

STORAGE NAME: h0265a.rpp

DATE: February 21, 2000

**HOUSE OF REPRESENTATIVES
AS REVISED BY THE COMMITTEE ON
REAL PROPERTY AND PROBATE
ANALYSIS**

BILL #: HB 265

RELATING TO: Sales Tax/Commercial Property Leases

SPONSOR(S): Representative Wallace

TIED BILL(S):

ORIGINATING COMMITTEE(S)/COMMITTEE(S) OF REFERENCE:

- (1) BUSINESS DEVELOPMENT & INTERNATIONAL TRADE YEAS 6 NAYS 0
 - (2) REAL PROPERTY AND PROBATE YEAS 7 NAYS 1
 - (3) FINANCE & TAXATION
 - (4) GENERAL GOVERNMENT APPROPRIATIONS
 - (5)
-

I. SUMMARY:

Currently, a tenant pays a tax on all rent paid to a landlord, including portions of the rent representing ad valorem taxes, insurance, and maintenance charges. This bill excludes from taxation a charge by a landlord representing a tenant's proportionate share of ad valorem taxes, insurance, or maintenance charges when the proportionate share of each of those items is separately billed on an invoice by the landlord as a pass-through charge.

Two amendments are traveling with the bill. The Committee on Business Development and International Trade adopted one amendment which provides that maintenance charges exempted from taxation are "maintenance charges on which the landlord *has already paid* sales taxes". If a landlord were to charge a tenant for a maintenance charge prior to paying the underlying invoice, the landlord would not have "already paid" the sales tax. In that situation, then the amendatory language appears to effectively disallow any exemption. It is also unclear whether this provision would apply to the use tax, or to the sales tax only.

The Committee on Real Property and Probate adopted one amendment to this bill. The amendment changes the term "maintenance" to "common area maintenance"; it clarifies that a tenant's proportionate share of ad valorem taxes, insurance, and common area maintenance are exempt from tax whether separately invoiced by the landlord or paid directly to a third party; and provides a definition of "common area maintenance". The definition of common area maintenance addresses the same issues addressed by the amendment that was adopted by the Committee on Business Development and International Trade. The amendment also addresses a title defect in the original bill.

The Revenue Estimating Conference has not yet addressed this bill. However, in 1998 the Revenue Estimating Conference analyzed a nearly identical bill and determined that it had a total annualized negative fiscal impact of \$179.6 million on state and local governments. The sponsor disagrees with this estimate, and the Revenue Estimating Conference has not addressed this bill for this session. See "Fiscal Analysis & Economic Impact Statement" herein.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

- | | | | |
|-----------------------------------|---|-----------------------------|---|
| 1. <u>Less Government</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 2. <u>Lower Taxes</u> | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/> |
| 3. <u>Individual Freedom</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. <u>Personal Responsibility</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. <u>Family Empowerment</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

For any principle that received a "no" above, please explain:

B. PRESENT SITUATION:

Section 212.031(1)(a), F.S., provides: "It is the legislative intent that every person is exercising a taxable privilege who engages in the business of renting, leasing, letting, or granting a license for the use of any real property unless such property is" specifically exempt from tax. The rate is 6 percent of the total rent or license fee charged for the real property by the person charging or collecting the rental or license fee,¹ unless the county has enacted a discretionary sales tax, in which case the rate is the same as the sales tax rate imposed by that county.² The total rent or license fee charged for the real property includes payments for the granting of a privilege to use or occupy real property for any purpose and includes base rent, percentage rents, or similar charges.³

The amount of any ad valorem taxes paid by a tenant⁴ to the landlord or any other person on behalf of the landlord is taxable as rent.⁵ Common area maintenance charges paid by a tenant to the landlord for the privilege or right to use or occupy real property is taxable as rent.⁶ If a tenant or other person pays insurance for his or her own protection, the premium is not regarded as rental or license fee consideration, even though the landlord or other person granting the right to occupy or use the real property may also be protected by the coverage; however, any portion of the premium which secures the protection of the landlord or person granting the right to occupy or use the real property and which is separately

¹ Section 212.031(1)(c), F.S.

² Section 212.054(2)(a), F.S.

³ Section 212.031(1)(c), F.S.

⁴ A "tenant" is also known as a "lessee", and a "landlord" is also known as a "lessor". Although the current statutes use lessor and lessee, this analysis will use landlord and tenant for ease of reading.

⁵ F.A.C. 12A-1.070(4)(c). See also, Seaboard Coast Line Railroad Company v. Askew, Case No. 72-15 (Fla. 2nd Circuit 1972).

⁶ F.A.C. 12A-1.070(4)(d).

stated or itemized by the landlord and paid by the tenant is regarded as a rental or license fee and is thus taxable.⁷

C. EFFECT OF PROPOSED CHANGES:

This bill provides that the term "total rent or license fee" does not include "ad valorem taxes, maintenance charges, or insurance premiums paid for the benefit and protection of the landlord when the proportionate share of each of those items is separately billed on an invoice by the landlord." Accordingly, a payment by a tenant to a landlord for an ad valorem tax, maintenance charge, or insurance premium would be exempt from tax.

However, if a tenant pays an ad valorem tax, maintenance charge, or insurance premium for the benefit and protection of the landlord directly to any person or entity other than the landlord, the payment may still be subject to taxation⁸ under the bill as originally filed. See "Amendments or Committee Substitute Changes" herein, as this result was changed by amendment.

D. SECTION-BY-SECTION ANALYSIS:

See "Present Situation" and "Effect of Proposed Changes".

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

The 1998 Revenue Estimating Conference analyzed a nearly identical bill, and determined the following negative fiscal impact:⁹

	FY 1998-99 Annualized
General Revenue	(\$154,900,000)
Solid Waste TF	(\$300,000)
Total State Impact	(\$155,200,000)

2. Expenditures:

none

⁷ F.A.C. 12A-1.070(12).

⁸ See, Seaboard Coast Line Railroad Company v. Askew, Case No. 72-15 (Fla. 2nd Circuit 1972).

⁹ Revenue Estimating Conference estimate regarding 1998 HB 3375, March 13, 1998.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

The 1998 Revenue Estimating Conference analyzed a nearly identical bill, and determined the following negative fiscal impact:¹⁰

FY 1998-99 Annualized

Local Government Half Cent	(\$14,500,000)
Local Option Sales Tax	(\$9,900,000)
Total Local Tax Impact	(\$24,400,000)

2. Expenditures:

none

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

This bill may result in lower taxes for persons or businesses that rent or license the use of real property.

D. FISCAL COMMENTS:

The Revenue Estimating Conference for this legislative session has not yet addressed this bill.

The bill sponsor disagrees with the 1998 estimate of the Revenue Estimating Conference, and asserts that the estimate of negative fiscal impact should be approximately \$20 million.¹¹

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

This bill does not require counties or municipalities to spend funds or to take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill does not reduce the authority that municipalities or counties have to raise revenues in the aggregate.

¹⁰ Id.

¹¹ Comments by Representative Wallace before the Committee on Real Property and Probate, February 21, 2000.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

This bill does not reduce the percentage of a state tax shared with counties or municipalities.

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

The title to this bill states that it “[excludes] certain pass-through charges on commercial real property leases”. However, the tax exemption created by this bill is not limited to leases nor is it limited to commercial real property. The tax provided in s. 212.031, F.S., also applies to certain residential tenancies. Accordingly, the tax exemption provided by this bill may be applicable to rental of residential real property in addition to rental of commercial real property. Article II, Section 6, of the Florida Constitution, provides that the subject of a bill must be briefly expressed in the title. There is a concern that the title to this bill is inaccurate, and may need a title amendment. The Committee on Real Property and Probate adopted an amendment that resolves this issue.

At the Committee on Real Property and Probate, it was suggested that this bill may perhaps violate equal protection because it grants a tax exemption to commercial tenants. This bill, however, is not limited to commercial tenants, and applies equally to tenants liable for the tax whether the tenant is commercial or residential.

B. RULE-MAKING AUTHORITY:

none

C. OTHER COMMENTS:

Nearly identical bills have been filed in the previous two legislative sessions.¹² This bill as originally filed is nearly identical to this session’s SB 362.

The phrase “paid for the benefit and protection of the landlord” in this bill would seem to be applicable only to insurance premiums, but under the wording of this bill the phrase may apply to ad valorem taxes and maintenance.

The amendment adopted by the Committee on Business Development and International Trade which is traveling with this bill provides that maintenance charges exempted from taxation are “maintenance charges on which the landlord *has already paid* sales taxes”. If a landlord were to charge a tenant for a maintenance charge prior to paying the underlying invoice, the landlord would not have “already paid” the sales tax. In that situation, then the amendatory language appears to effectively disallow any exemption. It is also unclear whether this provision would apply to the use tax, or to the sales tax only. Additionally, the amendment refers to “landlord” when the analogous term “lessor” is used throughout the rest of Chapter 212, F.S.

¹² 1999 HB 1627, 1998 HB 3375.

The word "maintenance" and the phrase "pass-through charges" are not defined by this bill. The amendment adopted by the Committee on Real Property and Probate changed "maintenance" to "common area maintenance" and provided a definition; and the amendment deletes the use of the phrase "pass-through charges".

The Department of Revenue has concerns regarding this bill as originally filed. The department's analysis states:

The exemption, as currently worded, only applies to expenses in the three specific categories when separately billed by a landlord as "pass-through charges." When the parties to a lease have contracted for the tenant to pay for maintenance, insurance for the benefit of the landlord, or ad valorem taxes directly, these payments will continue to be taxed as rent under this bill. See Seaboard Coast Line Railroad Company v. Askew, No. 72-15 (Fla. 2d Cir. Ct. 1972).

The bill does not define "maintenance charges." This term is very broad, and may have different meanings to landlords, tenants, and the Department. The lack of clarity may raise questions of interpretation for "maintenance charges," such as the type of maintenance, or the way in which maintenance is contracted or provided.¹³

The department's concerns regarding the bill as originally filed are addressed by the amendment adopted by the Committee on Real Property and Probate.

A bill proponent asserts that imposing a tax on a payment from a tenant to a landlord for ad valorem tax is a "tax on a tax", and that this bill will correct "tax inequities" between Florida and other states regarding the tax treatment of payments by tenants for ad valorem taxes, insurance, and maintenance charges in commercial real estate leasing.¹⁴ The proponent also notes that Florida imposes a sales or use tax on some maintenance and supply items that become part of a common area charge, and that Florida imposes a tax on insurance premiums that is intended to be in lieu of imposing a sales tax on insurance premiums.¹⁵

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

On February 7, 2000, the Committee on Business Development and International Trade adopted one amendment to this bill. The amendment limits the term "maintenance charges" to those maintenance charges "on which the landlord has already paid sales taxes." The bill was then reported favorably as amended.

On February 21, 2000, the Committee on Real Property and Probate adopted one amendment to this bill. The amendment changes the term "maintenance" to "common area maintenance"; it clarifies that a tenant's proportionate share of ad valorem taxes, insurance, and common area maintenance are exempt from tax whether separately invoiced by the landlord or paid directly to a third party; and provides a definition of "common area maintenance". The definition of common area maintenance addresses the same issues addressed by the amendment that was adopted by the Committee on Business Development and International Trade. The amendment

¹³ Department of Revenue Bill Analysis of HB 265, October 29, 1999.

¹⁴ Comments by Gene Adams, lobbyist for the Florida Association of Realtors, to the Committee on Business Development and International Trade, February 7, 2000.

¹⁵ Comments by Gene Adams, lobbyist for the Florida Association of Realtors, to the Committee on Real Property and Probate, February 21, 2000.

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also addresses a title defect in the original bill. The bill was then reported favorably as amended.

VII. SIGNATURES:

COMMITTEE ON BUSINESS DEVELOPMENT & INTERNATIONAL TRADE:

Prepared by:

Staff Director:

James M. Cox

J. Paul Whitfield, Jr.

AS REVISED BY THE COMMITTEE ON REAL PROPERTY AND PROBATE:

Prepared by:

Staff Director:

Nathan L. Bond, J.D.

J. Marleen Ahearn, Ph.D, J.D.