

STORAGE NAME: h0099a.ft

DATE: April 19, 1999

**HOUSE OF REPRESENTATIVES
AS REVISED BY THE COMMITTEE ON
FINANCE AND TAXATION
ANALYSIS**

BILL #: HB 99

RELATING TO: Sales Tax Exemption/Ad Agencies

SPONSOR(S): Representative Dockery

COMPANION BILL(S): Similar SB 1330

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

- (1) BUSINESS DEVELOPMENT AND INTERNATIONAL TRADE YEAS 8 NAYS 0
 - (2) FINANCE AND TAXATION YEAS 15 NAYS 0
 - (3) GENERAL APPROPRIATIONS
 - (4)
 - (5)
-

I. SUMMARY:

This bill creates a sales tax exemption for certain items of tangible personal property when they are: sold to an advertising agency acting as an agent for its client; produced or created by the advertising agency for its client and used in the performance of advertising services for its client; or sold by the advertising agency to its client in the performance of advertising services for its client. Additionally, this bill specifically states that creative services used by an advertising agency to design promotional items are not subject to taxation.

This bill provides that the exemptions created are retroactive; however, taxes paid before July 1, 1999 are not subject to refund.

The total estimated fiscal impact upon General Revenue is (\$11.2) million for FY 99-2000 and (\$11.9) million for FY 2000-2001. There will be a negative, but insignificant impact on the Solid Waste Management Trust Fund. The estimated fiscal impact upon local governments is (\$1.8) million for FY 1999-2000 and (\$1.9) for FY2000-2001. The total estimated fiscal impact for this bill is (\$13.0) million for FY 1999-2000 and (\$13.8) million for FY 2000-2001.

The strike-everything amendment adopted by the House Committee on Business Development and International Trade added language to the bill providing the Department of Revenue with rulemaking authority to interpret or define the provisions of the bill.

The bill provides an effective date of July 1, 1999.

II. SUBSTANTIVE ANALYSIS:

A. PRESENT SITUATION:

Chapter 212, F.S., imposes a 6 percent tax on sales, use and other transactions including the transfer of tangible personal property. Section 212.02(19), F.S., provides a definition for tangible personal property of property which may be seen, weighed, measured, or touched or is in any manner perceptible to the senses. Section 212.08, F.S., provides for certain exemptions from the tax imposed by this chapter and s. 212.08(7)(v), F.S., provides for an exemption for certain professional services, specifically: "professional, insurance, or personal service transactions that involve sales as inconsequential elements for which no separate charges are made." Tangible personal property intended for resale is exempt, except that property purchased for use in manufacturing other property intended for resale must be physically incorporated into the product later sold.

Advertising agencies purchase tangible items such as videos, photographs and illustrations when providing their services to a client. Additionally, advertising agencies may sell items such as videos and other forms of design work to their client as part of the advertising service. The Department of Revenue's position on the transfer of such tangible personal property is that it is taxable because the items are a *consequential* part of the sale of the professional service. Advertising agencies take the position that their creative services are the *consequential* part of the sale and the medium on which those services are delivered is *inconsequential* thereby making the transfer of those items exempt under s. 212.08(7)(v), F.S.

Court Cases In Favor of the Advertising Agencies' Position

In Southern Bell v. Department of Revenue, 336 So.2nd 30 (1979), the First District Court of Appeal held that sales of artwork to Southern Bell for yellow page advertisements were in fact purchases of a professional service and that the tangible personal property on which the artist's ideas were transmitted were inconsequential elements of the transaction.

The court's conclusion was based on three factors: 1.) whether the property transferred was already in existence or produced in the course of providing the service; 2.) the value of the individual effort involved compared to the value of the property transferred; and, 3.) whether or not it was essential to the transaction that the specific tangible personal property be created. The court found that the art in question was created solely for the particular transaction, that the value of the services performed for Southern Bell were much greater than the value of the tangible personal property transferred, and that the material on which the services were transferred was not essential to Southern Bell's realization of the value of the artist's services "because the designs created by the artist could be disassociated from the tangible personal property even though it might not have been economically feasible to do so."

In William Cook Agency v. Department of Revenue, 93 TAX FALR 458 (1993), the Fourth Circuit Court adopted the reasoning of the court in Southern Bell, including the three factor test, and specifically applied it to advertising agencies. The court found that the William Cook agency "develops and sells an advertising strategy delivered through the medium of paper, print, visual tapes and audiotapes" and that "it is generally not essential to the transaction that tangible personal property be created." The court ruled that the advertising services provided by the agency were professional services involving sales as inconsequential elements and therefore no sales tax was due. The court also applied this reasoning to purchases made by the advertising agency from such vendors as typographers, photographers, and artists, finding that these were also professional services with sales as inconsequential elements and therefore not taxable.

Court Cases In Favor of the Department of Revenue's Position

In Green v. Sgurovsky, 133 So.2nd 663 (1961), the Third District Court of Appeal found that artwork provided to an architect by an artist was taxable. The court stated:

Unquestionably personal services of the artist or craftsman furnish or bring about the main value of the product. But it is the product which is sold, and the renderer's services without the product would not be of any value to the architect. The sale can not be said to be "inconsequential." It is comparable to an artist's preparation and sale of a portrait to a customer.

And, in Florida Association of Broadcasters v. Kirk, 264 So.2nd 437 (1972), the First District Court of Appeal found that the rental of a film for television broadcast was taxable even though the taxpayer argued that the cost of renting the physical film was nominal while the payment was mostly for the right to use the film. The court stated:

Every purchase or rental of property is the acquisition of the right to use that property for its intended purposes. Likewise, practically every piece of property subject to rent or sale is a product of someone's original idea and the rental thereof is for the purpose of using it.

Declaratory Statement by the Department of Revenue

In a recent ruling by the Department of Revenue, they reaffirmed their position requiring advertising agencies and other buyers and sellers of artwork, photos, illustrations and similar products to charge or collect sales tax. In the case of Terry A. Renna, Photographer (Case No. 96-1-DS), the photographer had petitioned the Department to determine whether his charges for creating exposed negatives and granting his customers a license to use them was subject to sales tax. The negatives were created mostly for commercial customers for use in brochures and advertisements. The Department, in a 1996 declaratory statement, reasoned:

Unfortunately, the majority opinion in Southern Bell did not address the First District's earlier opinion in Kirk, or the Third District's opinion in Green, cited above. Nor did the majority appear to resolve what seems to be obvious doubts regarding the transactions at issue against granting the exemption, as the law requires, and as the Court in Green specifically acknowledged. As a result, the Department cannot logically or consistently apply the majority opinion in Southern Bell to Petitioner's sales as referenced in the record. The decisions in Kirk and Green, cited above, are more on point and, together with the governing statutes, serve as the basis for the conclusions reached in this Declaratory Statement.

The Department has reached these conclusions aware of the trial court order in The William Cook Agency, Inc. V. Dept. Of Revenue. However, the First District per curiam affirmed Cook, which does not establish precedent or a point of law.

The Department concludes that Florida Association of Broadcasters v. Kirk and Green v. Sgurovsky, supra, correctly state the law, and therefore apply to Petitioner's facts in the record. Petitioner's negatives and transparencies are clearly what his customers require and the reason for which he is being paid. The negatives and transparencies are finished products created for his customer's use, and his services are of no value to his customer without them.

B. EFFECT OF PROPOSED CHANGES:

This bill would adopt the holding of the Fourth Circuit Court in William Cook Agency v. Department of Revenue, as state law for taxation of advertising agencies.

This bill provides a definition for "advertising agencies" as a firm regularly engaged in the business of providing advertising materials and services to its clients. Such agencies would be exempt from sales tax on items of tangible personal property such as photographic negatives and positives, videos, films, galleys, mechanicals, veloxes, illustrations, and artwork and the services used to produce them if the items are: 1) sold to the agency acting as an agent for its client and are created for the performance of advertising services; 2) created or produced by an advertising agency for its clients and used in the performance of advertising services; or 3) sold by an advertising agency to its client in the performance of advertising services.

The bill provides that promotional items and creative services used by the advertising agency are exempt; however, when promotional items such as key chains, shirts, hats, pens, etc..., are produced for distribution, tax applies to the cost price.

The exemption is to apply retroactively except with respect to taxes that have already been remitted. The bill does not allow for refunds of taxes paid prior to July 1, 1999.

C. APPLICATION OF PRINCIPLES:

1. Less Government:

a. Does the bill create, increase or reduce, either directly or indirectly:

(1) any authority to make rules or adjudicate disputes?

The passage of this bill *may* increase the Department of Revenue's authority to make rules and resolve disputes for the newly-crafted and clearly-defined tax exemptions provided to advertising agencies.

(2) any new responsibilities, obligations or work for other governmental or private organizations or individuals?

The Department of Revenue would possibly have to establish a way to determine when advertising agencies, acting as agents for their clients, purchasing certain items of tangible personal property are exempt from paying sales tax on such property.

(3) any entitlement to a government service or benefit?

No.

b. If an agency or program is eliminated or reduced:

(1) what responsibilities, costs and powers are passed on to another program, agency, level of government, or private entity?

N/A

(2) what is the cost of such responsibility at the new level/agency?

N/A

(3) how is the new agency accountable to the people governed?

N/A

2. Lower Taxes:

a. Does the bill increase anyone's taxes?

No.

b. Does the bill require or authorize an increase in any fees?

No.

c. Does the bill reduce total taxes, both rates and revenues?

Yes. The bill may reduce taxes on certain items sold to and sold by advertising agencies.

d. Does the bill reduce total fees, both rates and revenues?

No.

e. Does the bill authorize any fee or tax increase by any local government?

No.

3. Personal Responsibility:

a. Does the bill reduce or eliminate an entitlement to government services or subsidy?

No.

b. Do the beneficiaries of the legislation directly pay any portion of the cost of implementation and operation?

No.

4. Individual Freedom:

a. Does the bill increase the allowable options of individuals or private organizations/associations to conduct their own affairs?

N/A

b. Does the bill prohibit, or create new government interference with, any presently lawful activity?

N/A

5. Family Empowerment:

a. If the bill purports to provide services to families or children:

(1) Who evaluates the family's needs?

N/A

(2) Who makes the decisions?

N/A

(3) Are private alternatives permitted?

N/A

(4) Are families required to participate in a program?

N/A

(5) Are families penalized for not participating in a program?

N/A

b. Does the bill directly affect the legal rights and obligations between family members?

N/A

c. If the bill creates or changes a program providing services to families or children, in which of the following does the bill vest control of the program, either through direct participation or appointment authority:

(1) parents and guardians?

N/A

(2) service providers?

N/A

(3) government employees/agencies?

N/A

D. STATUTE(S) AFFECTED:

Section 212.08, F.S.

E. SECTION-BY-SECTION ANALYSIS:

Section 1 - Amends 212.08(7), F.S., providing a definition for advertising agencies, exempting from sales tax certain items of tangible personal property when sold to an advertising agency acting as an agent for a client or sold by the advertising agency to a client as part of the performance of the advertising services for a client.

Section 2 - Provides an effective date of July 1, 1999.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE AGENCIES/STATE FUNDS:

1. Non-recurring Effects:

None.

2. Recurring Effects:

	<u>FY 99-2000</u>	<u>FY 2000-01</u>
General Revenue	(\$11.2M)	(\$11.9M)
Trust Fund	(*)	(*)
Local Government	(\$1.8M)	(\$1.9)

3. Long Run Effects Other Than Normal Growth:

None.

4. Total Revenues and Expenditures:

See A. 2.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS AS A WHOLE:

1. Non-recurring Effects:

None.

2. Recurring Effects:

See III. A. 2.

3. Long Run Effects Other Than Normal Growth:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

1. Direct Private Sector Costs:

None.

2. Direct Private Sector Benefits:

Advertising agencies would have a clearly defined tax exemption on certain items of tangible personal property.

3. Effects on Competition, Private Enterprise and Employment Markets:

None.

D. FISCAL COMMENTS:

None.

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

A. APPLICABILITY OF THE MANDATES PROVISION:

The 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:

Although the bill will reduce the authority of municipalities and counties to raise revenues, the impact is expected to be insignificant and the bill is therefore exempt from the provisions of Article VII, Section 18(b), Florida Constitution.

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

While the bill will reduce the amount of the Local Government Half Cent Sales Tax shared with municipalities and counties, it does not reduce the percentage of a state tax shared with municipalities and counties. Therefore, Article VII, Section 18(b), Florida Constitution does not apply.

V. COMMENTS:

During the 1998 Legislative Session, the House passed CS/HB 1795 and it subsequently died in the Senate in messages.

HB 99 is almost identical to CS/HB 1795.

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

On February 16, the House Committee on Business Development and International Trade passed HB 99 with a strike-everything amendment. The language in the amendment was identical to the original bill with three exceptions providing clarity and specificity.

Specifically:

- ◆ Language in paragraph 1., providing a definition for an advertising agency based upon the agency's activities, was changed from *regularly* to *primarily* engaged in the business of providing advertising materials and services to its client's.
- ◆ Language was added to the new paragraph 3., specifying tax liability on promotional goods produced for distribution.
- ◆ Language was added giving the Department of Revenue limited rulemaking authority interpreting or defining the provisions of the bill.

STORAGE NAME: h0099a.ft

DATE: April 19, 1999

PAGE 9

VII. SIGNATURES:

COMMITTEE ON BUSINESS DEVELOPMENT AND INTERNATIONAL TRADE:

Prepared by:

Staff Director:

Jill F. Turman

J. Paul Whitfield, Jr.

AS REVISED BY THE COMMITTEE ON FINANCE AND TAXATION:

Prepared by:

Staff Director:

Lynne Overton

Alan Johansen