fees because the fees support specific public services.

Administration (High)

Once the levels of user fees are set, the fees are not difficult to administer.

Compliance (High)

Since user charges are for services received, services can be cut off if not paid for. For example, admission can be denied to recreational and entertainment activities if a ticket is not presented.

Exportability (Low)

User fees are generally not exportable. When the fee schedules reflect the cost of services consumes, there is no burden left to export.

Efficiency (High)

User fees can be highly efficient (i.e., have a neutral effect on decision-making regarding the use of economic resources) if they reflect the incremental cost of providing goods and services. Their strength is their ability to allocate resources based on demand and willingness to pay. Average-cost pricing of utility services thus undermines efficiency, as does overcharging for profit.

Growth (Not Applicable)

Growth over time is not applicable to user fees, because they are used to fund services that are demand responsive.

Diversity (Medium)

Businesses usually benefit by paying user fees for as many services as possible, rather than by being taxed for services. User fees result in the more efficient use of economic resources as they reflect cost-conscious demand for government services by the private sector. Benefits of a diverse system of fees, however, can be defeated if the fees do not reflect the true cost of providing the services.

Neutrality (Medium)

If applied inappropriately, user fees, special assessments, and impact fees can harm industries that develop undeveloped properties more than those that purchase developed ones.

These revenue sources must be used only to recover incurred costs. Moreover, they must be consistently applied in the future for capital expenditures benefiting existing properties. New development must not pay the infrastructure bills for capacity already in place, other than the taxes that apply to all taxpayers.

If these conditions are not present, there is an incentive to purchase developed properties over undeveloped properties, with a resulting reduction in the value of undeveloped property. The reduction in value must be sufficient to offset the benefits of purchasing developed properties. If this occurs, the expected rate of return for landholders and developers will be reduced. Therefore, the location of business activity will not be affected.

Pro-investment (Medium)

The use of user fees instead of taxes generally reduces the burden on business to pay for government services from which it does not benefit. This can increase rates of return and encourage investment.

Special Assessments

The cost of new development can be categorized as "site-specific costs" and "off-site costs." Site-specific costs are easily identified and can be recovered by special assessment (or hookup charges and subdivision exactions). Special assessments become a lien against property benefiting from public improvements (e.g., neighborhood streets). As they typically are levied annually over a specified time period, they are bondable and an attractive way to finance capital improvements.

Equity

Ability to pay (Not Applicable)

The ability to pay approach is not applicable because special assessments are designed explicitly to link to benefits received.

Benefits received (High)

Special assessments are used to finance improvements that have a clear link to the taxed property.

Stability (Not Applicable)

Stability is not important for special assessments because they are used to cover services demanded each year.

Administration (High)

Once the level of special assessments is set, the assessments are not difficult to administer.

Compliance (High)

Avoiding special assessments is also difficult since they are a lien on the benefiting property.

Exportability (Low)

Special assessments are generally not exportable.

Efficiency (High)

Special assessments are more efficient than impact fees. The cost of financing special assessments is lower than that for impact fees; special assessments result in lower construction costs than do impact fees. Special assessments are paid over a series of years and are not included in the cost of construction, whereas impact fees are considered a cost of construction that construction loans and mortgages must cover.

If a special assessment is based on the value of land, it is likely that a special district levying property taxes also would be appropriate. Property taxes are deductible for federal tax purposes.

Since special assessments are efficient, they could be used on a larger scale, even by state government. The expansion of general access roads could be paid for by special assessments on benefiting properties. The fee could be based on the real increase in land values over a 30-year period.

Growth (Not Applicable)

Growth over time is not applicable to special assessments because fees collected are specifically linked to demand.

Diversity (Medium)

Business benefits from extensive use of special assessments to the extent that they substitute for higher taxes.

Neutrality (Medium)

Special assessments, if applied inappropriately, can harm industries that develop undeveloped properties more than those that purchase developed ones (see *Neutrality* under User Fees).

Pro-investment (Medium)

The use of special assessments to pay for government services is compatible with efforts to encourage investment. Taxes by their nature distort economic decision-making. Special assessments, because they are linked to benefits received, should result in more optional allocation of companies' investment resources.

Impact Fees

Governments use impact fees to recapture the "off-site" costs of growth that are related to new development. Impact fees are one-time payments made by the developer/builder when getting a building permit. The tax does not have a uniform base, and may be levied on a per square foot or per bedroom basis. Road impact fees use lane miles traveled per day.

Equity

Ability to pay (Medium)

To the extent that impact fees are used to pay for services that benefit others besides the payer, the benefits-received principle is eroded. Developers are sometimes charged because they are perceived as having the ability to pay, rather than because they will be the exclusive beneficiaries of service improvements made with impact fee revenue.

Benefits received (Medium)

Whereas special assessments are used for "site-specific costs," impact fees can be used for off-site community costs. Proponents argue that new development imposes costs on the rest of the community beyond the additional tax revenue generated by the new development. Several problems can arise in estimating the impact on the community and cost to the public of new development.

First, impact fees can have an unclear relationship to benefits received from the levy. Impact fees currently support roads, fire stations, and regional parks, and have been sought for local schools, police services, and other general government activities. The use of impact fees for these latter services is controversial; the courts have stated clearly that impact fees must have a direct relationship to the benefits received from the fee. With education, for example, there is no direct link between the costs of local schools and exclusive benefit to new development. Communities have a long-standing practice of funding schools with general-purpose taxes precisely because the general community benefits from an educated population.

Second, fees are sometimes levied when there is unused capacity. If new development takes place in areas with excess infrastructure capacity, impact fees or other charges are unnecessary, since there are no new development costs. Arguments made in behalf of downtown redevelopment are often based on the underutilization of infrastructure facilities. Greater use of these facilities would actually reduce the cost for other users.

Third, inequities arise when new development pays impact fees for new facilities and pays for facilities used by other residents through average-cost-based user fees and general taxes. In the future, problems will arise when impact fees are used to pay for the replacement of older infrastructure facilities.

Fourth, impact fees for roads often double count the traffic flow. Each residential unit pays an impact fee for the estimated road use that it generates. In addition, commercial properties pay a fee based on the traffic they generate. This "traffic generated" is often the simple sum of the residential traffic flow.

If new development pays all on-site development cost and properly conceived user charges for utility services, off-site impact fees appear not to be needed.

Stability (Not Applicable)

Stability is not important for impact fees because they are used primarily to cover services demanded each year.

Administration (Medium)

Developing standards for fee structures and accounting mechanisms for impact fees can be difficult. Once the levels of impact fees are established, however, the fees are not difficult to administer.

Changes in the administration of revenue sharing could negate the need for impact fees at the local level. Impact fees are attractive to local governments because they bring immediate revenue. State tax coffers benefit immediately from new development. The state receives revenue from the intangibles tax on mortgages and construction loans, the documentary stamp taxes on deeds and construction loans, and the sales tax on building material and supplies. Local governments, however, receive increased property taxes on a delayed basis. Revenues shared with local governments that come from new construction are not returned to the specific communities where the new construction takes place.

Estate Tax

Florida imposes a tax on the net estates of deceased residents (and on the Florida property of nonresidents). The Florida Constitution, Article VII, Section 5, limits the state's estate tax to the amount of the federal credit, minus amounts paid to other states.

Although it means "giving up" potential revenue, Florida uses the "other state" tax credit as a means to encourage persons with large estates to move to Florida. Florida's state tax is not a deterrent since all states pick up the federal credit.[9] Nine states impose estate taxes that exceed the credit. Seven states have companion gift taxes that tax certain predeath distributions.

In fiscal 1989-90, Florida collected $258 million from its estate tax. The Department of Revenue does not tabulate the value of the credits given other states.

Equity

Ability to pay (High)

The burden of the estate tax falls on beneficiaries as a decrease in the amount of their inheritance. The tax is generally considered progressive, since it falls hardest on the wealthiest estates. The Florida tax itself represents no extra burden to the descendants; without the Florida tax, the federal government would collect the same amount from descendants.

Benefits received (Low)

The estate tax has no relationship to benefits received.

Stability (Low)

The estate tax has proven to be an unstable source of revenue in the short run; collections vary dramatically from year to year. Revenue is quite unpredictable, since it is difficult to speculate about the size of estates that will be left in a given year.

Administration (High)

Responsibility for administering the estate tax lies chiefly with the federal government. All states have to do is process a state tax return that is identical to the federal return. The Internal Revenue Service (IRS) handles all auditing, with no state involvement.

[9] If the federal credit were eliminated, states would have to decide whether an estate tax should be part of their tax structure. Absent the federal credit, it might make more sense to levy an inheritance tax.

Compliance (High)

In general, the estate tax is difficult to evade and leaves little room for fraud. States must resolve disputes over the residence of the deceased and the location of the estate's assets.

Exportability (High)

The existence of the federal credit allows the state's estate tax to be fully exported to the federal government. The credit represents a form of federal revenue sharing. In turn, however, the federal government may reexport the lost tax revenue by increasing other (possibly less progressive) federal taxes, by reducing spending, or by deficit spending.

Efficiency (High)

Florida's estate tax does not affect the efficient use of productive resources because of the federal credit. The combined federal and state tax on a Florida estate will be the same whether or not Florida imposes a tax.

Some argue that the tax is inefficient because of the double taxation of income. Income is taxed when earned and again when accumulated to form an estate (a stock of wealth).

Growth (High)

The average annual rate of growth of the estate tax surpasses that of major state taxes and exceeds the growth of the state's economy as measured by state personal income. As the population of the state grows older, growth of estate tax collections may accelerate.

Diversity (Low)

The estate tax is not a diversified source of revenue because few taxpayers have taxable estates. The federal tax with its exemptions and credits taxes estates when they have a value of $600,000 or more. If the estate tax is considered a tax on income, it taxes a very small portion of the income that would be taxed under a broad-based income tax.

Florida's estate tax base would be broader if it did not allow a credit for other states' estate tax. Florida grants this credit even when other states do not reciprocate. Florida is not bound by federal law to grant this credit .

Neutrality (Not Applicable)

The neutrality principle is not applicable because the estate tax does not affect businesses.

Pro-investment (Medium)

The federal estate tax probably has a neutral effect on savings and investment decisions. Some argue that the estate tax reduces the incentive to work and save. People may save less if they know their heirs will not receive it all. Any negative effect, however, would be minor compared with a personal income tax of a comparable yield. Income taxes reduce the return from work *during* a lifetime. Because they are imposed at death, estate taxes are unlikely to affect work effort adversely during life.[10] If anything, people might work harder or save more to accumulate an estate with a particular after-tax value.

Utilities Taxes

Florida has six separate taxes that affect utility services—more than any other state. Table V-11 shows the taxes imposed on each of seven utility services. Table V-12 shows the amount of revenue derived from each source.

Table V-11

FLORIDA TAXES ON UTILITY SERVICES

	State Utilities Gross Receipts Tax	State Sales Tax	Local Option Sales Tax	Municipal Public Service Tax	Local Franchise Fees	911 Tax
Electric	Yes	Part	Part	Yes	Yes	No
Telephone	Yes	Part	Part	Yes	Yes	Yes
Natural Gas	Yes	Part	Part	Yes	Yes	No
Water	No	No	No	Yes	Part	No
Sewage	No	No	No	No	Part	No
Bottled Gas	No	Yes	Part	Yes	No	No
Fuel Oil	No	Part	Part	Yes	No	No

Note: Fuel oil and bottled gas are not utility services but are taxed as utilities under the municipal public services tax because they are substitutes for metered gas.

The sum of these taxes burdens Florida utilities and their consumers more than those in other states. In 1987-88, Florida levied $80 per capita in specific utility taxes, compared with a national average of $43 per capita. Most of the Florida tax is collected by local governments from franchise fees and the municipal public service tax; Florida is the only state in the country whose localities levy a municipal public service tax. Nationally, local governments collected $18 per capita in local franchise fees and utility taxes; Florida's local governments collected $62 per capita in local franchise fees and public service taxes. Excluding local taxes and fees, Florida's

[10] Corina Eckl, "Death Taxes," *Reforming State Tax Systems*, National Conference of State Legislatures, December 1986.

average utility bills for industrial and, customers would actually be quite competitive (see Table V-13 and Table V-14).

Table V-12

RECENT UTILITY TAX COLLECTIONS

Utilities Taxes	Millions of Dollars
State Utilities Gross Receipts Tax*	$290.8
State Sales Tax**	487.2
Local Option Sales Tax**	1.1
Municipal Public Service Tax***	
Muncipalities	386.7
Counties	77.0
Local Franchise Fees***	
Muncipalities	242.5
Counties	59.7
Total	$1,545.0

* Fiscal 1989-90.
** Calendar year 1989.
*** Fiscal 1987-88, which began October 1, 1987.
Sources: Florida Sales Tax Return Data—Calendar Year 1989, Florida Department of Revenue.
Local Government Financial Report, 1987-88, Florida Department of Banking & Finance.

Table V-13

INDUSTRIAL ELECTRIC UTILITY BILLS FOR SELECTED CITIES, 1988

	60 MWh		2,500 MWh	
Cities	Level	Rank*	Level	Rank*
Cambridge, MA	$5,192	12	$161,387	11
Charlotte, NC	3,784	3	113,991	6
Dayton, OH	4,465	6	104,460	4
Denver, CO	3,974	4	97,765	3
Houston, TX	4,207	5	97,762	2
Los Angeles, CA	5,042	10	182,800	12
Miami, FL	4,801	8	144,371	9
Mobile, AL	5,154	11	119,549	7
Orlando, FL	4,603	7	138,690	8
Pensacola, FL	3,660	2	109,499	5
Tacoma, WA	1,868	1	55,364	1
Tampa, FL	5,033	9	147,995	10

*Rank is from least expensive (1) to most expensive (12).
Source: Electric Sales, Revenue, and Bills 1988, Energy Information Administration, U.S. Department of Energy, 1990.

Table V-14

COMMERCIAL ELECTRIC UTILITY BILLS FOR SELECTED CITIES, 1988

	6,000 MWh		30,000 MWh	
	Level	Rank*	Level	Rank*
Boston, MA	$585	12	$2,220	10
Charlotte, NC	447	6	1,812	4
Dayton, OH	498	9	1,861	6
Denver, CO	430	3	1,599	3
Houston, TX	434	5	1,851	5
Los Angeles, CA	564	11	2,484	12
Miami, FL	461	7	2,090	7
Mobile, AL	515	10	2,240	11
Orlando, FL	432	4	2,138	8
Pensacola, FL	396	2	1,574	2
Tacoma, WA	213	1	841	1
Tampa, FL	477	8	2,181	9

*Rank is from least expensive (1) to most expensive (12).

Source: Electric Sales, Revenue, and Bills 1988, Energy Information Administration, U.S. Department of Energy, 1990.

The following are brief descriptions of the major utilities taxes:

- *State utilities gross receipts tax*—This tax is levied on the gross receipts of telephone, electric, and natural gas providers, both private companies and governmental producers. The tax is passed on to purchasers through higher rates or the separate listing of the tax. The tax applies to self-providers of utility services as well as to some co-generators of electric power. The tax rate was 1.5% for years until its increase this year. The tax for fiscal 1990-91 will be 2.0% with .25 percentage point increases the following two years.

  Article VII, Section 9, of the constitution requires that all revenues from this tax be deposited in the Public Education Capital Outlay trust fund to be used for public school capital facilities. Most of the funds are used to pay the principal and interest on issued bonds.

- *State and local option sales taxes*—Residential purchases of utility services, fuel oil, and bottled gas are exempt from Florida's retail sales tax. Sales to other purchasers, however, are taxable at 6% plus a local option rate not to exceed 1%. The local tax must be levied by referendum and can be used only for infrastructure purposes. It does not apply to sale amounts in excess of $5,000 per transaction for tangible personal property. Twenty-four counties levy the optional sales tax, with all but two at the 1% rate. Counties must share the revenues from this tax with municipalities.

- *Municipal public service tax*—Most municipalities in Florida levy the municipal public service tax. The maximum rate on the purchase of local telephone and telegraph services, electricity, water services, and metered and bottled gas is 10%. The tax on telephone services is limited to 7% if both local services and intrastate toll services are taxed; about 70 municipalities have chosen this option. The tax on fuel oil cannot exceed 4 cents per gallon. Fuel oil must be taxed if electricity and metered and bottled gas are taxed.

Each municipality has its own method of levying the municipal public service tax. Some levy a flat 10% tax; others use a sliding scale and exempt some services like water. Most large municipalities with high property tax rates levy the maximum tax.

Counties do not have the general authority to levy this tax unless they have municipal powers—like Metropolitan Dade County or Jacksonville-Duval. Several other counties have been given special authority to levy the tax.

- *Local franchise fees*—Franchise fees are levied by counties and municipalities against private utility companies, waste disposal companies, and cable television operators. The fee for telephone services is limited to 1% of gross receipts from local service charges. The fee for electric power companies is generally 6%. Franchise fees for water services, waste disposal, and cable television services are negotiated.

  Governmentally owned utilities occasionally charge rates that exceed their cost of providing utility services. The excess proceeds are used to support general government activities. The excess charges are taxes but not reported as so by governments.

Equity

Ability to pay (Low)

The municipal service tax, franchise fees, and state gross receipts tax are very regressive. The local taxes amount to 1% of income for lower-income households and .4% for higher-income households.[11] To make the sales tax less regressive, residential utility users are exempt from the state and local option sales tax. (The same policy goal could be reached, however, with less loss of revenue by exempting only local service charges for telephone services and setting a fixed dollar or usage exemption for electricity.)

Benefits received (Low)

There is no relationship between utility taxes paid and benefits received from the government.

Stability (Medium)

There is great variation in degree of stability among the major utility taxes.

The state gross receipts tax has been an unstable source of revenue over the last 19 years. This instability stems from a number of factors: the nonsystematic pattern of rate increases, the timing of oil prices increases, changes in the growth of Florida's economy, weather, conservation practices, changes in the date tax collections are remitted to the state, and the broadening of the telecommunications tax base.

[11] William Bell, William Serow, and William Shelley, "Measuring the Impact of a State's Tax Structure on an Elderly Population," AARP Andrus Foundation, 1986.

The municipal utility tax, on the other hand, has been a very stable source of revenue for two reasons. The tax base excludes changes in the cost of fuel since 1974 for electric power companies. And, until recently, the tax base for telecommunication services was limited to local service charges, which follow consistent use patterns.

The stability of franchise fees falls between that of the gross receipts and municipal utility taxes, since franchise fees have features of both. Franchise fees are based on total gross receipts for electric power companies and on receipts for local service for telephone companies. Toll call revenues are excluded from the franchise fees.

Administration (High)

All of the taxes on utility services are easy to administer because of the computerized nature of most utility billing systems. Each tax is collected by a small number of businesses and governments.

Compliance (High)

Taxpayer compliance is high because customers must pay each tax to receive utility service and substitute services are not readily available.

Exportability (Medium)

Utility taxes could be exported by businesses (energy users) that sell substantially to tourists or that dominate markets in other states, allowing them to "pass on" the cost of the tax.

Efficiency (Low)

The excessive taxation of utility services in Florida distorts business decisions regarding resource use and location. This distortion is most pronounced for electricity, because it is the most essential utility needed to produce goods and services.

First, high utility tax rates provide unintended incentives for companies to make investments in energy-saving equipment or otherwise alter their input mix to avoid the high tax cost. Second, the fact that municipal utility taxes, with few exceptions, do not apply in unincorporated areas creates a tax-induced incentive to relocate out of cities. This incentive is also strengthened by the desire to escape the municipal property tax. Businesses in cities can pay state and local utility taxes on electricity amounting to 25%—7% state and local sales tax, 2% state utilities gross receipts tax, 6% local franchise fee, and the 10% municipal tax. This relocation incentive is insignificant, of course, if governmental services essential to the business are not available in unincorporated areas.

Growth (Medium)

There is great variation in the growth potential of the individual utilities taxes.

Between 1970 and 1988, the state's *gross receipts tax* has increased by 550%. Its average annual growth rate of 15.4% exceeds the 11.8% growth of personal income. Most of the growth in the state's utility tax resulted from increased utility usage due to population growth and from periodic increases in utility rates. Some growth also resulted from broadening the taxation of telecommunication services.

The growth of *local utility tax* collections has not kept pace with the growth of the state's economy for several reasons. First, since 1974 municipalities have not been able to tax the increase in fuel cost reflected in electric utility charges. Second, the tax on telephone services is limited to the local service charge in most cities—at a time when revenues from toll services are increasing relative to revenues from the basic telephone charge. Last, there has been a substantial reduction in the number of persons potentially subject to the municipal utility tax and franchise fees. In 1970, 68% of the state's population lived in municipalities, compared with 56% today.

Diversity (Low)

The utilities taxes have a narrow base on two accounts. By their very nature, utilities taxes have a narrow tax base because they are levied on one specific set of industries. Even within the realm of utilities, however, the base is not as broad as possible, because all utility services are not taxed. In some cases, special industry taxes substitute for the sales tax, but not always intentionally, as with the insurance premium tax.

Neutrality (Low)

The taxes on utility services are not neutral in their effect on Florida industries. First, there is no solid economic rationale for singling out utility services for taxation, when most services are exempt from all state or local transaction taxes.

Second, the heavy taxation of utility services affects urban firms more than rural ones and large users more than small ones. Large users of power include certain manufacturers, hotels and motels, restaurants, amusements, retail trade, and health and educational facilities. The insurance, finance, retail trade, lodging, and business services industries are large users of telecommunication services.

Pro-investment (Low)

High utility tax rates that are not offset by benefits to the taxpayer may affect the location of "footloose" firms—either out of urban areas or out of Florida. Firms seeking to minimize operating costs, rather than those dependent on particular locations, are most likely to react negatively to high rates. High utility taxes may also induce firms to redirect investment funds away from productive uses toward investments made primarily to reduce their usage of utility services, particularly energy.

VI ASSESSMENT OF POTENTIAL NEW REVENUE SOURCES

Overview

This chapter examines four potential new taxes for Florida according to the 10 criteria for a pro-competitive tax system outlined previously in Exhibit VI-C. The taxes—the services tax, personal income tax, Single Business Tax, and inheritance tax—were chosen because they are used by other states or because they have been considered seriously by Florida before.[13] Drawing on the experience of other states and Florida, each tax is ranked "high," "medium," or "low" for how well it meets each of the criteria.

Table VI-1 provides a summary of the evaluation. Key findings are summarized below.

Services Tax

- Taxing services in addition to goods is equitable. There is no logical economic reason why output from Florida's growing service sector should not be taxed.
- Taxing business services in addition to consumer services, however, causes inefficiency and pyramiding, in the same way that taxing retail goods does.
- The effort to comply with and administer the tax would be moderate, similar to the retail sales tax.
- When business services are excluded from the services tax base, the tax's revenue-raising potential sharply decreases.
- The tax makes consumer purchase decisions more neutral, but a tax on business purchases could cause companies to perform more services in-house.

Personal Income Tax

- The personal income tax rates medium on stability, efficiency, and pro-investment, and high on ability-to-pay equity, neutrality, diversity, exportability, compliance and administration.
- Personal income is the fairest of the three main taxes (income, sales, and property) because net income is believed to be the best indicator of the ability to pay.

---

[13]Although the gross receipts tax has been considered in Florida before, it was rejected after initial analysis because it runs directly counter to key pro-competitive criteria (efficiency, pro-investment), and is not widely used by other states. The trend worldwide, moreover, has been away from turnover-based taxes like the gross receipts tax.

- Progressive income taxes are less efficient than proportional income taxes because they alter patterns of income distribution, change the work/leisure trade-off, and fall more heavily on savings than on consumption.
- The tax is easy to administer based on federal adjusted gross income or federal tax liability, and compliance would be high.
- The tax can be unstable in the short run because revenues parallel the cycle of the economy, but they are less susceptible to swings than the retail sales tax. In the long run, tax revenue grows proportionally faster than the state personal income. The presence of an income tax can diversify a state's tax structure.
- Florida's constitutional limitation on personal income tax creates problems of acceptance.

Single Business Tax

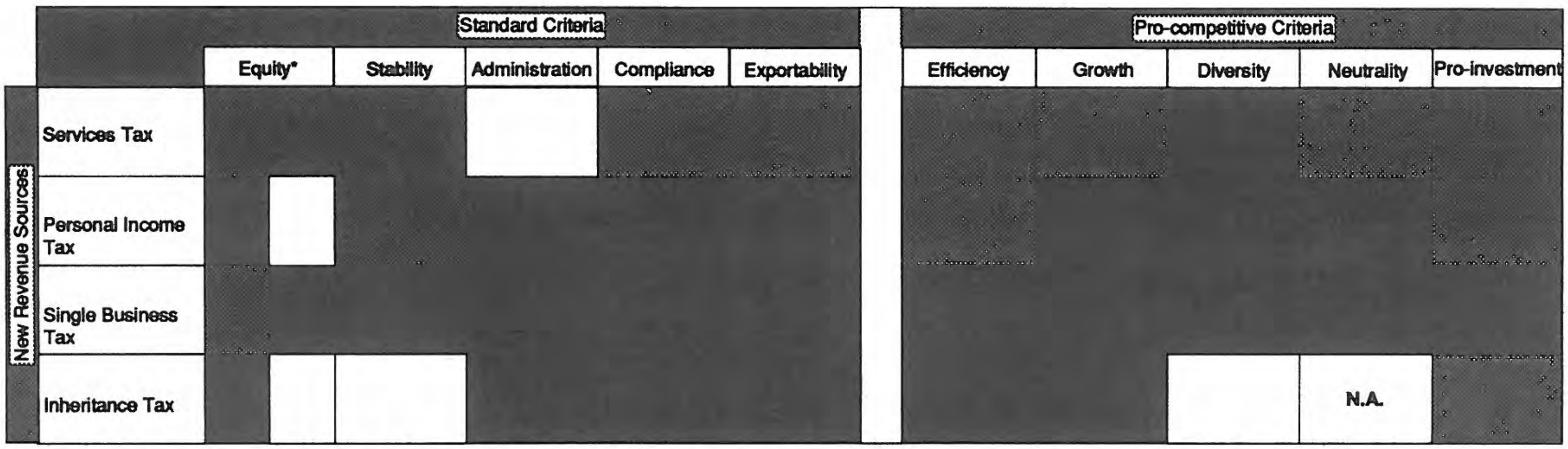
- The Single Business Tax (SBT) rates high on all criteria except ability-to-pay equity, which is rated medium.
- In 1975, Michigan levied a 2.35% SBT in place of 7 taxes affecting business.
- SBT can be a broad-based, low-rate tax that encourages investment while promoting neutrality across industries and firms. One of its most important economic benefits is that it avoids "pyramiding"—the taxing of intermediate inputs—a major problem with retail sales taxes.
- With minimum fluctuation in revenue from year to year, the SBT is particularly appropriate for states with cyclical economies.
- SBT revenues grow in proportion to the economy. With no rate or base changes, Michigan's SBT revenues have stayed at roughly 1% of state personal income each year.
- SBT promotes new capital investment because capital expenditures for real and personal property are excluded from the tax base.
- SBT provides a stronger link to benefits received from government services than the corporate income tax.
- Although Florida would face transition costs from moving toward this tax, once established the SBT would be easy to administer and comply with.

Inheritance Tax

- The inheritance tax taxes wealth transferred to a beneficiary at death.
- The tax ranks high on equity because it can introduce progressivity into the tax structure.
- The tax is easy to administer and to comply with, and is highly exportable and efficient.
- It does, however, have low short-run stability because of its narrow, unpredictable base.
- The tax has a strong ability to grow over time and has a moderately negative effect on investment.

Table VI-1

SUMMARY
ASSESSMENT OF POTENTIAL NEW REVENUE SOURCES



*Equity is judged on both "ability to pay" (left box) and "benefits received" (right box) principles.

High   Medium   Low   N.A. = Not applicable

Services Tax

Since its enactment in 1949, Florida's sales tax base has been broadened to include other items besides tangible personal property. In 1968, the tax base was broadened to include commercial rentals, utility services, and admissions. In 1985, the tax base was broadened to include all telecommunications activities. In 1986, laundry and dry cleaning were taxed and all service exemptions and 44 nonservice exemptions were repealed effective July 1, 1987. After much controversy, the tax on services (including laundry and dry cleaning) was repealed by a special session of the legislature in December 1987, effective January 1, 1988. When the services tax was repealed, the sales tax rate was increased from 5% to 6%.

It is estimated that a tax on all services, except labor services, would increase sales tax collections by $6.4 billion. Because there are strong arguments to exclude a number of services from the tax base, actual revenues raised by a services tax would be much lower.

Equity

Ability to pay (Medium)

As long as tangible personal property, leases, admissions, and other transactions are subject to taxation, there is no intrinsic reason why services should not be taxed. Proponents of the services tax claim that taxing services would make the tax system more equitable and less regressive. Taxing consumer services may, however, make the sales tax more regressive (see Table VI-2).

Benefits received (Medium)

Businesses that produce services receive benefits from government services just like businesses that produce goods; taxing their output recognizes this growing sector of the economy. Florida already taxes utility services and commercial rents and leases.

Stability (Medium)

The stability of the service tax depends on the base used. Taxing services can help increase the stability of the tax system because demand for services is less volatile than the demand for goods.[13] As Florida's services tax legislation evolved, most services with the potential to add stability to the tax system (e.g., financial services, insurance, transportation) were exempted. The largest remaining sector taxed, construction services, is also one of the state's most unstable.

---

[13] Steven D. Gold, "Choppy Waters Ahead," *State Legislatures*, September 1990, pp. 11-13.

Table VI-2

FLORIDA SALES TAX PER HOUSEHOLD, AMOUNT PAID AND PERCENT OF INCOME, BY INCOME CLASS, 1979 DOLLARS

Income Class	Age Group	Amount Paid		As Percent of Income		Percent
		Old Tax	With Services	Old Tax	With Services	Change
$0-$4,999	65+	135	179	3.8	5.0	32.6
	Under 65	130	166	4.4	5.6	27.7
$5,000-$9,999	65+	182	235	2.6	3.4	29.1
	Under 65	169	213	2.2	2.8	26.0
$10,000-$14,999	65+	252	309	2.0	2.5	22.6
	Under 65	224	277	1.8	2.2	23.7
$15,000-$19,999	65+	225	283	1.3	1.6	25.8
	Under 65	308	373	1.8	2.2	21.1
$20,000-$24,999	65+	364	450	1.6	2.0	23.6
	Under 65	378	467	1.7	2.1	23.5
$25,000-$34,999	65+	435	530	1.5	1.8	21.8
	Under 65	473	574	1.6	1.9	21.4
$35,000-$49,999	65+	598	716	1.5	1.8	19.7
	Under 65	548	680	1.3	1.6	24.1
$50,000+	65+	733	869	1.1	1.3	18.6
	Under 65	771	1,039	1.2	1.6	34.8
All		310	382	1.7	2.1	23.2

Source: William J. Shelley, W. G. Bell, and W. J. Serow, *Measuring the Impact of a State's Tax Structure on an Elderly Population*, Tallahassee, 1986.

Administration (Low)

A tax on services is more difficult to administer and audit than a tax on tangible personal property. Auditing the tax on tangible personal property is easier since property is not consumed immediately and can be located, whereas services are consumed when sold. Determining the location and source of the service provided, especially for "imported" services, is difficult and controversial. Charging a "use tax" for services provided by out-of-state parents to in-state firms is also problematic.

Compliance (Medium)

Initial compliance with the 1987 tax on services was not very good because of the complexity of the law and the remaining exemption of many services. Since the tax applied to the purchases of out-of-state parents of Florida corporations or divisions, much confusion resulted over what was taxable and how it should be allocated to Florida. The new method of taxing construction based on total cost was also confusing. However, if the tax on services had not been repealed, compliance would have increased as taxpayers became more knowledgeable about the tax.

Because many providers of services are small, barter arrangements are likely to develop in order to escape the tax. There is no doubt that a tax on services is more difficult to comply with than a tax on tangible personal property.

Exportability (Medium)

Like a sales tax on goods, there would be opportunities to export some of the consumer service tax to nonresidents and tourists. The burden could be exported when services are sold to nonresidents or when the services tax cost is passed on in an exported product.

Efficiency (Medium)

Taxing services purchased by consumers eliminates the incentive to purchase services over goods. Taxing both goods and services is a backdoor approach to taxing income less savings.

A tax on business services would be highly inefficient. Just as with the sales tax on goods, tax pyramiding would result from taxing services purchased by businesses. Taxing business purchases would encourage businesses to avoid the tax by performing services "in-house" (e.g., hiring janitors rather than a janitorial service).

Growth (Medium)

The ability of the tax to grow over time depends on the tax base. Taxing services to any extent increases the ability of sales tax revenues to reflect economic activity more accurately, because more sectors of the economy are captured. The services covered by Florida's services tax legislation offered no greater prospects for growth than did those covered by the sales tax on goods. Most of the high-growth-rate services were exempted—medical services, financial services, insurance, real estate brokers, and others.

Although business services should not be taxed because of pyramiding, frequent sales tax rate increases are likely if they are exempt, because the remaining consumer services tax base is quite small.

Diversity (High)

Adding services to the sales tax base has the potential to broaden and diversify the sales tax base. Again, the extent of the diversification depends on the number of exemptions.

Neutrality (Medium)

Taxing business services would have different effects across industries. Tax pyramiding would cause the cost of some businesses to increase more than others. Tables VI-3 and VI-4 illustrate the impact of the services tax on major industries. Table VI-3 shows which industries purchase various types of services, suggesting that the initial impact of the tax varies across industries. Table VI-4 compares the tax on services with other potential tax bases. Larger firms can avoid the tax by performing the service "in-house" unless a use tax is imposed on self-provided services.

Pro-investment (Medium)

Taxing services has a mixed effect on investment. On one hand, taxing the *consumption* of services and goods increases the attractiveness of savings and investment. Also, since services have been underpriced relative to capital goods, taxing services might encourage investment. On the other hand, taxing financial services will increase the cost of capital and thus discourage investment.

Personal Income Tax

The individual income tax ranks second to the sales tax as a producer of state revenue, raising from 24% to 30% of total tax receipts between 1976 and 1984. Forty-five states and the District of Columbia levy a personal income tax. Forty-two states and the District impose broad-based personal income taxes. The remaining three states have more limited tax bases, such as capital gains, dividends, and interest. Eight states levy a flat-rate tax; the rest use incremental tax rate schedules.

Florida has a constitutional provision that effectively prohibits the levying of a personal income tax. A 1% levy against Florida's federal tax liability in 1989-90 would have raised $292 million. In that same period, a 1% levy against federal adjusted gross income (the more common tax base) would have raised $1.7 billion.

The main attributes of the income tax are its ability to grow with the economy and its progressivity. Although the income responsiveness of the tax makes it sensitive to economic cycles, it is not as unstable as the retail sales tax. At high levels, the income tax may discourage work or encourage tax evasion.

Table VI-3

PERCENT DISTRIBUTION OF EXPENDITURES FOR SELECTED SERVICES BY MAJOR INDUSTRIES

Industry	Motor Freight	Nonbank Financial	Banking	Insurance	Computer Services	Advertising	Legal Services	Engineering	Accounting Services	Other Business Services
Agriculture	3.2	1.7	5.0	4.9	0.2	0.2	0.9	0.0	1.2	2.4
Mining										
Chemical Mining	0.0	0.1	0.5	0.1	0.0	0.0	0.0	0.1	0.0	0.1
Other Mining	0.5	1.0	1.8	1.1	1.9	0.4	0.4	0.3	0.6	1.8
Construction										
New Construction	8.5	0.1	4.0	7.2	2.4	0.0	0.0	77.7	1.3	4.6
Other Construction	3.2	0.0	1.7	1.0	0.6	0.0	0.0	0.0	0.5	1.9
Manufacturing										
Food & Kindred Products	6.9	1.2	2.4	2.0	1.5	8.6	1.3	0.6	2.0	2.3
Apparel	0.5	1.8	0.3	0.4	0.1	0.7	0.5	0.1	0.7	0.8
Printing, Publishing	1.2	1.1	1.3	1.0	3.3	2.1	1.8	0.1	1.5	2.4
Other Manufacturing	30.4	10.6	20.8	12.1	20.2	24.6	12.4	11.2	17.2	24.0
Transport & Warehousing	20.6	4.1	3.1	6.1	4.9	1.9	3.2	0.0	2.2	4.4
Telephone Service	0.4	1.1	1.1	0.6	1.7	0.4	0.6	0.0	0.4	1.6
Radio & TV	0.0	0.0	0.3	0.1	0.1	0.2	0.3	0.0	0.2	0.3
Utilities - Electric, Gas	0.8	3.5	2.1	1.0	2.2	0.4	1.1	0.0	1.2	0.7
Wholesale Trade	10.1	3.0	7.9	7.6	5.5	9.4	10.6	1.2	26.2	12.3
Retail Trade	3.1	0.7	6.9	9.7	4.2	24.4	26.1	0.0	9.2	5.9
Finance & Insurance										
Banking	0.3	12.9	6.6	0.6	16.7	2.6	4.1	0.0	3.8	1.4
Nonbank Financial	0.1	18.0	7.3	0.5	2.6	0.9	2.8	0.0	3.2	1.7
Insurance	0.6	12.1	4.2	1.0	3.9	1.3	4.2	0.0	2.4	1.0
Real Estate	0.1	9.1	12.8	26.3	0.2	4.7	11.3	1.4	1.1	4.6
Personal & Repair Service	0.2	3.8	0.6	0.7	1.2	1.0	1.5	0.0	1.2	0.8
Business Services	1.1	2.3	3.4	3.2	15.7	3.3	5.7	5.9	8.5	8.3
Tourism										
Lodging	0.1	2.7	0.4	1.2	0.0	0.8	0.7	0.0	0.5	1.3
Eating & Drinking Places	2.4	6.3	1.6	1.8	0.6	2.9	2.0	0.0	3.4	3.3
Amusements	0.5	0.1	0.9	1.4	0.3	2.2	1.0	0.0	2.4	1.6
Other Industries	5.1	2.8	3.0	8.3	9.9	6.9	7.5	1.3	9.2	10.7
All Industries	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Table VI-4

REVENUE FROM EXPANDED SALES TAX ON MAJOR SERVICES, AND EQUIVALENT TAX ON PURCHASES, LABOR, AND VALUE ADDED BY INDUSTRY PAYING TAX (MILLIONS OF DOLLARS)

	Tax on				
Industry	Services	Purchases	Labor	Value* Added	Output
Agriculture	$481.4	$496.1	$108.4	$449.0	$369.5
Mining					
Chemical Mining	7.0	6.4	4.0	7.5	3.6
Other Mining	131.7	164.8	457.9	293.2	202.6
Construction					
New Construction	951.6	718.5	545.0	668.5	543.5
Other Construction	149.7	220.8	298.2	130.3	209.9
Manufacturing					
Food & Kindred Products	406.0	850.7	236.7	647.1	539.2
Apparel	61.8	159.7	111.7	146.1	118.1
Printing, Publishing	181.7	162.9	155.4	174.9	142.5
Other Manufacturing	2,248.7	4,990.7	2,432.2	3,136.4	3,836.4
Transport & Warehousing	634.8	337.6	462.7	431.4	359.7
Telephone Service	87.9	64.9	171.3	167.4	150.7
Radio & TV	19.8	23.3	25.6	30.4	24.1
Utilities - Electric, Gas	105.8	373.9	112.0	356.6	300.9
Wholesale Trade	1,050.8	354.9	690.4	582.7	547.1
Retail Trade	967.1	318.3	821.1	590.0	548.5
Finance & Insurance					
Banking	344.3	83.9	167.0	107.1	128.0
Nonbank Financial	265.1	54.5	112.4	29.2	51.9
Insurance	121.9	174.7	212.0	120.9	188.4
Real Estate	689.3	356.3	62.3	807.9	786.4
Personal & Repair Service	96.0	82.9	105.2	118.3	89.1
Business Services	582.9	218.7	496.5	471.8	383.6
Tourism					
Lodging	70.3	19.6	50.7	40.0	43.2
Eating & Drinking Places	259.3	294.4	243.2	292.7	245.2
Amusements	132.6	73.1	66.8	82.1	70.0
Other Industries	1,038.0	480.3	2,933.2	1,206.8	1,195.7
All Industries	$11,085.0	$11,081.6	$11,081.9	$11,088.4	$11,077.8

*Value Added = Total receipts less purchases of goods and services.

Equity

Ability to pay (High)

With the personal income tax, the question of tax burden is simple. The person whose income is taxed bears the full burden of the tax, after allowing for federal income tax deductibility. The personal income tax is often considered the fairest of the three main taxes (income, sales, and property), because income is believed to be the best single indicator of the ability to pay taxes.

The personal income tax is the only major source of progressivity in the state-local tax system, often serving to moderate the regressivity of the sales and property taxes. The tax is progressive if the ratio of taxes paid to income rises as income increases. In practice, most state income taxes are progressive and became more so during the 1980s. Wide variation in the use and design of the tax, however, makes for wide variation in the degree of progressivity. The degree of progressivity depends on the scope of the base; deductions, exemptions, and credits; marginal tax rates; linkages with the federal tax system; and whether adjusted gross income or federal tax liability is taxed.

The tax satisfies horizontal equity best when the tax base is broad. Deductions (e.g., for homeowners) can lead to different tax burdens for families with similar incomes but different earning or spending patterns.

Benefits received (Low)

The personal income tax is not explicitly related to benefits received. To the extent that a progressive income tax is used as a means of income redistribution, taxpayers with low or no income may receive government benefits far in excess of their financial contribution.

Stability (Medium)

Because income tax revenues parallel the cycles of the economy, they are unstable in the short run. They are, however, less susceptible to swings in the economy than the retail sales tax.

Administration (High)

The income tax is easy to administer when based on federal adjusted gross income or on federal tax liability. This conformity also allows states to use IRS assistance in enforcing collection of state income taxes. Forecasting of state income tax revenue becomes tied to that of federal income tax revenue.

Half of the states with personal income taxes tied to federal definitions of adjusted gross or taxable income conform automatically to changes at the federal level. The rest update periodically through legislative procedure.

Compliance (High)

The income tax is easy to comply with when based on federal adjusted gross income or on federal tax liability.

Exportability (High)

The personal income tax is exportable because it is deductible for purposes of the federal income tax.

Efficiency (Medium)

A proportional income tax (one rate for all filers) is the most efficient; that is, it does not significantly distort the workings of the marketplace. Although the tax does reduce income, it does not change the relative income position of taxpayers or the pattern of spending.

Progressive income taxes are less efficient, because they "interfere" in the normal operation of the economy. (Such interference may, of course, be desirable for equity or other objectives.) The tax changes the pattern of income distribution, alters relative prices, reduces the rate of investment because it falls more heavily on savings than on consumption, changes the work/leisure trade-off, and increases the difficulty of moving from low- to high-income status.

Exceptionally high state income taxes may affect the location decisions of middle- and upper-income individuals and businesses.

Growth (High)

Over time, revenues from state income taxes typically grow faster than state personal income. The tax has been demonstrated to be elastic; that is, when personal income grows, tax revenue grows proportionally more. The tax's elasticity is generally between 1.1 and 1.6. (If, for example, personal income grows by 10%, revenue will grow between 11% and 16%.)

This wide variation in growth patterns exists because states define tax bases differently. Revenue growth from an income tax with progressive rates, for example, will be more responsive to income growth than that from a flat-rate income tax.

Diversity (High)

States narrow the base of the income tax by having deductions that are more generous than those allowed by the federal income tax. Note that the base of the personal income tax is broader than that of the retail sales tax, since the income tax taxes income generated in the production of both goods and services.

Most importantly, the presence of the income tax diversifies a state's tax structure away from a focus on the consumption base. The personal income tax can offset the negative characteristics of the sales tax: slow long-term growth, tremendous short-run fluctuation, and strong regressivity.

Neutrality (High)

Historically, the income tax has been far from neutral in its impact across industries. Special deductions from the income tax base provided indirect subsidies to certain industries, most notably the construction, food and entertainment, and financial services industries.

By eliminating most of these provisions, the federal tax reform of 1986 broadened the base and improved the neutrality of the personal income tax. The deduction for interest on mortgage payments on residential housing remains at both the federal and state levels.

Pro-investment (Medium)

By reducing the financial rewards of greater work effort, the personal income tax could discourage work (substitution effect). On the other hand, the tax may actually provide a greater incentive to obtain more income because it reduces income left for spending (income effect). Evidence suggests that, in the aggregate, the substitution effect may be stronger than the income effect, but that the substitution effect applies primarily to secondary, rather than primary, wage earners in a family. (The reason is that work habits are not easily changed, and most people have little real opportunity to vary their hours of work or intensity of effort in response to tax rate changes.)

Excessively high personal income tax rates could discourage higher income taxpayers from wanting to work in-state, or encourage them to demand higher pay for doing so. Florida's lack of a personal income tax can be perceived as symbolic of an environment that encourages personal advancement, reward for work efforts, and minimalist government. The absence of the tax has definitely spurred development based on population growth. At the margin, it may have also encouraged risk-taking, both by entrepreneurs and investors, and economic mobility.

Single Business Tax

The Single Business Tax (SBT) is a tax on the value added by a company to the inputs it purchases to make final products and services. Michigan adopted the SBT in 1975 to replace eight other taxes on business.

The SBT embodies many of the goals articulated at the federal level by the Tax Reform Act of 1986. It is a broad-based, low-rate tax which has horizontal equity in the distribution of tax burdens across industries and firms. It is particularly appropriate for states with cyclical economies, states wishing to encourage investment, and states wanting to rid their tax systems of targeted industry provisions and tax pyramiding.

Equity

Ability to pay (Medium)

Determining the ultimate burden of the SBT as it is passed on to consumers, shareholders, workers, or other individuals is nearly impossible, as it is for the corporate income tax.

The SBT has strong horizontal equity among firms because firms of different types (industries) and different organizational forms (corporate vs. noncorporate), that add similar amounts of value as they provide goods and services are treated equally. The tax also promotes fairness because it treats different types of income uniformly (profits vs. interest, distributed vs. undistributed profits).

Benefits received (High)

The SBT scores high on the benefits received criteria of equity, which holds that taxpayers should contribute in line with the benefits they receive from public goods and services. A firm's value added can be considered a reasonable proxy for the benefits it receives from the state and local public sectors, such as fire protection, transportation, and educated workers. Since all business operations, not just corporations, benefit from public services, all should support them. Even firms with no profit, the logic goes, should still pay some taxes for government resources used, just as they still must pay labor, energy, material, and other production costs.

Advocates of the ability to pay principle find this reasoning preposterous. Believing that only firms with profits should pay taxes, they view the corporate income tax as more equitable. Compared to the corporate profits tax, an SBT in pure form is likely to increase the tax burden on unincorporated, labor-intensive, and low-profit businesses.

To promote equity, Michigan has introduced an ability-to-pay element into its SBT by creating some special exemptions, deductions, and credits for small, low-profit, and labor-intensive businesses:

- *Accommodation for small businesses*—Michigan designed a statutory exemption to remove the majority of small businesses from the SBT. The exemption equals $40,000, but is phased out at the rate of $2 to $1 of total business income. The fact that the exemption is negatively related to profits maintains a profit-sensitive, ability-to-pay element. The exemption was particularly important in reducing taxes in retail trade, construction, agriculture, consumer services, real estate, and other industries characterized by large numbers of small firms.

- *Accommodation for labor-intensive businesses*—Michigan has an excess compensation deduction, which reduces the tax base by the extent to which compensation exceeds 64% of value added. This deduction helps industries with high ratios of compensation to value added, such as retail trade and durable manufacturing.
- *Accommodation for low profit businesses*—In 1977 and 1984, Michigan introduced a low-profit credit equal to 1 minus the ratio of business income to 45% of a firm's value-added base. The credit is available to firms with gross receipts less than $6 million, business income less than $475,000 ($95,000 for individuals), and business income less than 45% of the value-added base.

Reflecting the importance of the accommodations outlined above, in 1982-83 61% of Michigan businesses registered for the SBT either filed no SBT return or had no positive tax liability.

Stability (High)

The SBT demonstrates insignificant short-run swings in revenue relative to other taxes. Through the upturns and downturns of the cyclical Michigan economy, SBT revenues as a share of personal income (and of total state tax revenues) have remained remarkably constant. Many analysts consider this feature desirable, because it means that long-run tax base growth will be stable and moderate—resulting in neither revenue shortages nor excessive public sector revenue from year to year.

There are several reasons for this cyclical stability. The low marginal rates and the diversified base make the tax revenues less sensitive to economic cycles than the corporate income tax. Taxing unincorporated services companies reduces instability because demand for services generally remains strong even during cyclical downturns. The exclusion of capital acquisitions from the tax base is also an important stabilizing factor. Because capital spending is generally procyclical, the exclusion helps moderate the rise and fall of SBT revenues over the business cycle.

Administration (High)

The SBT can be administered via two methods, which will both result in the same value added tax base for a firm.

Under the *additive method*, businesses add their payments to labor (wages, fringe benefits, other compensation) to their payments to capital (profits, interest, dividends, rent, royalties) to determine their tax base. This approach is used by Michigan.

Under the *subtraction method*, companies subtract their cost of inputs (intermediate goods and services, capital purchases) from their gross receipts. The remainder is the value added, which will be exactly the same as the result achieved by using the additive approach. A strength of the subtraction method is that is more closely parallels the subtracting process businesses follow when computing their federal corporate income tax base.

Once established, administration of the SBT is simple. Generally, the rate is uniform and all businesses are required to file. Especially if the SBT provides a way to eliminate miscellaneous taxes (e.g., intangibles tax, documentary stamp tax) or tax industries that currently have special taxes (e.g., telecommunications, banking, insurance), significant administrative simplicity is gained. Transition difficulties will involve educating a broad base of taxpayers. Enforcement is simplified because the data to pay the SBT is taken off of federal tax returns.

The SBT could be problematic to administer for industries whose prices do not accurately reflect the cost of providing services. Examples include banks and insurance companies, where it is often difficult to determine the value added because services are priced below cost. The additive approach, measuring the sum of factor payments rather than the sales revenue-input cost spread, is one way around this problem. Michigan subjects banks and insurance companies to the SBT.

Compliance (High)

Compliance under either method of administration is easy. The information needed to comply is available on the filer's federal tax return or in basic business financial records. If the SBT is administered as a replacement for a variety of business taxes, as happened in Michigan, the SBT can greatly reduce the compliance burden on firms.

Exportability (High)

An attractive feature of the SBT is that it is deductible by business on federal returns and thus exportable to the federal government. The degree to which the tax can be exported to out-of-state firms depends on the treatment of multi-state firms.

Two principles could guide the treatment of multi-state firms. The *origin principle* views the SBT as a benefit tax levied to pay for government goods and services, and assigns tax liability based on share of production in the levying state. The value-added of multistate firms is apportioned on the basis of payroll and property located in the state. The *destination principle* apportions value added on the basis of sales in the state, whether produced by in-state or out-of-state firms.

A variety of hybrid apportionment formulas are of course possible. Michigan uses a three-factor formula (payroll, property, sales) to apportion the tax base of multistate firms. The result outside Michigan and a portion of value added in Michigan is not subject to the SBT. This specific formula is being challenged in court.

Efficiency (High)

Relative to other taxes, the SBT creates few economic distortions over time. The tax avoids pyramiding because inputs are excluded from the tax base. Unlike the corporate income tax, the SBT will not distort a company's decisions about how to raise or invest funds. The tax is neutral as it applies to equity earnings and interest or debt, and to distributed and undistributed income.

The SBT also does not distort a business entity's decision about how to organize itself and affects all industries more equally than the retail sales and corporate income taxes (see *Neutrality*).

Growth (High)

In the long run, SBT revenues grow in proportion to personal income. With no rate or significant base changes, Michigan's SBT revenues have stayed at roughly 1% of state personal income each year.

The broad base means that rates can remain low and change infrequently. Michigan's SBT rate of 2.35% is the same one it enacted in 1975.

Diversity (High)

The SBT base is extremely broad, encompassing corporate and noncorporate entities and all industries.

Neutrality (High)

The broad base means that the SBT is neutral as it applies to corporations, partnerships, and sole proprietorships, and across industries.

The 1986 Tax Reform Act has encouraged change in the way businesses organize. Since the top marginal tax rate for individuals (28%) is below the highest corporate tax rate (34%), businesses have an incentive to shift from a corporate form of organization to partnerships, sole proprietorships, and S corporations. In many states, this change significantly decreased the number of firms paying the corporate income tax. In states with individuals income taxes, this revenue is captured by greater individual income tax collections. In states like Florida with no income tax, these firms escape taxation. entirely.

A large portion of the rapidly expanding service sector is organized in noncorporate form and pays no corporate or personal income tax. In the services sector, over 40% of total business receipts come from unincorporated businesses. In all other industries, unincorporated businesses account for less than 10% of business receipts.

Michigan has found strong neutrality of the SBT across industries. In a study of 1982-83 tax returns, the Michigan Department of Treasury found that, "With the exception of the very smallest and largest firms, the SBT is remarkably neutral in treating equally firms of different types, but of similar size."[15]

Pro-investment (High)

An SBT that excludes new capital investment from the tax base in the year that it is purchased encourages capital spending. Most business and sales tax systems discriminate against capital spending. The SBT tax would effectively restore at the state level the capital investment incentives lost at the federal level. Many firms would have about the same investment incentive created by the combination of the Investment Tax Credit and the accelerated depreciation allowances repealed by the Tax Reform Act. This incentive could be viewed as an important economic development tool.

Inheritance Tax

An inheritance tax taxes wealth transferred to a beneficiary at death. Transfers of wealth in contemplation of death are subject to a gift tax in many states that have estate and inheritance taxes. The typical inheritance tax grants a number of exemptions based on the relationship of the heir to the deceased. The closest relatives of a decendant are generally subject to the lowest rates, and many states exempt distributions to nonprofit organizations. Eighteen states have inheritance taxes instead of estate taxes that exceed the federal credit.

Florida's constitution effectively prohibits the imposition of an inheritance tax. The constitution permits an inheritance tax only if the federal government allows a 100% credit for the Florida levy. The federal government, however, has never levied an inheritance tax, only a creditable estate tax.

Based on other states' collection experience, a Florida inheritance tax probably would produce $150-$200 million yearly.

---

[15]Michigan Department of Treasury, *Analysis of the Michigan Single Business Tax*, p. 7.

Equity

Ability to pay (High)

An inheritance tax is progressive—the majority of the revenue from this tax comes from persons receiving the largest inheritances.[15] The tax is thus one way to offset the general regressivity of most state and local tax systems.

Benefits received (Low)

The tax has no relationship to benefits received.

Stability (Low)

Like the estate tax, inheritance tax revenues are quite unstable. They are difficult to predict and historically have fluctuated widely from one year to the next. Stability could be increased by minimizing the number and level of exemptions allowed for different classes of heirs.

Administration (High)

The inheritance tax is administered in conjunction with an estate tax or the probating of an estate. This collection process makes the tax easier to administer than if the tax were collected after the distribution of the proceeds of an estate.

Compliance (High)

Compliance is simple and problems are minimal if the tax is paid on the distribution of an estate.

Exportability (High)

The portion of the inheritance tax levied on non-Florida heirs is exported. A Florida inheritance tax that covers all heirs should have a relatively high export rate, especially since many Florida residents originally come from out-of-state.

Efficiency (High)

Inheritance taxes are efficient; they do not tax or affect the *relative use* of productive resources. Some inheritances are considered "windfalls" or unexpected income—an ideal but limited source of revenue. A tax on windfall income does not affect the allocation of productive

---

[15] See Carlyn Johnson, "The Indiana Death Tax," in *Indiana's Revenue Structure: Major Components and Issues*, James A Papke, ed. (West Lafayette, Indiana: Purdue University, 1982), pp. 82-89. Cited in Corina Eckl, "Death Taxes," in *Reforming State Tax Systems*, Steven D. Gold, ed. (Denver, Colorado: National Conference of State Legislatures, 1986).

resources, as do most other taxes. Although the economic behavior of individuals receiving inheritances may change (they may decide to work less), this change is induced by receiving the "windfall" income, not by the presence of the tax.

Evidence suggests, however, that the *mere presence* of the tax encourages wealthy people to move to states without inheritance taxes. Studies have found that capital mobility in response to death tax rate increases is substantial.[16]

Growth (High)

Whether the revenue from an inheritance tax will grow as fast as the economy depends on the size of estates, the death rate, and the number and level of exemptions from the tax. If the rate of growth of a Florida inheritance tax tracks the growth rate of the state's estate tax, it will grow more than the economy.

Diversity (Low)

The inheritance tax base is quite narrow; only a small group of people inherit wealth of any kind. For states that have personal income taxes, the inheritance tax represents a way to broaden the tax base. The personal income tax picks up capital gains, while the inheritance picks up a similar type of "windfall" income.

Neutrality (Not Applicable)

Neutrality is not applicable because the inheritance tax does not fall on businesses.

Pro-investment (Medium)

There are two ways in which the inheritance tax could impede investment in Florida. First, if heirs choose to reinvest their inheritance in Florida, the tax diminishes the amount available for reinvestment. Yet note that the tax itself does not affect the decision whether to reinvest in Florida, reinvest elsewhere, or consume.

Second, the presence of the tax might cause people to shift assets out of Florida or discourage them from moving to Florida. To the extent that these people would have invested their assets in Florida financial institutions, property, and companies, capital investment in Florida would be forgone.

---

[16] See John P. Laitner, "The Inheritance Tax," in *Michigan's Fiscal and Economic Structure*, Harvey E. Brazer and Deborah S. Laren, eds. (Ann Arbor: The University of Michigan Press, 1982), p. 666.

VII EXAMPLES OF PRO-COMPETITIVE STRUCTURAL IMPROVEMENTS

Overview

This chapter presents five examples of tax changes that improve the structure of Florida's existing tax system so that it better meets the pro-competitive criteria. These examples are presented to illustrate how the pro-competitive criteria can be used to propose and evaluate potential tax reform changes. The five examples are:

- Example 1: Reform the Existing Tax System
- Example 2: Establish a Services Tax
- Example 3: Create a Single Business Tax
- Example 4: Institute a Personal Income Tax
- Example 5: A Comprehensive Structural Reform.

The first four examples are presented, for purposes of discussion, as being mutually exclusive. The first example attempts to "fix" Florida's current revenue sources to improve the current system's performance. The other three examples make new revenue sources the centerpiece of structural reform. The last example combines some of the strong elements of examples 1 through 4 to offer a more comprehensive example of structural reform.

For each example, there is a discussion of the rationale underlying the changes considered and of the distribution of revenues among different taxes. For discussion purposes, the examples are presented as raising roughly the same amount of state and local revenue as Florida's current system will raise in 1990-91 (see Exhibit VII-A on revenue neutrality).

All examples do make structural improvements over Florida's overall tax system, though to varying degrees. Table VII-1 compares the structural characteristics of each example with those of Florida's existing tax system.

Exhibit VII-A
REVENUE ASSUMPTIONS:
REVENUE NEUTRAL IN SHORT TERM, NEED FOR GROWTH OVER LONG TERM

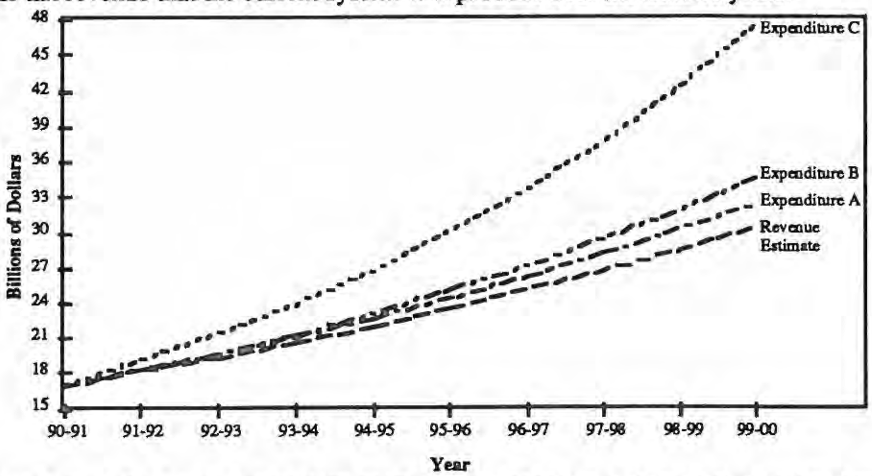
The most fundamental premise of this project is that Florida needs tax reform to create a pro-competitive fiscal foundation—one creating a sound environment for investment by Florida's public and private sectors. The project argues that there are more pro-competitive ways to raise revenues, given any level of expenditures that is required. The focus, therefore, is on the need for basic structural reform, not immediate increases or decreases in tax rates or revenue.

Short-Run Revenue Neutrality

For purposes of discussion, the examples of structural change presented below follow the general principle of short-run revenue neutrality. *Revenue neutrality means that each tax example is presented to raise roughly the same amount that Florida's combined state and local tax systems are anticipated to raise in 1990-91.* The examples, therefore, are presented as better ways to raise the revenues required to meet current expenditures, not as means for raising additional revenue next year.

Need for Long-Term Growth

From a longer-term perspective, Florida's revenue system does need to grow with the economy over time. The figure below, first presented in Chapter IV, provides alternative ways to look at state tax estimates during the decade of the 1990s. The lowest line reflects the projections for tax revenue that the current system will produce over the next 10 years.



PROJECTED STATE REVENUE AND ALTERNATIVE EXPENDITURE LEVELS, FY 1990-91 TO FY 1999-2000

Revenue estimates quickly fall below the three alternative expenditure levels. *Expenditure A*, the most conservative estimate, assumes no real increase in per household expenditures. *Expenditure B* assumes that state expenditures as a share of personal income do not climb above the 1990 level—6.72%. *Expenditure C* assumes that increases in expenditures during the 1990s will occur at the average annual growth rate of the 1980s—12.1%. By the year 2000, the $30 billion raised by the current system is far below all spending levels.

Florida's current revenue system faces the real possibility of a continuing structural deficit in relation to expenditure growth in the 1990s. From a "pro-competitive" standpoint, there are several long-term solutions to this structural problem. First, steps should continuously be taken to ensure that government spending is efficient, effective, and accountable. Cost-effectiveness principles should be applied to every dollar spent by government to ensure that scarce economic resources at not wasted.

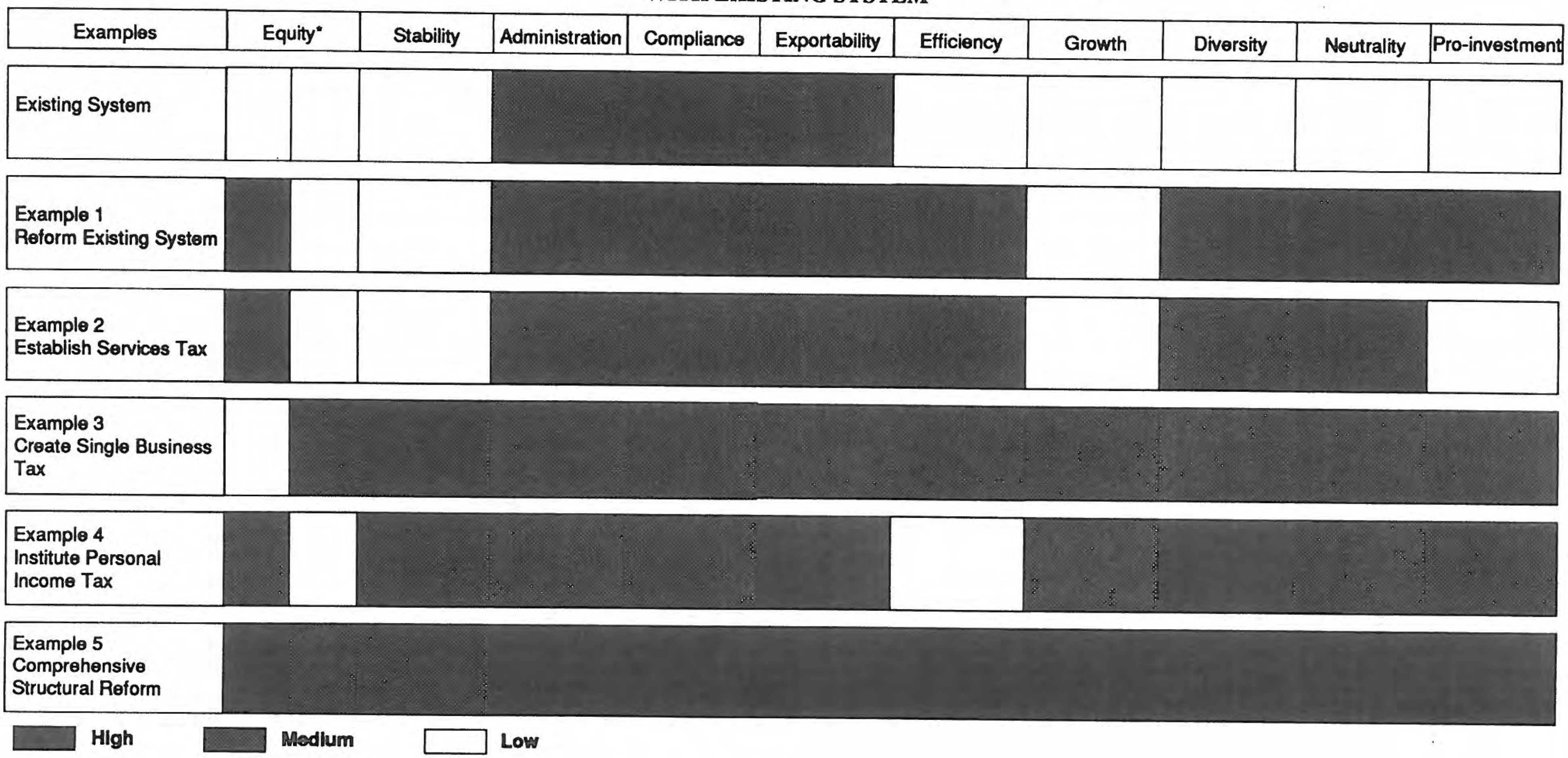
Second, the state's tax structure needs to be reformed so that tax revenues grow in proportion to growth of the economy. Meeting the pro-competitive "growth" criterion will ensure that revenue rises with Florida's economic activity, avoiding the need for frequent tax rate increases.

In 1991, Florida's legislature again will face a significant revenue shortfall resulting from both this long-term structural problem and a short-term downturn in the economy. On the expenditure side, the cost of government services funded in 1989-90 will increase because of inflation, legal requirements to provide basic services, population growth, and increased federal requirements. On the revenue side, the tax changes made in 1990 did not create a tax system that can keep pace with growth of the economy.

Instead of another patchwork solution to Florida's yearly budget crisis, the Florida legislature has the opportunity to both meet 1990-91 revenue needs and set the tax system on a course that grows with Florida's economy through fundamental structural reform.

Table VII-1

COMPARISON OF ALTERNATIVE STRUCTURAL CHANGES WITH EXISTING SYSTEM



*Equity is judged on both "ability to pay" (left box) and "benefits received" (right box) principles.

Example 1: Reform the Existing System

The first example is to reform Florida's existing revenue sources so that they better meet the pro-competitive criteria. Chapter V evaluated each of Florida's major state and local taxes to determine their strengths and weakness in contributing to a pro-competitive tax system. Table VII-2 summarizes this analysis and provides an overall evaluation of Florida's existing tax system. Weaknesses in Florida's current taxes, including major revenue raisers, contribute to the failure of Florida's overall state and local system to rank high on the pro-competitive criteria.

To reform Florida's current system would entail making four significant changes to Florida's sales and property taxes, and a host of changes to Florida's other revenue sources.

The four significant changes include:

- *Tax goods that currently are exempt from the sales tax*—Broaden the tax base, and improve stability and neutrality by taxing goods currently exempt from the sales tax.
- *Minimize multiple layers of sales taxation*—Substantially improve efficiency (reduce pyramiding) and pro-investment by exempting business purchases of machinery and equipment, electricity, and telecommunication services.
- *Assess property at market value*—Broaden the tax base and improve neutrality, equity, and administration by assessing all property at full market value.
- *Eliminate the homestead and personal property exemptions*—Broaden the tax base and improve efficiency and neutrality by eliminating the homestead exemption and taxing certain types of personal property currently exempt under the constitution. (Contitituional amendment to Article VII, Section 6 required).

In addition to these changes, a variety of less significant improvements could be made to each of Florida's existing taxes. Appendix C provides a summary and rationale of the specific changes that could be made to each tax to improve its ability to contribute positively to a marginally more pro-competitive system. All suggested changes follow from pro-competitive weaknesses identified for each tax in Chapter V.

The fundamental problem with this approach is that, after undertaking numerous specific reforms, the effect of the major and minor changes in individual taxes on the pro-competitiveness of the overall tax system is at best marginal .

Table VII-3 shows how Florida's current revenue sources, when reshaped into their most pro-competitive form, result in only five marginal improvements to Florida's overall tax structure:

- Equity increases from low to medium.
- Efficiency increases from low to medium.
- Diversity increases from low to medium.
- Neutrality increases from low to medium.
- Pro-investment increases from low to medium.

In addition to the lack of significant improvement in any criterion, the fact that this alternative results in no improvement to the growth criterion is cause for its rejection.

The changes examined in this example create a state tax system that raises an amount of revenue similar to what the current system will raise in 1990-91 (see again Table VII-3). The changes affecting local taxes increase revenues from $16.9 billion to $21.1 billion. To maintain revenue neutrality, millage rate reductions could be used to compensate for the expanded property tax base and decrease the amount of new revenue raised at the local level.

Table VII-2

SUMMARY
ASSESSMENT OF FLORIDA'S EXISTING TAX SYSTEM

Revenue Sources	Criteria: Equity* (ability to pay)	Equity* (benefits received)	Stability	Administration	Compliance	Exportability	Efficiency	Growth	Diversity	Neutrality	Pro-investment	1990-91 Revenue (billions): State	Local
Sales Tax												$8.3b	—
Property Tax												—	9.3
Corporate Income Tax												.825	—
Intangibles Tax												.543	—
Documentary Stamp Tax												.548	—
User Fees	N.A.		N.A.					N.A.				—	6.2
Special Assessments	N.A.		N.A.					N.A.				—	.194
Impact Fees			N.A.					N.A.				—	.045
Estate Tax										N.A.		.260	—
Utilities Taxes												.336	1.2
Other State Taxes**												5.8	—
Overall State*** and Local System												$16.6b	$16.9b

High Medium Low N.A. = Not applicable

* Equity is judged on both "ability to pay" (left box) and "benefits received" (right box) principles.

** Other state taxes include alcohol and cigarette taxes, severance taxes, the lottery, unemployment taxes, and miscellaneous taxes.

*** The overall rankings are not the sum of each criterion, but an evaluation that takes into account the share of total revenue raised by each tax.

Table VII-3

SUMMARY OF EXAMPLE 1
REFORM THE EXISTING SYSTEM

Revenue Sources	Criteria: Equity*		Stability	Administration	Compliance	Exportability	Efficiency	Growth	Diversity	Neutrality	Pro-investment	1990-91 Revenue (billions): State	Local
Sales Tax												$7.9b	—
Property Tax [1]												—	13.5
Corporate Income Tax												1.2	—
Intangibles Tax												.494	—
Documentary Stamp Tax												.588	—
User Fees	N.A.		N.A.					N.A.				—	6.2
Special Assessments	N.A.		N.A.					N.A.				—	.194
Impact Fees			N.A.					N.A.				—	.045
Estate and Inheritance Taxes										N.A.		.475	—
Utilities Taxes												.336	1.2
Other State Taxes**												5.8	
Overall State*** and Local System												$16.8b	$21.1b[1]

High — Medium — Low — N.A. = Not applicable

* Equity is judged on both "ability to pay" (left box) and "benefits received" (right box) principles.

** Other state taxes include alcohol and cigarette taxes, severance taxes, the lottery, unemployment taxes, and miscellaneous taxes.

*** The overall rankings are not the sum of each criterion, but an evaluation that takes into account the share of total revenue raised by each tax.

[1] Millage reductions could be used to compensate for the revenue-raising effects of an expanded property tax base.

Example 2: Establish a Services Tax Without Pyramiding

In 1987, Florida became the first state in recent history to enact a significant tax on services. Although the services tax legislation was subsequently repealed, interest remains in taxing Florida's large, growing service sector. Recent debate about revisiting a services tax focuses on the most appropriate base for the tax—especially in light of Massachusetts' controversial decision in spring of 1990 to levy a tax on business services.

This example has three key elements:

- *Tax all services*—Tax all services not currently subject to the sales tax (except medical services, education services, and employment services).
- *Minimize services tax pyramiding*—Exempt services used to produce final goods and services that are subject to the sales tax.
- *Tax insurance and financial services*—Tax insurance and financial services purchased by consumers under the use tax. Repeal the insurance premium tax.

Taxing services improves the the sales tax's neutrality, equity, and diversity. The base of the current retail sales tax is broadened, recognizing the growing importance that the service sector plays in Florida's economy. Taxing services levels the playing field among businesses and removes distortions in purchasing decisions. There are moderate improvements in minimizing regressivity. Although administrative problems will occur during start-up, these will be minimal over time.

Exempting services used to produce final goods and services maximizes efficiency, but decreases the potential scope of the tax base. These services are exempt from taxation to avoid tax pyramiding—an inefficient situation where consumers pay sales tax on a base that includes sales tax paid by companies for intermediate services. Taxing these services could also create incentives for companies to bring services in-house (e.g., hiring staff instead of contracting out). The trade-off from exempting some services is, however, quite large. Total business purchases of services account for over two-thirds of service purchases.

Taxing insurance and financial services under the use tax improves neutrality. The use tax provides a method for taxing these services, which were exempted from the 1987 services tax. For insurance, the tax base would be the cost of providing insurance, rather than the value of the premiums. The insurance premium tax would then be repealed so that insurance is not subject to more than one tax.

By itself, instituting this version of a services tax leads to only modest improvements over Florida's existing system. Table VII-4 shows that adding the services tax results in the following changes to Florida's overall tax system:

- "Ability to pay" equity increases from low to medium.
- Efficiency increases from low to medium.
- Diversity increases from low to medium.
- Neutrality increases from low to medium.

There is no improvement in the growth and stability of the overall system because the services tax taps a relatively unstable, low-growth base—consumption.

Adding a services tax without pyramiding to Florida's existing tax system brings a modest net gain of $1.2 billion in revenue. This figure is arrived at as follows:

Tax all services	$3.757 billion
Minimize pyramiding	(2.162 billion)
Repeal insurance premium tax	(.216 billion)
Net gain	$1.379 billion

To add this version of the services tax in a revenue-neutral manner, the sales tax on goods and services could be reduced by three-quarters of a percentage point.

Compared with other services tax proposals, this version is relatively "pure" because it minimizes pyramiding. Other proposals suggest taxing all services or only those purchased by business. Although these proposals would raise more revenue than a services tax without pyramiding, they would increase the inefficiency of the existing system.

Yet merely adding this nonpyramiding version of the services tax to the existing system proves to be a "second-best" solution, because pyramiding remains in the sales tax on goods. From a pro-competitive standpoint, the best type of consumption tax would be a broad-based tax on final purchases of both goods and services. Such a tax would encourage savings, foster a level-playing field between goods and services, and be highly efficient.

Table VII-4

SUMMARY OF EXAMPLE 2
ESTABLISH A SERVICES TAX

Revenue Sources	Criteria: Equity* (ability to pay)	Equity* (benefits received)	Stability	Administration	Compliance	Exportability	Efficiency	Growth	Diversity	Neutrality	Pro-investment	1990-91 Revenue (billions): State	Local
Sales Tax on Goods & Services												$9.7b	—
Property Tax												—	9.3
Corporate Income Tax												.825	—
Intangibles Tax												.543	—
Documentary Stamp Tax												.548	—
User Fees	N.A.		N.A.					N.A.				—	6.2
Special Assessments	N.A.		N.A.					N.A.				—	.194
Impact Fees			N.A.					N.A.				—	.045
Estate Tax										N.A.		.260	—
Utilities Taxes												.336	1.2
Other State Taxes**												5.8	
Overall State*** and Local System												$18.0b	$16.9b

High   Medium   Low   N.A. = Not applicable

* Equity is judged on both "ability to pay" (left box) and "benefits received" (right box) principles.

** Other state taxes include alcohol and cigarette taxes, severance taxes, the lottery, unemployment taxes, and miscellaneous taxes.

*** The overall rankings are not the sum of each criterion, but an evaluation that takes into account the share of total revenue raised by each tax.

Example 3: Create a Single Business Tax

Example 3 centers around the establishment of a Single Business Tax (SBT), similar to the one used by Michigan. The SBT would be levied annually on the value added by businesses. Five other taxes on business would then be eliminated and the SBT rate would be set to be revenue neutral. The creation of the SBT would significantly increase the stability, growth, neutrality, diversity, and pro-investment characteristics of the current tax system.

The key elements of this example are as follows:

- *Impose a Single Business Tax*—Florida would establish a single tax on business activity, similar to Michigan's Single Business Tax.
- *Eliminate 5 taxes on business*—Florida would eliminate the state corporate income tax; the retail sales tax paid by businesses on machinery, equipment, and utility services; the intangibles tax; the documentary stamp tax on documents other than deeds; and the insurance premium tax.

Description and Rationale

The SBT is an annual tax on the value that businesses add to goods and service inputs purchased from other businesses or government. In essence, value added is the difference between cost of inputs and the price that a good or service commands on the market. Technically, value added is defined as payments to capital (profits, interest, rents, and royalties) and payments to labor (wages, salaries, fringe benefits, other compensation). All of this information is available on companies' federal corporate income tax forms, and state SBT payments are deductible for federal tax purposes.

The only state to adopt such tax, Michigan established its SBT in 1976 primarily to find a more stable source of revenue for its cyclical economy. Many countries have a value-added tax at the national level, but these are taxes on final consumer expenditures (similar to a retail goods and services tax), rather than a tax paid by business.

The SBT is proposed because it has several unique characteristics:

- *Grows in proportion to economic activity*—In the long run, SBT revenues grow in proportion to personal income. With no rate or base changes, Michigan's SBT revenues have stayed at roughly 1% of state personal income each year. Had Florida had an SBT over the last 10 years, frequent changes in rates and bases of taxes affecting business would not have been necessary.
- *Promotes investment in capital*—The SBT promotes new capital investment because capital expenditures for real and personal property are excluded from the tax base, effectively reducing tax liability in the year in which they occur. The SBT provides firms with approximately the same capital investment incentives created by the combination of the

federal Investment Tax Credit and the accelerated depreciation allowances repealed by the Tax Reform Act of 1986.

- *Has minimal fluctuation in revenue from year to year*—With minimal fluctuation from year to year, the SBT is particularly appropriate for states with cyclical economies. The tax has moderate short-run swings in revenue because its base is broader than profits. Also, the deduction of capital expenditure acts as a built-in stabilizer, because capital spending is pro-cyclical.
- *Promotes neutrality*—The SBT is neutral in treating firms from different industries equally. All companies, service and goods providers, incorporated and unincorporated, are subject to the SBT. The tax has a remarkable degree of horizontal equity in the distribution of tax burdens across industries.
- *Simple compliance and administration*—The broad base of the tax means that the same amount of revenue can be raised from *a low-rate SBT* as can be raised from *5 existing business taxes*. Although transition to an SBT may bring difficulties in the short-run, business compliance and state administrative burdens would be reduced significantly over the long-run.

This last characteristic of the SBT raises concern about equity for small and labor-intensive businesses. In addition, firms with low profits, or even losses, would still be subject to the SBT on compensation and the other components of value added. Florida could depart from the pure form of the SBT, as Michigan has, and create some special exemptions that promote equity:

- *Accommodation for small businesses*—Michigan designed a statutory exemption to remove the majority of small businesses from the SBT. The exemption equals $40,000, but is phased out at the rate of $2 to $1 of total business income. The fact that the exemption is negatively related to profits maintains a profit-sensitive, ability-to-pay element. The exemption was particularly important in reducing taxes in retail trade, construction, agriculture, services, real estate, and other industries characterized by large numbers of small firms.
- *Accommodation for labor-intensive businesses*—Michigan has an excess compensation deduction, which reduces the tax base by the extent to which compensation exceeds 64% of value added. This deduction helps industries with high ratios of compensation to value added, such as retail trade and durable manufacturing.
- *Accommodation for low profit*—In 1977 and 1984, Michigan introduced a low-profit credit equal to 1 minus the ratio of business income to 45% of a firm's value-added base. The credit is available to firms with gross receipts less than $6 million, business income less than $475,000 ($95,000 for individuals), and business income less than 45% of the value-added base.

Although the introduction of these ability-to-pay factors undermines the pure nature of the SBT, the characteristics inherent in the tax make it a better business tax than the other traditional taxes on business.

A final issue regarding the SBT concerns the tax treatment of multistate firms. Two principles could underlie the design of an SBT. The *origin principle* views the SBT as a benefit tax levied to pay for government goods and services, and assigns tax liability based on production in the state. The value-added tax base of multistate firms is apportioned on the basis of payroll and property located in the state. The *destination principle* apportions value added on the basis of sales in the state, whether produced by in-state or out-of-state firms.

Michigan uses a three-factor formula (payroll, property, and sales) to apportion the tax base for multistate firms. The result is that a portion of the value added of multistate firms attributed to Michigan reflects production outside Michigan and a portion of value added in Michigan is not subject to the SBT. This formula has recently been challenged in court.

If an SBT were established, Florida's corporate income tax would be repealed to avoid taxing corporate profits twice. Gone with the corporate income tax would be its negative qualities: cyclical instability, narrow base, unequal treatment across industries and types of firms, and its investment disincentive.

Companies would also be exempt from paying sales tax on their purchases of machinery, equipment, and utility services. This would eliminate tax pyramiding and disincentives to invest. Repealing the intangibles tax would yet eliminate its low neutrality caused by taxing accounts receivables and its many exemptions. Repealing the documentary stamp tax on documents other than deeds eliminates its lack of neutrality and reduces compliance and administrative burdens. (The documentary stamp tax on deeds would remain. Revenues "lost" by eliminating the intangibles tax on mortgages could be made up by a higher documentary stamp tax rate on deeds). The insurance premiums tax is repealed because insurance companies would pay the SBT.

Revenue Implications

Florida's SBT rate could be chosen to be revenue neutral.[17] Assuming that Florida's value-added base in 1990 is approximately $160 billion, a tax rate of approximately 2.4% would allow a revenue-neutral substitution for the corporate income tax, intangibles tax, sales tax on utility services and machinery and equipment, documentary stamp tax, and insurance premium tax (see Table VII-5). This rate is figured on a minimal tax base because it does not include the tax base of out-of-state firms that would be included under the destination principle. To make a revenue-neutral substitution, the actual rate probably would be lower.

[17]Michigan's rate of 2.35% was chosen in 1976 to achieve a revenue-neutral substitution of tax sources. The broad base of the tax has allowed the rate to stay the same since the tax was enacted in 1976.

Effects on Florida's Tax Structure

Table VII-5 shows the effects of this example on Florida's overall tax structure. The establishment of an SBT and the elimination of the 5 taxes paid by business would have the following effects:

- Benefits received equity increases from low to medium.
- Stability increases from low to medium.
- Efficiency increases from low to medium.
- Growth increases from low to medium.
- Diversity increases from low to medium.
- Neutrality increases from low to medium.
- Pro-investment increases from low to medium.

Compared with the first two examples, this SBT example is the first to bring improvement in stability and growth. There is no improvement in ability-to-pay equity, however, because this tax is not levied on individuals.

Although adding an SBT to Florida's existing tax system brings important improvements to six criteria for a pro-competitive tax system, including stability and growth, it does not by itself move any criterion toward a "high" ranking because SBT revenues account for a small share of total revenue relative to the sales and property taxes.

Table VII-5

SUMMARY OF EXAMPLE 3
CREATE A SINGLE BUSINESS TAX

Revenue Sources	Criteria: Equity* (ability to pay)	Equity* (benefits received)	Stability	Administration	Compliance	Exportability	Efficiency	Growth	Diversity	Neutrality	Pro-investment	1990-91 Revenue (billions): State	Local
Sales Tax												$6.3b	—
Property Tax												—	9.3
Single Business Tax												4.3	—
Documentary Stamp Tax on Deeds												.420	—
User Fees	N.A.		N.A.					N.A.				—	6.2
Special Assessments	N.A.		N.A.					N.A.				—	.194
Impact Fees			N.A.					N.A.				—	.045
Estate Tax										N.A.		.260	—
Utilities Taxes												.336	1.2
Other State Taxes**												5.8	
Overall State*** and Local System												$17.4b	$16.9b

High Medium Low N.A. = Not applicable

* Equity is judged on both "ability to pay" (left box) and "benefits received" (right box) principles.
** Other state taxes include alcohol and cigarette taxes, severance taxes, the lottery, unemployment taxes, and miscellaneous taxes.
*** The overall rankings are not the sum of each criterion, but an evaluation that takes into account the share of total revenue raised by each tax.

Example 4: Institute a Personal Income Tax

Example 4 centers around the enactment of a personal income tax, which would increase the stability, equity, and long-run growth potential of Florida's tax system. Residents are given property tax relief. To encourage investment in people, research, and Florida companies, individuals and companies are given special credits and exemptions from their income taxes.

The key elements of the personal income tax example are as follows:

- *Adopt a personal income tax*—Florida would repeal its constitutional prohibition on the taxation of income and establish a personal income tax on income earned in Florida.
- *Share revenues and provide property tax relief*—Funds raised by the income tax could be used to provide property tax relief.
- *Encourage investment in economic foundations*—To encourage individuals and industry to invest in Florida's economic capacity, Florida could establish Individual Training Accounts, an Employee Training Tax Credit, and an R&D Tax Credit, with a special provision to encourage research collaboration with Florida universities.

Description and Rationale

Adding a personal income tax would significantly improve the following elements of Florida's current tax system:

- *Decrease the regressivity of the current system*—Whether the personal income tax has proportional or progressive rates, the presence of the tax will decrease the regressivity that characterizes Florida's current tax system.
- *Increase the ability of the system to grow with the economy*—By definition, revenues from the personal income tax grow in proportion to economic activity over time, which is measured by changes in state personal income. Although state expenditures have grown in proportion to state income, revenues from the state's current structure cannot, necessitating frequent rate and base changes.
- *Enhance the short-run stability of the system*—Although the personal income tax is sensitive to short-run swings in the economy, it is less volatile than the sales tax.
- *Enhance exportability*—A personal income tax would allow Florida to exploit an untapped source of exportability: deductibility from federal tax liability.
- *Increase diversity*—By adding income to Florida's wealth and consumption tax bases, a personal income tax would increase the diversity of the state tax base.

To simplify compliance and administration, Florida's personal income tax could "piggyback" off of the federal income tax. Federal adjusted gross income, rather than federal tax liability, would be the strongest base for the tax, since adjusted gross income is more stable. Tax rates could be either proportional or progressive, though a mildly progressive rate structure would do more to counter the regressivity of the sales and property taxes. The tax could be applied in 2 ways: to all taxpayers with federal tax liability, to taxpayers above a "threshold" level.

To enact a personal income tax, Florida voters will have to change Florida's constitutional prohibition on the taxation of income (required amendment—Article VII, Section 5 [a]). To overcome traditional opposition to the tax, voters will need to feel that they are getting something in return.

This example includes giving voters property tax relief in exchange for the imposition of a personal income tax. This could be done in two ways:

- *Establish a "circuit breaker"*—Allow property tax payments in excess of 5% of income to be used as a credit for the personal income tax.
- *Partial state funding of K-12 education*—The state would reduce the property taxes required for localities to participate in the state K-12 education program.

Another idea for winning voter support for a personal income tax is to link revenues to specific government investments. Targeting income tax revenues to education and training, for example, by creating a Human Investment Trust Fund would be particularly appropriate as Florida prepares for a 21st century economy.

The Cornerstone report identified skilled human resources, appropriate technology, and available finance—rather than cheap land, abundant but unskilled labor, and laissez faire regulation—as the foundations of an advanced Florida economy of the future. The pro-competitive criteria developed in Phase II represent the characteristics that Florida's business community thinks must be present in Florida's tax system to create a stable and fair business environment, support public investment in economic foundations, and encourage private investment in these foundations.

Chapters V and VI found that only one potential tax source specifically encourages investment: the Single Business Tax, which encourages investment in capital equipment. All the other revenue sources either discourage or have a neutral effect on capital investment, and none by their nature encourage investment in people or technology.

This example includes some ideas for encouraging investment by business and individuals in economic foundations through the personal and corporate income taxes. The difference between the business incentives and those traditionally offered by states is that these are designed to encourage more investment on the part of all industries, rather than to promote the development of specific industries. Investing in people, research, and capital equipment is vital to the future of all Florida industries—from citrus to retail to health services to aerospace. Investments in people, research, and equipment will help all industries add more value and compete in local, national, and regional markets. Exhibit VII-B presents some ways to encourage such investment.

Exhibit VII-B
WAYS TO ENCOURAGE INVESTMENT IN FLORIDA'S ECONOMIC FOUNDATIONS

Individual Training Accounts

The opportunity could be created for Floridians to establish Individual Training Accounts (ITAs) to help finance training to update skills or prepare for another career. Employees would make annual contributions to their ITA, deductible from their personal income for tax purposes, of $300 to $500 each year. Employee contributions, which could be made through payroll deductions, would be matched by employer contributions. Employer contributions would be fully deductible from state corporate income tax.

Funds would be allowed to accumulate up to a predetermined level, perhaps $4,000 to $6,000. Employees could draw on their account to fund training at an approved institution. Approved institutions would include the range of postsecondary institutions covered under the GI Bill. Amounts withdrawn would be taxed as income when spent. Like employer-matched Individual Retirement Accounts, employees could take their ITA, including interest, with them to a new job. Funds not used would be returned to the employee at retirement.

Illinois is the first state to test the ITA concept. The ITA concept has been endorsed by the American Council on Education through the Business—Higher Education Forum, and variations on the theme have been proposed in Congress.[18]

Employer Training Tax Credit

Just as countries and states have used corporate income tax credits to encourage investment in machine capital and R&D, Florida could create an Employer Training Tax Credit to encourage formal employer-based training. The credit could effectively subsidize the development and direct delivery costs of training programs. Direct costs are the actual costs of the training itself—the trainer and use of facilities, equipment, and materials—rather than overhead, wage costs of trainees, and travel. Excluding overhead and wages from the costs will encourage more generic kinds of training, encourage employers to link with outside suppliers, and encourage more training of nonsupervisory personnel.

The credit, which would apply only to new employer-based training programs, could run at about 20%. This level is high enough to focus employer attention on job-related learning and to recognize the public, external benefits of worker training. At the same time, a marginal rather than complete level of subsidy ensures that market discipline can promote accountability and wise use of funds. A refundable tax credit could be available for private not-for-profit employers.

Although Florida would be the lead state in implementing an employer training tax credit, evidence of the effect of such a credit on training levels can be gleaned by experience with the corporate R&D tax credit. The R&D tax credit had a "unitary" effect; that is, a 1% increase in the incentive was associated with a 1% increase in business spending on R&D. It may be reasonable to assume, then, that a 20% tax credit for new training expenses could lead to a 20% increase in employer spending for formal training.

R&D Tax Credit

Florida could enact an R&D credit against the corporate income tax for R&D expenses incurred in Florida, perhaps providing a larger credit for companies that conduct research with Florida universities. This would encourage companies of all sorts to take advantage of the university system and provide demand-pull encouragement for universities to develop relationships with Florida businesses.

California offers an 8% regular R&D tax credit and a 12% credit for university research. The research can be of an applied or basic nature, advancing science or engineering knowledge or resulting in technical improvements to commercial products and processes (commercial improvements in appearance or aesthetics do not qualify).

---

[18]In March, 1984, Congressman Richard Durbin (D-Illinois) introduced a federal bill to allow workers to establish ITAs. Under his plan, employees and employers would have contributed 0.8 percent of the employee's wages or $250 per year, whichever was less, up to a maximum amount of $4,000. The employer would have received a tax deduction equal to 125 percent of its contribution as an incentive to participate. Contributions would have been fully deductible for employees.

Revenue Implications

Florida could establish a personal income tax and provide compensating property or sales tax relief so that the changes would be revenue neutral. A revenue-neutral substitution for the property tax would probably not generate enough new benefits for Florida's overall tax system to be desirable and would probably create unearned capital gains. (For purposes of discussion, the revenue implications of this revenue neutral example are shown in Table VII-6.) A revenue-neutral substitution for the sales tax, by reducing the impact of the sales tax's negative characteristics, would bring improvements to the overall system.

For many, the attractiveness of the personal income tax is its ability to raise additional net revenue. Even a small personal income tax has the power to raise a significant amount of revenue. A 1% levy on Florida's anticipated 1990-91 federal adjusted gross income would raise $1.7 billion.

Effect on Florida's Tax Structure

Adding an investment-oriented personal income tax would make the following improvements to Florida's existing tax structure (see Table VII-6):

- Equity increases from low to medium.
- Stability increases from low to medium.
- Exportability increases from medium to high.
- Growth increases from low to medium.
- Diversity increases from low to high.
- Neutrality increases from low to medium.
- Pro-investment increases from low to medium.

Like the Single Business Tax example, adding a personal income tax to Florida's existing system improves the stability, growth, and pro-investment characteristics. Two strengths are unique to this example: with a personal income tax, Florida could export tax burden to the federal government and could tap a truly diverse tax base.

Table VII-6

SUMMARY OF EXAMPLE 4
INSTITUTE A PERSONAL INCOME TAX

Revenue Sources	Criteria: Equity*		Stability	Administration	Compliance	Exportability	Efficiency	Growth	Diversity	Neutrality	Pro-investment	1990-91 Revenue (billions): State	Local
Personal Income Tax[1]												$1.7b	—
Sales Tax												$8.3 b	—
Property Tax												—	7.6
Corporate Income Tax												.825	—
Intangibles Tax												.543	—
Documentary Stamp Tax												.548	—
User Fees	N.A.		N.A.					N.A.				—	6.2
Special Assessments	N.A.		N.A.					N.A.				—	.194
Impact Fees			N.A.					N.A.				—	.045
Estate Tax										N.A.		.260	—
Utilities Taxes												.336	1.2
Other State Taxes**												5.8	—
Overall State*** and Local System												$18.3b	$15.2b

High Medium Low N.A. = Not applicable

[1]Assumes that a 1% personal income tax raises $1.7b and that property tax relief is given proportionality.

* Equity is judged on both "ability to pay" (left box) and "benefits received" (right box) principles.

** Other state taxes include alcohol and cigarette taxes, severance taxes, the lottery, unemployment taxes, and miscellaneous taxes.

*** The overall rankings are not the sum of each criterion, but an evaluation that takes into account the share of total revenue raised by each tax.

Example 5: Comprehensive Pro-competitive Reform

The preceding four examples all showed the effect that changes to existing taxes or the introduction of a new tax could have on Florida's overall tax structure. Considered independent of one another, all fell short of making significant strides toward a highly pro-competitive tax structure. Although the examples that centered around the introduction of the Single Business Tax and the personal income tax proved strongest, even they resulted in only moderate progress toward attaining the best rankings on the pro-competitive criteria.

Drawing on the best features of examples 1 through 4, this example illustrates how revenue sources with complementary and reinforcing strengths can be combined to create a highly pro-competitive tax structure.

This example of comprehensive structural reform has the following key elements:

- *A Single Business Tax*—The SBT would be the only major state tax levied on business, as described in Example 3.
- *A retail sales tax on goods and services*—Florida would have a pure retail sales tax on the final consumption of goods and services. This combines the sales tax without pyramiding in Example 1 with the services tax in Example 2.
- *A broad-based property tax*—A tax would be levied on property, as described in Example 1.
- *Personal income tax*—Florida residents would be subject to a personal income tax, with "circuit breaker" property tax relief, as described in Example 4.
- *Expanded estate tax*—An estate tax above the credit for other states' taxes would be levied, as suggested in the appendix to Example 1.
- *Other taxes*—A documentary stamp tax on deeds only would be established, as suggested in Example 3. Utilities taxes, user fees, special assessments, and impact fees would be used as suggested in the appendix to Example 1.

Effect on Florida's Tax Structure

Table VII-7 shows how this combination of taxes improves the pro-competitiveness of the whole system. There are across-the-board improvements over both the existing system and examples 1 through 4.

The interplay between the taxes works for the benefit of the whole system.

Equity—Together these taxes work to create a system that is likely to have minimal regressivity or be slightly progressive. The presence of the personal income tax offsets the natural regressivity of the sales tax. The income tax also provides opportunity to decrease the regressivity of the property tax through a "circuit breaker," which would be available to both homeowners and renters. The "benefits received" aspect of equity is enhanced by the SBT.

Stability—On balance, this system has medium stability. The SBT and property taxes are highly stable, countering the estate tax, which has low stability but high growth. The consumption and income taxes have medium stability. Recognizing the trade-off with long-run growth, medium stability over the short-run may be the most appropriate target for a pro-competitive system. A system with high stability is likely to be dominated by taxes growing less than the economy over the long-run.

Administration—The component taxes add up to a system that is strong on administration. Administering one major tax on business is easier than administering several. The personal income tax, estate tax, and consumption tax all rank high on administration.

Compliance—This system ranks high on compliance. The presence of one tax on business simplifies business compliance. The broad-based tax on all consumer consumption simplifies compliance for retailers.

Exportability—The system can take advantage of all opportunities to export tax burden. The state SBT, personal income tax, and property tax can be deducted for federal tax purposes. A broad-based sales tax ensures that tourists will pick up as much of Florida's tax burden as possible.

Efficiency—Overall, the broad base of these taxes could result in rates low enough to minimize the role of taxes as much as possible in business and consumer decision-making. The broad base of the retail sales tax, for example, precludes an effect of taxes on consumption decisions between goods and services. The broad base of the property tax and use of the personal income tax allows lower property tax burdens and better targeting of property tax relief to financial need. Finally, there is no inefficient pyramiding in this system.

Growth —The combination of a relatively low-growth tax (retail sales) with some high-growth taxes (personal income, property, estate) and one that grows proportionately with the economy (SBT) results in an overall system that will grow over time with economic activity.

Diversity—This system is diverse in two respects. First, the base of each individual tax is as broad as possible. Second, the system as a whole taps the three major bases: consumption, wealth, and income.

Neutrality—The use of the SBT and a retail sales tax that falls on both goods and services results in a highly level playing field among Florida businesses. Using circuit-breaker property tax relief instead of the homestead exemption results in fair competition between the residential and rental property industries.

Pro-investment—This system encourages investment primarily through the use of the SBT. It lacks the investment-discouraging effects of a tax on business purchases.

Revenue Implications

This example could be applied in an approximately revenue-neutral manner (see Table VII-7). For purposes of discussion, revenue estimates assume: a personal income tax of 2% of federal adjusted gross income with circuit breaker property tax relief, a retail sales tax of 5%, and cuts in property tax millage rates of 30%.

Although the criteria rankings for comprehensive structural reform look markedly different from Florida's existing system (see Table VII-1), the share of taxes paid by business and individuals is approximately the same in both cases. Moving to a pro-competitive system can bring dramatic improvement in criteria rankings without shifting aggregate tax burdens between Florida residents and businesses—a "win-win" situation for the state.

Results from Designing a Pro-competitive Tax Structure

Designing a pro-competitive tax structure is but one of the steps Florida needs to take to become a competitive, value-added economy. It is, however, a critical step to help build the other elements of Florida's economic foundation: human resources and education, technology, physical infrastructure, finance, regulatory environment, and quality of life.

If Florida designs a pro-competitive tax system, Floridians can expect the following results:

- Florida's public sector will have the stability and revenue growth needed to plan and make long-term investments in other economic foundations: education, human resources, physical infrastructure, technology, finance, quality of life.

- Florida's private sector will have tax-based incentives to invest in people, research, and equipment. Many disincentives to invest will be eliminated.
- The overall competitiveness of Florida's tax environment will be enhanced. Uncertainty regarding tax liability from one year to the next and tax-induced advantages to specific industries will be minimal.

When public sector investments in economic foundations are strengthened, Florida businesses will have the support needed to produce value-added goods and services. A high-quality tax structure will encourage individual businesses to invest in training, R&D, and capital equipment, increasing their opportunities to enter new value-added markets. Reducing the uncertainty in Florida's tax climate will provide a clear signal to existing and potentially new Florida businesses that Florida understands the importance of stability to business planning.

The combination of the above will help all Florida industries—from citrus to tourism to aerospace—continually move toward higher value added. When companies produce more value added, they can stay competitive in the global economy and offer high-quality, high-wage jobs. The end result will be rising real standards of living for Floridians.

Finally, structural tax reform of the kind envisioned in this study, coupled with commitments by government to make improvements in areas like education and physical infrastructure, can work to restore public confidence in government. Comprehensive, competent structural tax reform, however, is a necessary but not sufficient step towards building a renewed climate of public trust. Structural tax reform must be accompanied by accountability measures and expenditures which show Florida residents the benefits of revenues they entrust to state and local government.

Table VII-7

SUMMARY OF EXAMPLE 5
COMPREHENSIVE STRUCTURAL REFORM

	Criteria											1990-91 Revenue (billions)	
	Equity*		Stability	Administration	Compliance	Exportability	Efficiency	Growth	Diversity	Neutrality	Pro-investment	State	Local
Single Business Tax												4.3	—
Retail Sales Tax on Goods and Services												5.0	—
Property Tax												—	9.5
Personal Income Tax												2.4	—
Estate and Inheritance Taxes										N.A.		.5	—
Documentary Stamp Tax on Deeds												.5	—
User Fees	N.A.		N.A.					N.A.				—	6.2
Special Assessments	N.A.		N.A.					N.A.				—	.2
Impact Fees			N.A.					N.A.				—	.05
Utilities Taxes												.4	1.2
Other State Taxes**												5.8	
Overall State and Local Tax System												$18.9b	$17.2b

High — Medium — Low

*Equity is judged on both "ability to pay" (left box) and "benefits received" (right box) principles.
**Other state taxes include alcohol and cigarette taxes, severance taxes, the lottery, unemployment taxes, and miscellaneous taxes.

Appendix A
LESSONS FROM STATE TAX REFORM IN THE 1980S

During the 1980s, a number of states attempted reform of their tax structures. Some sought massive overhaul, others incremental change. Although each state's experience sprang from unique political, economic, and cultural situations, it is possible to learn from successful and unsuccessful reform attempts. Lessons from other states can help Florida pave the way for positive fiscal change.

Successful Tax Reform

The states of Tennessee, Indiana, and California provide examples of successful tax reform. Each state, however, accomplished very different objectives. In the early 1980s, Tennessee, under the direction of Governor Lamar Alexander, undertook far-reaching reform to develop the fiscal capacity to invest in Tennessee's future. Indiana Governor Robert Orr launched a successful campaign to raise the state income tax to finance comprehensive education reform in 1987. Also in 1987, California simplified its tax code to conform to the Federal Tax Reform Act of 1986 and also added several provisions, such as tax credits for research conducted with universities, designed to spur technology-based economic development. The experiences of states such as these suggest the following reform principles:

- *Tie change to specific initiatives*—From the beginning, both Tennessee and Indiana linked their tax changes explicitly to specific expenditures, namely, on education and other factors fostering competitiveness. Citizens knew where their additional dollars would go and what the expected results of their expenditures would be. Once convinced of the reform's merits, voters could feel positive about a change that would allow greater control over their state's future, rather than demoralized by a change that merely allowed an administration to cover a deficit or sustain existing programs. Creating an atmosphere of crisis and threat, especially through use of the media, was critical in winning broad-based support.
- *Emphasis on accountability*—Voters knew what the tax change was expected to accomplish and how the state would know it was meeting its promised goals. In Indiana, accountability—ensuring "bang for the taxpayer's buck"—was the linchpin of both fiscal change and education reform. As taxpayers grow ever more distrustful of government, government must demonstrate efficient use of taxpayer resources and build accountability measures into policy reform.
- *Focus on simplicity*—In California and Tennessee, simplicity was a pragmatic objective that proved politically powerful. The drive toward simplicity, in compliance and administration, was a powerful argument for change to a system, such as California's, perceived as overly complex. Especially after the federal reform experience of 1986, simplicity may be synonymous in voters' minds with fairness.

Unsuccessful Tax Reform

Louisiana, North Dakota, and Pennsylvania provide recent examples of unsuccessful tax reform. Louisiana voters twice rejected a tax overhaul plan promoted by Governor Buddy Roemer in 1989, which, among other measures, would have raised gasoline and income taxes. In North Dakota, a very low-tax state by any measure, voters rejected modest increases in the state's sales, income, and motor fuel taxes. The increases were supported strongly by the Governor and the state Chamber of Commerce. From these state experiences, the following lessons might be drawn:

- *Broad change*—Changes in several different tax provisions to enable across-the-board expenditure increases in public services proved too extensive. Voters in North Dakota and Louisiana could not relate the proposed increases to their personal or community needs. Louisiana voters, who have never been involved in tax changes, had to choose among 13 amendments that they knew were broadly designed to shift more tax burden onto individuals rather than businesses.
- *Climate of government mistrust*—In Louisiana, voters simply could not believe the reform advocates' promise that tax change would be extensive but not affect most Louisianans. North Dakota's referendum on the tax increase came when voter confidence in state legislators was low, because of perceived voting in their self-interest. This climate helped engender excessively conservative, some would say even spiteful, voting patterns on the tax issue in this normally cautious state.
- *Effective use of media by populist opposition*—For some populist advocacy groups, any tax, no matter how small, no matter how "necessary," is too much tax. In North Dakota and Louisiana these groups orchestrated sophisticated media campaigns (commercials, toll-free numbers) to fuel voter distrust of and disdain for government.

Appendix B
SUPPORTING DATA FOR CHAPTERS V AND VI

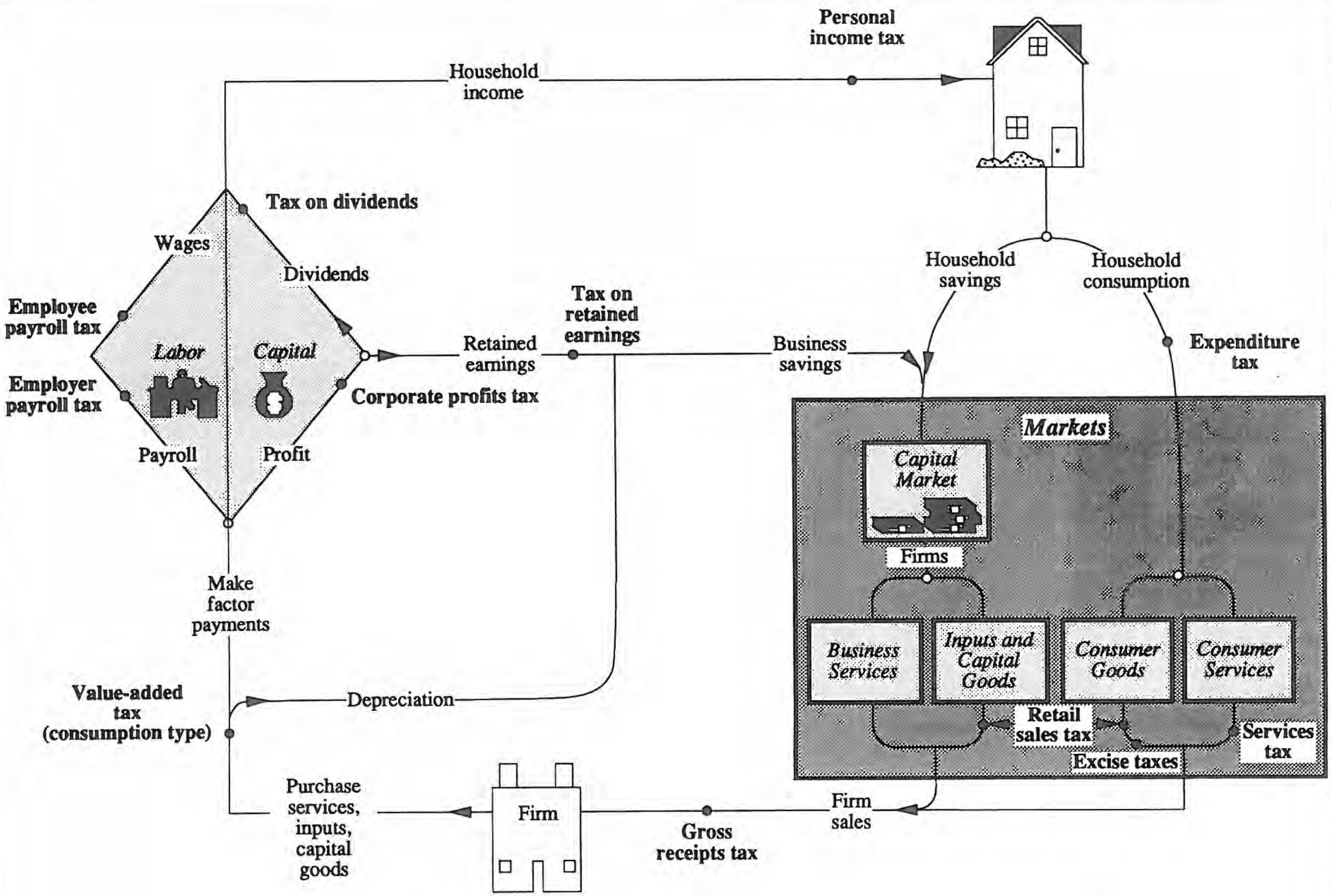


FIGURE B-1 POTENTIAL SOURCES OF GOVERNMENT REVENUE

Table B-1

GROWTH OF MAJOR STATE AND LOCAL TAXES, ACTUAL COLLECTIONS, AND COLLECTIONS BASED ON 1970 TAX RATES, PER HOUSEHOLD, ADJUSTED FOR INFLATION, 1970-89

Taxes	Index of Growth		Average Rate of Growth	
	Actual	1970 Rate	Actual	1970 Rate
Total state taxes	116	84	1.04	-0.73
Total quantity-based taxes	45	34	-3.95	-5.33
Spirits	37	21	-4.83	-7.79
Wine	74	38	-1.04	-4.85
Beer	59	40	-2.48	-4.71
Gas tax	44	32	-3.79	-5.49
Motor vehicle tag fees	48	52	-3.19	-2.91
Tobacco	40	28	-4.52	-6.37
Total value-based taxes	163	117	2.91	1.07
Corporate income*	97	87	0.24	-0.34
Documentary stamp	153	83	3.70	0.76
Estate	199	199	5.00	
Insurance premium	97	80	0.56	-0.80
Intangibles	124	124	3.29	3.29
Parimutuel	28	29	-6.37	-6.10
Sales and use	163	107	2.88	0.62
Utilities—gross receipts	196	163	4.00	2.96
Local taxes	126			
Property tax	126		1.42	
Municipal franchise fees*			0.89	
Municipal public service tax***			-1.01	
Households	221		4.27	
Real personal income per household	118		0.89	
Real taxable value per household	158		2.59	

* Based on period 1972-89.
** Based on period 1977-87.
*** Based on period 1972-87.

Note: Index of growth is based on values set to 100 for 1970, per household, adjusted for inflation.
Sources: *Florida Tax Handbook*, Finance, Taxation, and Claims Committee, various issues.
Florida Consensus Estimating Conference, various issues.

Table B-2

STABILITY OF MAJOR STATE AND LOCAL TAXES, ACTUAL COLLECTIONS, AND COLLECTIONS BASED ON 1970 TAX RATES, PER HOUSEHOLD, ADJUSTED FOR INFLATION, 1970-89

Taxes	Actual Tax Rates	1970 Tax Rates
Total state taxes	10.40	7.32
Total quantity-based taxes	8.60	7.32
Spirits	7.29	5.58
Wine	10.51	5.55
Beer	6.71	5.26
Gas tax	14.69	10.91
Motor vehicle tag fees	12.45	11.07
Tobacco	7.55	7.79
Total value-based taxes	10.10	7.33
Corporate income*	10.57	9.30
Documentary stamp	16.00	17.70
Estate	19.59	
Insurance premium	16.55	12.40
Intangibles	24.12	24.12
Parimutuel	5.74	6.86
Sales and use	11.29	6.26
Utilities—gross receipts	8.81	9.74
Local taxes		
Property tax	10.02	
Municipal franchise fees**	5.08	
Municipal public service tax*	5.87	

* Based on period 1972-89.
** Based on period 1977-87.

Note: Stability is measured by computing the standard deviation of each year's tax collections from its long-term trend value. Taxes with lower values have greater stability.

Sources: *Florida Tax Handbook*, Finance, Taxation, and Claims Committee, various issues.
Florida Consensus Estimating Conference, various issues.

Low Taxes	This indicator measures how much a state uses its capacity to tax compared with other states. The source of the data is the annual study of state fiscal capacity conducted by the Advisory Commission on Intergovernmental Relations (ACIR), a leading authority on state tax burden.
Low Labor Costs	This indicator measures the cost of manufacturing labor in a state. The source is prepublished data from the U.S. Department of Labor, Bureau of Labor Statistics, *Employment and Earnings*, May 1989.
Available Workforce	This is a composite indicator comprising percentage of adults 25 and over with 4 years of college education, number of engineers and scientists per civilian labor force, ratio of workers employed in advanced-technology industries to total workers, and the ratio of employed adults to the total adult population. The source is a special study conducted by Grant Thornton, Chicago, IL, March 1989.
Education	This is a composite indicator comprising the average salary of teachers as a proportion of average pay of all workers, student-teacher ratio (K-12), high school graduation rate, state expenditure per student for public education (K-12), per capita higher education expenditures as a percentage of per capita income, and literacy rates. The source is a special study conducted by Grant Thornton, Chicago, IL, March 1989.
Transportation	This indicator measures the quality of transportation for individuals, in both commuting and daily life. Among the factors used in this index are the percentage of a state's expenditures dedicated to transportation, the average urban commute time, the pavement condition of roadways, traffic-related fatalities and injuries per capita, per capita state transportation expenditures, and the average daily traffic volume. The source is a special study conducted by Grant Thornton, Chicago, IL, March 1989.

EXHIBIT B-1 EXPLANATION OF GRANT THORNTON INDICATORS (FIGURES II-1 THROUGH II-4)

Appendix C
DETAILED DESCRIPTION AND RATIONALE FOR EXAMPLE 1—REFORM THE EXISTING SYSTEM

This appendix provides a detailed explanation of the changes that could be made to each of Florida's existing revenue sources, changes that together would result in marginal improvements in the pro-competitiveness of the overall system.

Sales Tax

- *Eliminate exemptions where taxation won't cause pyramiding*—Repeal exemptions for products and other activities where like products or activities are taxed. This includes motor fuel and taxing on-site construction in the same manner as factory-built homes and buildings. Tax consumer purchases of household utility services, with exemptions for basic local telephone charges, the first 750 kWh of electricity, and a comparable quantity of natural and bottled gas.
- *Reduce pyramiding*—Reduce pyramiding by exempting certain purchases by business firms—machinery and equipment, electricity, and telecommunication services.
- *Expand use of "use tax"*—Apply "use tax" to television, radio broadcasting, and the "gift" portion of newspapers, magazines, and other publications.

The major effect of these sales tax changes is to improve the efficiency, pro-investment, and neutrality of the current sales tax. Efficiency is improved when some pyramiding is eliminated by exempting the purchase of machinery and equipment, electricity, and telecommunication services by business firms. The exemption of machinery and equipment will encourage more investment by reducing the cost of capital.

Neutrality is improved by eliminating certain exemptions on consumer purchases. A "use tax" is applied to the "gift" portion of newspapers, magazines, and other publications whose sale price does not reflect the true cost of the publication. Their full costs will thus be taxable, as is the full cost of other goods and services. The use tax is applied to television and radio broadcasting, so that they are treated in the same manner as other information and entertainment services. Construction activity is treated in the same manner as factory built buildings. Household utility services are taxed above a certain minimum level; business utility purchases are already taxed.

Property Tax

- *Eliminate exemptions*—Eliminate the homestead exemption and replace with a "circuit breaker" form of property tax relief. (Required constitutional amendment—Article VII, Section 6). Assess currently exempt personal property.

- *Change assessment practices*—Assess property at full value. Assess all land at market value. Assess personal property at IRS book value if close to market value. Put new construction on tax roll when usable.
- *Make rate changes*—Tax nonagricultural land at a higher rate than other property. (Required constitutional amendment—Article VII, Section 2).
- *Other changes*—Repeal or modify "early" payment discount.

Overall, the changes in the property tax increase its equity, efficiency, exportability, diversity, and neutrality.

Eliminating exemptions improves the diversity, neutrality, and equity of the tax base. Certain types of personal property, currently exempted under the constitution, are taxed. These include commercial motor vehicles, motor homes, some boats, airplanes, trailers, and trailer coaches. Railroad equipment is currently taxed, though it competes with the exempt trucking industry. Boats and mobile homes are exempt, though they are substitutes for real-property living quarters.

Replacing the homestead exemption with a "circuit breaker" form of tax relief will improve the tax's diversity, efficiency, and equity. The current homestead exemption provides tax savings benefits to homeowners regardless of their need, and provides no benefits to renters. Applying to both homeowners and renters, this change could provide tax relief in the form of a rebate or income tax credit, when property tax payments exceed a portion of taxpayer income—typically 5%. The rebate or credit would be limited to $250-$500.

Changing assessment practices improves diversity, neutrality, and administration. A statewide Florida grand jury has criticized the fact that Florida assesses property at 75% of market value or less, rather than full market value. Taxation at full value, as recommended in this option, will expand the tax base and shift some of the tax burden to residential property.

This example also recommends taxing agricultural land at its market value, rather than its lower "use" value. No other industry receives this benefit. New construction should be put on the tax roll when put to its intended use; until then it is inventory. Currently, new construction, excluding the land value, can escape taxation for up to 22 months. Business personal property could be assessed at its reported book value for federal tax purposes if its value is close to current assessed values, since businesses and local appraisers often have difficulty assessing personal property. Last, consideration could be given to taxing nonagricultural land at higher rates than buildings and personal property to avoid discouraging investment in urban areas.

The expected increase in taxable values due to these assessment changes could lead to either rate reductions or additional revenue to fund schools and other local government activities.

Repealing or modifying the "early payment" discount improves efficiency. Florida gives taxpayers an early payment discount as large as 4% if they pay their property taxes within four months of the date bills are sent, instead of by the due date in April. Since school districts begin their fiscal year July 1, and other local governments October 1, the early payment discount may be too great and could be tied to short-term interest rates. Consideration could also be given to requiring the payment of property taxes for all taxpayers by the end of the year instead of April, when most of the school year is already over.

Corporate Income Tax

- *Eliminate or limit special deductions, exemptions, and credits*—Repeal deductions for the "loss carry-forward" from corporate purchases and mergers and the targeted jobs credit. Repeal $5,000 exemption. (Required constitutional amendment—Article VII, Section 5 (b)). Limit interest deductions for nonfinancial companies to net after-tax earnings. Repeal miscellaneous corporate tax credits.
- *Tax noncorporate entities*—Tax Subchapter S corporations and limited partnerships.
- *Create tax credits and deduction*—Allow credits for state gross receipts tax and local franchise fees on electricity-providing firms.

Eliminating or limiting special deductions, exemptions, and credits improves the tax's diversity and neutrality. The $5,000 exemption of net income could be repealed, since its value to a corporation is only $275, and it is applied to both large and small corporations. The deduction was intended for small businesses that actually operate as proprietorships or partnerships. The interest deduction could be limited to net after-tax earnings. The current deduction favors use of debt more than equity capital. Losses carried forward from purchased or merged businesses would be disallowed so that all companies are treated alike in their cost of capital. Other miscellaneous tax credits should be repealed and restored, if appropriate, only after their public purpose and accomplishments are evaluated.

Taxing noncorporate entities—Subchapter S corporations and limited partnerships—improves neutrality. These entities, which compete with corporations, escape taxation completely because Florida does not have a personal income tax.

Creating tax credits for the utilities gross receipts and local franchise fees will reduce the heavy impact of utility taxes in Florida relative to those in other states.

Intangibles Tax

Tax on mortgages

- *Eliminate tax on mortgages*—Repeal intangibles tax on mortgages and replace with an additional $.20 documentary stamp tax on deeds.

Tax on stocks, bonds, and other intangibles

- *Tax other intangibles*—Tax cash value of annuities, life insurance, and retirement accounts.
- *Change personal exemptions*—Repeal personal exemptions. Apply value of exempted securities against personal exemptions.
- *Eliminate taxes*—Repeal tax on accounts receivable.

Eliminating the intangibles tax on mortgages and replacing it with a $.20 increase in the documentary stamp tax on deeds improves its equity, diversity, neutrality, and administration. The tax on deeds is broader and more equitable than one on mortgages, since not all purchased property is mortgaged. Elimination of this tax will eliminate the cost of administering a second tax.

Eliminating the many exemptions to the tax improves the tax's equity, stability, neutrality, and efficiency. The tax on accounts receivable should be repealed since the capital to support such assets is already taxed as stocks, bonds, or bank loans. The tax exemptions granted life insurance, annuities, and retirement accounts should be repealed to broaden the base and improve neutrality. The existing household exemption should be repealed or made uniform. Individuals should not be treated differently from couples. Cash and near-cash substitutes may remain exempt or apply to the value of the exemption.

Documentary Stamp Tax

Tax on deeds

- Increase the documentary stamp tax on deeds by $.20 to make up for repealing the intangibles tax on mortgages.

Tax on notes, charge accounts, etc.

- *Change in the tax base*—Limit the tax to documents not subject to the intangibles tax. Tax security dealer loans.

Changes in the documentary stamp tax improve its neutrality and efficiency. This option recommends extending the tax to security dealer loans, but then exempting from taxation those intangibles subject to the intangibles tax.

Estate and Inheritance Taxes

- *Change credit and rate*—Repeal credit for other states' taxes.
- *Add an inheritance tax*—Instead of increasing the estate tax above the federal credit, add an inheritance tax.

The change to the estate tax improves growth. Florida's take is reduced by the amount of tax paid other states for the property in those states. It is argued that Florida must give the credit so that it maintains an advantage over other states in attracting wealthy persons. There is no evidence to substantiate this claim and the credit's importance to Florida's economy. Florida's estate tax is one of three taxes to grow faster than the state's economy, though it amounts to only 20% of a 1-cent sales tax.

The addition of an inheritance tax improves diversity, growth, equity, and exportability. Exportability is increased because the *nonresidents* who benefit from Florida estates would be taxed. Vertical equity is increased because the tax is mildly progressive. Horizontal equity is improved because all inheritors of Florida estates, including nonresidents, are taxed. The addition of the inheritance tax broadens Florida's tax base and provides growth likely to exceed that of the economy.

Utilities Taxes

Local utilities tax

- *Improve neutrality*—Extend tax to unincorporated areas. Tax all interstate and intrastate telephone calls at lower tax rate.

The changes recommended in the municipal utilities tax improve its neutrality and diversity. This option recommends giving authority to all counties to levy the tax in unincorporated areas. This would eliminate the current reward for locating in unincorporated areas. Three counties (Dade, Duvall, Brevard) already apply the tax countywide. This option also recommends improving the uniformity of the tax on telecommunication services. The tax should apply to all telecommunication services, not just to local service charges.

As corporate payments of the state utilities gross receipts tax and local franchise fees will be deductible under the corporate income tax, Florida's high utility tax burden relative to other states will be reduced.

User Fees

- *Set fees appropriately*—Require fees to reflect marginal cost of providing the service, including seasonal variation in use. Require fees in excess of total cost to be listed as a tax. Provide capital contribution credit for the portion of fee received for future expansion.
- *Expand use of fees*—Use fees to cover traffic accident reports, bridge tenders, and ambulance service.

Changes recommended in user fees improve their link to benefits received and efficiency. User fees that are intentionally set above cost should be separately identified on each bill, so the true cost of the service is known to the public. User fees, specifically those for the provision of utility services, should reflect the cost of providing services to different locations at different times of the year or day. Existing utility users should not be charged for the cost of plant expansion to serve new development or for future plant replacement without receiving some credit for their above-cost charge. Last, this option recommends expanding the use of user fees where appropriate, perhaps for traffic accident reports, bridge tenders, and ambulance services.

Special Assessments

- *Expand use of assessments*—Use for property benefiting from road improvements, for local parks, for meeting full costs of airports and waterports (in conjunction with user fees), and for utility extensions.
- *Improve collections*—Collect monthly when possible.

Changes recommended in special assessments improve their efficiency, neutrality, and diversity. Identify additional opportunities to use special assessments when there are justifiable benefits to property, such as for local parks, airports and waterports, road improvements, and utility extensions. Develop guidelines for the use of special assessments to avoid cases where assessments do not bear a direct relationship to benefits received by property owners (e.g., landfills, solid waste disposal, fire protection services). Special assessments should be collected monthly, when possible, to avoid the once-a-year burden of paying special assessments and property taxes at the same time.

Impact Fees

- *Extend to existing properties*—Levy impact fees on existing properties when infrastructure is expanded or improved.
- *Refine levying practices*—Limit impact fees to directly benefiting properties; do not "double count" road trips for fees on business property; replace impact fees with special assessments where appropriate.

Changes recommended in impact fees improve equity and linkages to ability to pay. To be consistent, once impact fees are first used to pay for infrastructure for new development, they must be used to replace infrastructure needed by "old" development. Care should be taken not to double-count traffic flows in levying road impact fees. This option also recommends looking for opportunities to substitute special assessments for impact fees, since special assessments are a less costly way to pay for infrastructure (because they are bondable at municipal bond interest rates). Another alternative is to place all new construction in a property improvement district and use a special property tax to pay for the needed infrastructure. The property tax would then be partially exported.