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## FLORIDA'S NEW "INCOME" TAX

JOSEPH W. JACOBS\*

*When the Florida Legislature set out to broaden the state's tax base during the 1986 Regular Session, it extended the sales tax to services. Unfortunately, lawmakers did not specify what services would be taxed. In this Article, Professor Jacobs reviews the ambiguous 1986 Act to determine whether the sales tax may be applied to employee services unless the legislature limits the reach of the new levy. He argues that an employee services tax would differ from an individual income tax, which is prohibited by the Florida Constitution, and could be sustained by the courts. Nevertheless, he expresses concern that such a dramatic change in tax policy could arise from inadvertence.*

**A** TIME BOMB lies buried within the collected laws passed by the Florida Legislature during the 1986 Regular Session. Unless disarmed by legislative action during the 1987 Regular Session, it will detonate on July 1, 1987. The result will be something looking very much like a five percent tax imposed on all income earned in Florida.

This time bomb is hidden deep within chapter 86-166,<sup>1</sup> captioned "an act relating to sales tax exemptions . . ." Public interest in this law, to the extent that it exists at all, seems to have focused on the merits of extending the existing general sales tax to legal and other professional fees.<sup>2</sup> The truly spectacular feature of chapter 86-166 seems to have gone largely unnoticed. Effective July 1, 1987, there is imposed a five percent tax on the "consideration for performing or providing any service."<sup>3</sup> The phrase "any service" is not separately defined, but potentially covers a wide spectrum of situations not specifically considered by the legislators. Among the more radical possibilities is that the tax reaches

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1. Ch. 86-166, 1986 Fla. Laws 816.

2. FLA. STAT. § 212.08(7)(d)(1) (1985) exempts from the general sales tax "professional, insurance, or personal service transactions."

3. Ch. 86-166, § 3, 1986 Fla. Laws 816, 819 (amending FLA. STAT. § 212.05(1) (1985)). Paragraph (j) is created to read as quoted in the text. The professional services exemption will "sunset" July 1, 1987. *Id.* § 8, 1986 Fla. Laws at 825. This same sunset provision also will remove the existing exemptions for a hodgepodge of items, including magazine subscriptions, solar energy, and other energy-efficient heating and cooling devices. *Id.*

an ordinary employee's paycheck.<sup>4</sup> Such a paycheck is pretty clearly "the consideration [the employee receives] for performing or providing any service"<sup>5</sup> to his employer. Thus, if an employee earns \$20,000 annually, chapter 86-166 apparently<sup>6</sup> subjects him to a \$1,000 tax.<sup>7</sup>

This Article first examines the language of chapter 86-166, concluding that its plain language imposes a five percent tax on all wages and salaries. It then considers whether the Act, as so interpreted, could withstand constitutional attack.

## I.

*The first thing we do, let's [tax] all the lawyers.*<sup>8</sup>

Florida's sales tax is a traditional sales tax insofar as it imposes the tax on "every person . . . who engages in the business of selling tangible personal property at retail."<sup>9</sup> From the beginning, however, Florida broke with the custom of sister states by extending its "sales tax" to other kinds of transactions.<sup>10</sup> Chapter

4. This Article focuses on employees and the likelihood that their wages and salaries will become subject to a five percent tax. FLA. STAT. § 212.05(1)(j) will in fact cast a wider net. "[A]ny service," not just one performed by an employee, will potentially become taxable. Thus, charges made by independent contractors of all types for their services could be reached.

5. Ch. 86-166, § 3, 1986 Fla. Laws 816, 819 (creating FLA. STAT. § 212.05(1)(j)). The "service" provided in this example is the employee's labor. The plain meaning of the statute—the phrase "any service" is straightforward and clearly broad—arguably overrides the lack of specific legislative intent and thus imposes a broad-based tax measured by an employee's earnings. For a general discussion of the plain meaning rule of statutory construction, see Rhodes & Seereiter, *The Search for Intent: Aids to Statutory Construction in Florida—An Update*, 13 FLA. ST. U.L. REV. 485, 486-88 (1985). See also *infra* text accompanying notes 38-41.

6. As discussed later in this Article, there is some question as to the actual intent or impact of the section. Hence, the word "apparently."

7. The statute is arguably unclear as to whether the tax base is the gross or net consideration received by the employee (gross wages versus take-home pay). This distinction is not only politically important, it is relevant when analyzing whether ch. 86-166 imposes a "true" income tax. See *infra* text accompanying notes 84-85.

8. Shakespeare, *Henry VI (Part II)*, Act IV, sc. ii, 83. Dick the Butcher, of course, suggested killing the lawyers. Some segments of the Florida Bar have reacted so negatively to the idea of taxing legal fees that one might think the legislature, like Dick, wished to kill, not just tax.

9. FLA. STAT. § 212.05 (1985). Sales taxes were traditionally "limited to transfers of tangible personal property for purposes other than resale by the purchaser." Hellerstein, *The Scope of the Taxable Sale Under Sales and Use Tax Acts: Sales as Distinguished From Services*, 11 TAX L. REV. 261, 262 (1956).

10. The original version of ch. 212 imposed the tax on transient lodging charges, a most unusual feature for a sales tax. Ch. 26319, § 3(a), 1949 Fla. Laws 9, 14 (extraordinary ses-

212, Florida Statutes,<sup>11</sup> has long taxed most real estate rentals,<sup>12</sup> admissions to entertainment events,<sup>13</sup> telephone and cable television services,<sup>14</sup> and diaper services,<sup>15</sup> among other things. Plainly these items represent transactions above and beyond the retail sale of tangible personal property.

### A. *How the Legislature Approached the Revenue Problem*

This unique Florida approach to sales taxes is due largely to taxing limitations imposed by the Florida Constitution.<sup>16</sup> As Florida's population grew, so did the demand for government services and, consequently, the demand for additional tax revenue to pay for these services.<sup>17</sup> Since first imposed in 1949,<sup>18</sup> the general sales tax has been Florida's revenue workhorse.<sup>19</sup> Thus, when the legislature found the state in need of additional sources of revenue, it again turned to chapter 212.<sup>20</sup>

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sion). *See also* *Gaulden v. Kirk*, 47 So. 2d 567 (Fla. 1950) (validating criminal prosecution of landlord who leased to transients and refused to pay "rental" tax).

11. FLA. STAT. ch. 212 (1985).

12. In 1969, in response to a perceived need for additional revenue, the legislature both increased the rate of the sales tax from three to four percent, and extended its reach to include most rent paid for the lease of real property. Ch. 69-222, § 6, 1969 Fla. Laws 877, 881 (current version at FLA. STAT. § 212.031 (1985)). The principal exceptions are for agricultural property and dwelling units. *Id.*

13. Ch. 26319, § 4, 1949 Fla. Laws 9, 16 (extraordinary session) (current version at FLA. STAT. § 212.04 (1985)). Significantly, "[n]o tax shall be levied on admissions to the National Football League championship game." *Compare* FLA. STAT. § 212.04(2)(a)(4) (1985) with I.R.C. § 501(c)(6) (1985) ("professional football leagues" exempt from federal income taxation).

14. Ch. 69-222, § 9, 1969 Fla. Laws 877, 884 (current version at FLA. STAT. § 212.05(1)(e)1 (1985)).

15. FLA. ADMIN. CODE R. 12A-1.23(2) (1985).

16. Ad valorem taxation of real property and tangible personal property by the state is forbidden by FLA. CONST. art. VII, § 1. A tax "upon the income of natural persons" is forbidden by FLA. CONST. art. VII, § 5(a).

17. Rep. Samuel P. Bell, Dem., Ormond Beach, speaking to the Florida Bar Board of Governors on September 19, 1986, estimated the immediate revenue needs at \$1.3 billion. *Board opposes sunset of lawyers' tax exemption*, Florida Bar News, Oct. 1, 1986, at 1, col. 1. For a discussion of the impact of demographic and economic trends on tax revenues, see generally Zingale & Davies, *Why Florida's Tax Revenues Go Boom or Bust, and Why We Can't Afford It Anymore*, 14 FLA. ST. U.L. REV. 433 (1986).

18. Ch. 26319, 1949 Fla. Laws 9 (extraordinary session) (codified as amended in scattered sections of FLA. STAT. ch. 212 (1985)).

19. The great exception and major supplement of this revenue source has been the imposition of an income tax on corporations. *See* ch. 71-984, 1972 Fla. Laws 57 (current version at FLA. STAT. ch. 220 (1985)).

20. For a general discussion of ch. 212, the legislative history of the 1986 Act, and a summary of taxable events which fall currently within the ambit of ch. 212, see Pierce &

The legislature eschewed the obvious solution of merely raising the five percent rate.<sup>21</sup> Instead, it borrowed a page from the federal government,<sup>22</sup> seeking to raise more revenue by eliminating exemptions now found in chapter 212.<sup>23</sup> Some exemptions, such as that for food,<sup>24</sup> are rooted in sound public policy.<sup>25</sup> Others, such as the exemption for chlorine used in swimming pools,<sup>26</sup> have no discernible public policy underpinnings.

Although the entire smorgasbord of existing exemptions was under scrutiny, legislative attention focused on the so-called "professional services" exemption,<sup>27</sup> more specifically, on whether lawyers' fees should be subject to chapter 212.<sup>28</sup> Under a classical retail sales tax, the notion of taxing lawyers' fees or any other type of "pure" service transaction would be preposterous.<sup>29</sup> But, as has been shown, chapter 212 is manifestly more than a classical retail sales tax; iconoclasm in Florida's sales tax law is hardly novel.

The question for the legislature became how to extend chapter 212 to reach the revenue gold mine of professional and other presently untaxed services?

Peacock, *Broadening the Sales Tax Base: Answering One Question Leads to Others*, 14 FLA. ST. U.L. REV. 463 (1986).

21. The last rate increase took place only four years earlier. Ch. 82-154, § 4, 1982 Fla. Laws 450, 453 (rate raised from four to five percent). Quadrennial rate hikes would doubtless overtax the electoral patience, although some legislators seem prepared to do just that. Rep. Bell has predicted an eventual tax rate of eight percent. *Board opposes sunseting of lawyers tax exemption*, Florida Bar News, Oct. 1, 1986, at 4, col. 3.

22. Base-broadening is in vogue in Washington, too. The Tax Reform Act of 1986, Pub. L. No. 99-514, \_\_\_\_ Stat. \_\_\_\_, seeks to "broaden the base" to which the federal income tax applies, permitting significant rate reductions without a loss of revenue. See H.R. REP. NO. 841, 99th Cong., 2d Sess. *passim* (1986). See also Chirelstein, *Back From the Dead: How President Reagan Saved the Income Tax*, 14 FLA. ST. U.L. REV. 207 (1986).

23. Sales taxes frequently have been referred to as taxes by exemption. Barnett & Kirkwood, *Sale and Use Taxes*, 1 FLORIDA STATE AND LOCAL TAXES 663, 668 (Florida Bar 1984). An examination of the length and complexity of FLA. STAT. § 212.08 establishes that Florida has been no different in this regard. See FLA. STAT. § 212.08 (1985).

24. FLA. STAT. § 212.08(1) (1985).

25. Experts seem to agree that by exempting food for human consumption, a sales tax is made far less regressive. See, e.g., J. PECHMAN, FEDERAL TAX POLICY 197 (4th ed. 1983).

26. FLA. ADMIN. CODE R. 12A-1.20(11)(b) (1985). Chapter 86-166 overrules this exemption. Ch. 86-166, § 5, 1986 Fla. Laws 816, 823.

27. "Also exempted are professional, insurance, or personal service transactions which involve sales as inconsequential elements for which no separate charges are made." FLA. STAT. § 212.08(7)(d)(1) (1985). This language is found in other sales tax statutes. See Hellerstein, *supra* note 9, at 277 n.43.

28. See, e.g., *Board opposes sunseting of lawyers' tax exemption*, Florida Bar News, Oct. 1, 1986, at 1, col. 1.

29. "It would be strange indeed to consider that the lawyer drawing a will, the accountant a report, or the architect plans, are making 'sales'." Hellerstein, *supra* note 9, at 276-77.

### B. *The Statutory Drafting Problems Facing the Legislature*

A fine start toward this objective could be made by the repeal of the professional and other services exemption.<sup>30</sup> But mere repeal of the exemption might not do the trick. True, by repeal the legislature would remove an express prohibition now governing the Department of Revenue's conduct. Under our system of government, however, the tax collector is not privileged to begin collecting taxes merely because there is no specific statutory prohibition. Affirmative statutory authority is necessary.<sup>31</sup>

As applied to chapter 212, the question would be whether the operative taxing section<sup>32</sup> (as it presently exists) affirmatively imposes a tax on services, the levying of which being blocked only by a statutory services exemption? The answer is a resounding "maybe."<sup>33</sup>

### C. *The Four-Step "Solution"*

The solution reached by legislators has four steps. First, repeal the professional and other services exemption.<sup>34</sup> Second, add language to the operative provisions of chapter 212 expressly taxing services and providing a rudimentary collection mechanism.<sup>35</sup> Third, delay the effective date of steps one and two for more than a year, until July 1, 1987.<sup>36</sup> And fourth, set up a commission to study the question and make recommendations before the beginning of the 1987 Regular Session.<sup>37</sup>

30. Ch. 86-166, § 8, 1986 Fla. Laws 816, 825.

31. T. COOLEY, A TREATISE ON THE LAW OF TAXATION 41-43 (2d ed. 1886).

32. FLA. STAT. § 212.05 is the principal operative section of ch. 212. It imposes the tax on retail sales of tangible personal property. FLA. STAT. §§ 212.03, .031, and .04 are also operative sections, dealing with the tax on rents and admissions.

33. As written, § 212.05 reaches "every person . . . who . . . furnishes any of the . . . services taxable under this chapter." FLA. STAT. § 212.05 (1985). Clearly the statute contemplates that at least some services are taxable. None of the eight existing paragraphs of § 212.05(1) taxes professional or other services. The argument for taxability, then, would rest on the inference resulting from the repeal of the professional services exemption. Restated, if the services were not prima facie taxable under § 212.05(1), why was the professional services exemption of § 212.08(7)(d)(1) needed in the first place?

34. Ch. 86-166, § 8, 1986 Fla. Laws 816, 825.

35. *Id.* § 3, 1986 Fla. Laws at 819 (to be codified at FLA. STAT. § 212.05(1)(j)). The collection problem is solved by adding new paragraph (k) to FLA. STAT. § 212.06(2): "'Dealer' also means any person who provides or performs a taxable service for consideration." Ch. 86-166, § 4, 1986 Fla. Laws at 821. The collection mechanism of ch. 212 revolves around the classification of certain persons as "dealers" responsible for the collection and payment of the tax. FLA. STAT. § 212.06 (1985).

36. Ch. 86-166, §§ 3, 8, 1986 Fla. Laws 819, 825.

37. *Id.* § 9, 1986 Fla. Laws at 825.

The legislature was particularly aggressive in the execution of steps one and two. The simplest approach would have been to use the language of the old statutory exemption in the new operative section. Under this variation, the legislature simply would have taxed, for example, "professional, insurance, or personal service transactions which involve sales as inconsequential elements for which no separate charges are made."<sup>38</sup> In fact, the legislature went further. The actual operative provision contains the broadest conceivable language: A five percent tax is imposed on "the consideration for performing or providing any service."<sup>39</sup>

#### D. *But What Did They Really Mean To Do?*

An analysis of the legislative history and a reading of the face of the statute do not evince any clear expression of intent to impose a five percent tax on all employee services. There is no preamble clause, no statutory heading or caption, no committee report stating: "Beginning next July 1st, all wages and salaries will be subject to a five percent state tax."

Yet the plain language of chapter 86-166 imposes just such a tax regardless of the lack of specific legislative expression.<sup>40</sup> Again, it is not just the repeal of the services exemption that works this result. It is the addition of the new paragraph (j)<sup>41</sup> that puts the matter beyond cavil.

The key to legislative intent probably lies in what was identified as the fourth step, the creation of a new study commission. This commission is to perform a searching and fearless inventory of all exemptions, considering a host of policy and economic factors in the process,<sup>42</sup> and then make recommendations to the 1987 legislature.<sup>43</sup> Perhaps the idea was this: Steps one and two have the effect of putting a loaded gun to the head of the legislature in 1987. The consequences of inaction will be so horrendous as to make inaction distasteful, to say the least.<sup>44</sup>

38. FLA. STAT. § 212.08(7)(d)(1) (1985).

39. Ch. 86-166, § 3, 1986 Fla. Laws at 820 (to be codified at FLA. STAT. § 212.05(1)(j)) (emphasis added).

40. See Rhodes & Seereiter, *supra* note 5, at 486-88.

41. See *supra* text accompanying notes 38-39.

42. Ch. 86-166 contains specific instructions to the commission. Ch. 86-166, § 9, 1986 Fla. Laws 816, 826-27.

43. *Id.*, § 9(3)(a), 1986 Fla. Laws at 826.

44. A Department of Revenue study of ch. 86-166 understates the problem which would be created by inaction next year. One option would be: "Leave the concept of the current statute [ch. 86-166] largely unchanged, and proceed to register all salaried employees as

However, action by the legislature next year is by no means inevitable. Whatever the recommendation of the study commission, it is likely that the legislature will be asked to raise someone's taxes next year. The incentive to avoid voting for a tax increase is obvious.<sup>45</sup> The legislature avoided the tough political question in 1986 by appointing a commission and putting the matter off one year. The legislature could avoid the question in 1987 by inaction, allowing chapter 86-166 to spring into life on July 1, 1987. That way no one takes responsibility, at least not until the matter is taken into the courts following the inevitable challenge that chapter 86-166 imposes a "tax on income" within the meaning of article VII, section 5(a) of the Florida Constitution.<sup>46</sup>

## II.

*Income tax, if I may be pardoned for saying so, is a tax on income.*<sup>47</sup>

Lord Macnaghten's intuitive definition of an income tax would likely accord with the view of most Floridians. A tax which extracts five percent of everyone's yearly earnings sure looks like an income tax. Your author raised just this issue with several attorneys and colleagues. Their response was remarkably uniform. After strong initial disbelief that the legislature really passed such a tax, they responded: "Oh. If that's what they did, then it's obviously unconstitutional."<sup>48</sup>

With due respect to these colleagues, the legal answer to whether this new "services tax"<sup>49</sup> is an income tax is not so obvious. The Florida Constitution does, of course, prohibit the imposition of an

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sales tax dealers. While this approach is . . . straightforward, it is likely to be met with significant taxpayer resistance." Florida Dep't of Revenue, Study of Legal, Administrative and Revenue Implications of Applying the Sales and Use Tax to Services 21 (Aug. 25, 1986) (unpublished report) (on file, *Florida State University Law Review*) [hereinafter cited as Dep't of Revenue Study].

45. The voters probably would not take great solace in the explanation that less tax would be imposed by such a bill (that is, *any* bill the legislature may pass in 1987) than would have been imposed automatically by ch. 86-166.

46. See *infra* note 50.

47. *London County Council v. Attorney General*, 1901 A.C. 26, 35 (H.L. 1900) (Macnaghten, L.J.).

48. Most treated my assertion that a broad services tax was enacted as a prank.

49. The neutral term "services tax" is used in this part to describe the tax to be imposed by FLA. STAT. § 212.05(1)(j). As discussed below, the name given to this tax exerts a profound influence on its constitutional vitality.



individual income tax.<sup>50</sup> But only a "tax on income" is proscribed. A tax levied on something else is not expressly prohibited.<sup>51</sup>

A court squarely presented with the constitutional question could hold the services tax unconstitutional.<sup>52</sup> The court's initial reaction would likely mirror that of my colleagues: the services tax is a disguised income tax. Abundant precedent supports such a ruling.<sup>53</sup> The point to be made here, however, is that this same court could, if so inclined, invoke ample and compelling precedent to overcome the intuitive reaction of unconstitutionality. Chapter 86-166 can be sustained.

### A. *The Excise Tax Argument*

An excise tax is a governmental assessment on the privilege of doing something.<sup>54</sup> Gasoline taxes, communications taxes, and license taxes are common examples. Some excise taxes are levied in the form of a flat charge<sup>55</sup> and others as a percentage of the reve-

50. FLA. CONST. art. VII, § 5(a) prohibits a "tax upon . . . the income of natural persons who are residents or citizens of the state." This provision is discussed extensively in *In Re Advisory Opinion to Governor*, 243 So. 2d 573 (Fla. 1971). There, Gov. Askew requested advice on the constitutionality of his proposed corporate income tax. His theory was that corporations were not "residents or citizens of the state" within the meaning of the FLA. CONST. The court ruled that artificial, corporate persons were entitled to the protections of art. VII, § 5. *Id.* at 581. A constitutional amendment was needed in order to impose the tax. This was later passed and is found in art. VII, § 5(b).

51. "The power of taxation is an incident of sovereignty, and is possessed by the government without being expressly conferred by the people." T. COOLEY, *supra* note 31, at 4.

52. Ch. 86-166 contains no severability clause. Thus, a constitutional defect in the services tax could vitiate the entire chapter.

53. Technical arguments exist which support this conclusion. *State ex rel. McKay v. Keller*, 191 So. 542 (Fla. 1939), is helpful. *See infra* text accompanying notes 62-66. A good analogy is found in the treatment of local payroll taxes (closely resembling the services tax at issue here) under the Internal Revenue Code. Section 164(a)(3) grants individuals a deduction for "State and local . . . income . . . taxes." I.R.C. § 164(a)(3) (1985). A number of local payroll taxes (imposed solely on gross earnings from employment) have been held to be deductible under this section on the grounds that they are "income taxes" within the meaning of the Internal Revenue Code. *See, e.g.*, Rev. Rul. 54-598, 1954-2 C.B. 121. *See also* U.S. MASTER TAX GUIDE (CCH) ¶ 60, Check List VI-State and Local Taxes (1986). Finally, the four states (Hawaii, Iowa, New Mexico, and South Dakota) which have enacted expansive taxes on services took great care to enact statutes which clearly set out the services to be taxed and the method for collection. *See* Dep't of Revenue Study, *supra* note 44, at Exhibits C-F. Ch. 86-166 shows no such careful legislative thought. This gives rise to a separate constitutional attack: Whatever the name of the tax imposed by ch. 86-166, it is arguably so vague as to be unconstitutional under the due process clause of the fourteenth amendment to the Constitution.

54. *See* J. PECHMAN, *supra* note 25, at 185-193. For a more extensive listing of excise taxes on the federal level, see 1986 U.S. EXCISE TAX GUIDE (CCH) *passim*.

55. *See, e.g.*, *Paper Supply Co. v. City of Chicago*, 317 N.E.2d 3 (Ill. 1974) (three dollars per employee "occupational tax").

nue of the taxed transaction.<sup>56</sup> Still other excise taxes have used income as a measuring stick.<sup>57</sup> Here the question arises as to whether the tax is on the *privilege* of earning the income or upon the *income* itself. This distinction is extremely important in Florida, where an excise tax measured by income is constitutional and a tax on the income itself is not.<sup>58</sup>

The key to the analysis is the identification of the fine line between these two concepts. Four seminal cases indicate the difficulty courts have had with the issue. Of these, two Florida cases set the stage.

In *Gaulden v. Kirk*,<sup>59</sup> the petitioner was arrested because he refused to pay Florida's then recently enacted tax measured by the gross receipts of his business.<sup>60</sup> Mr. Gaulden instituted habeas corpus proceedings challenging the constitutionality of the statute.<sup>61</sup> The Florida Supreme Court upheld the tax, holding it was not imposed directly on personal property or services, but "upon the *privilege* of selling the same."<sup>62</sup> The tax, therefore, was an excise tax which could be levied without constitutional implications.

A counterpoint is provided by *State ex rel. McKay v. Keller*,<sup>63</sup> involving an attempt by the City of Tampa to impose a tax on attorneys.<sup>64</sup> The levy was characterized as a "license tax," the payment of which being a prerequisite to the annual issuance of a city license. The amount of the tax was computed by charging \$25 for the first \$2,500 of an attorney's gross receipts and \$10 for each

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56. A sales tax computed as a percentage of the gross sales amount is a simple example of this technique. See, e.g., FLA. STAT. § 212.05(1)(a),(c) (1985).

57. Early Florida examples of this approach include *City of DeLand v. Florida Pub. Serv. Co.*, 161 So. 735 (Fla. 1935) (municipal excise tax measured by 10% of the charge for all sales of electricity) and *City of Lakeland v. Amos*, 143 So. 744 (Fla. 1932) (tax on anyone who received payments for electricity, measured by gross receipts).

58. See, e.g., *Amos*, 143 So. at 744. "The tax is not upon earnings, but upon the occupation or business of selling measured by reference to gross receipts from sales." *Id.* at 747.

59. 47 So. 2d 567 (Fla. 1950).

60. This tax was levied as part of what is popularly called the Florida Revenue Act of 1949. Ch. 26319, 1949 Fla. Laws 9 (extraordinary session) (codified as amended in scattered sections of FLA. STAT. ch. 212 (1985)). See *supra* note 10.

61. *Gaulden*, 47 So. 2d at 567. The version of art. VII, § 5, FLA. CONST. in effect at the time of this litigation did not provide for a tax upon corporations. See *supra* notes 19, 50.

62. *Gaulden*, 47 So. 2d at 574 (emphasis added). The court also noted that in its judgment the tax at issue was not an income tax, it was measured by the compensation received. *Id.*

63. 191 So. 542 (Fla. 1939).

64. The Bar might well regard the repeal of the professional services exemption as an identical effort. See, e.g., *Board opposes sunset of lawyers tax exemption*, Florida Bar News, Oct. 1, 1986, at 1, col. 1.

\$1,000 of receipts thereafter.<sup>65</sup> A local attorney argued that the ordinance was an unconstitutional tax upon his income, regardless of the labels used by the City of Tampa. The city countered by arguing that it had simply imposed a levy on the privilege of practicing law, measured by the attorney's gross income. Nevertheless, the Florida Supreme Court struck down the tax as an unconstitutional income tax.<sup>66</sup> The court did not draw a bright line to differentiate this case from its precedents, indicating only that "[i]t is not difficult to distinguish between an excise tax or tax on the privilege of engaging in an occupation" and a prohibited income tax.<sup>67</sup>

Illinois and Colorado also have wrestled with this problem, and their efforts are relevant to the issues raised in this Article. The Colorado litigation<sup>68</sup> involved several taxes imposed by the City of Denver. One of these taxes was entitled "Employee Occupational Privilege Tax" and taxed all people employed within the City of Denver, ostensibly for the privilege of working there. The tax was imposed at the rate of \$2 per month on every employee whose compensation exceeded \$250 for that calendar month.<sup>69</sup> The taxes were challenged as an unconstitutional flat tax on income.<sup>70</sup> The Colorado Supreme Court upheld the tax on the grounds that it was valid because it did not tax other monetary income such as investment income and, alternatively, because occupation taxes had been upheld in a number of other jurisdictions; the court cited cases from Pennsylvania, Kentucky and Alabama.<sup>71</sup> The tax was measured at least in part by income, but was valid because it was not imposed on income.

The Illinois litigation<sup>72</sup> involved something labelled an "Employers' Expense Tax," which was imposed on the employer for the privilege of employing people in Chicago; the tax was a flat \$3 per month.<sup>73</sup> It was argued that the tax was unconstitutional because it was either an income, earnings, or occupational tax, prohibited by

65. *Keller*, 191 So. at 543.

66. *Id.* at 547.

67. *Id.* at 547-48.

68. *City & County of Denver v. Duffy Storage & Moving Co.*, 450 P.2d 339 (Colo. 1969).

69. *Id.* at 343-44.

70. A municipality did not have the authority to enact an income tax because the Colorado Constitution vested that exclusive authority in the state. *Id.* at 341; *City & County of Denver v. Sweet*, 329 P.2d 441 (Colo. 1958).

71. *Duffy Storage & Moving Co.*, 450 P.2d at 344.

72. *Paper Supply Co. v. City of Chicago*, 317 N.E.2d 3 (Ill. 1974).

73. *Id.* at 5.

Illinois' constitution. The court upheld the tax concluding that it did not fall within this prohibition.<sup>74</sup>

In light of such authority, the case for sustaining Florida's services tax is strong. The services tax is expressly imposed on those "exercising a taxable privilege [by furnishing] services taxable under this chapter."<sup>75</sup> The formal distinction between a tax measured by and a tax on income is observed. *Gaulden*, as well as the Colorado and Illinois cases, support the constitutionality of the services tax. Only *Keller*—which was decided before *Gaulden*—militates against it.

### B. *The Constitutional, Definitional Argument*

Essentially, the argument here is that an income tax, as a matter of constitutional law, must reach *both* earned income and investment income, the two types of "classical" income.<sup>76</sup> A tax which reaches only earned income or only investment income is not a true income tax.

A strong Florida constitutional argument has its roots in the federal constitutional law of income taxes. The debate began in the last century. In 1894, Congress passed a broad-based tax on individual incomes, reaching both earned income and investment income. The tax was immediately attacked as unconstitutional, on the grounds that it was a "direct" tax that could not be imposed without apportionment.<sup>77</sup> In the famous *Pollock v. Farmers' Loan & Trust Co.* case,<sup>78</sup> the United States Supreme Court agreed, and struck down the law.<sup>79</sup>

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74. Like Colorado's, the Illinois Constitution prohibited a local taxing unit from imposing an income tax without the consent of the General Assembly. *Id.* at 6. Unlike Colorado's, the Illinois Constitution went further by prohibiting the imposition of an "occupation tax." The court implied that a tax imposed on employees might be invalid for that reason, but likened the tax at issue to a payroll tax, which, if properly levied, could escape the constitutional proscription. *Id.* at 7-13.

75. Ch. 86-166, § 3, 1986 Fla. Laws 816, 819 (amending FLA. STAT. § 212.05 (1985)).

76. An income tax reaches " 'income' . . . derived from capital, from labor, or from both combined." *Stratton's Independence, Ltd. v. Collector*, 231 U.S. 399, 415 (1913).

77. The Constitution prohibits Congress from imposing "direct" taxes without apportionment. U.S. CONST. art. I, § 2, cl. 3 and § 9, cl. 4 (affected by amend. XVI). Other taxes may be imposed by Congress under its inherent powers. *See License Tax Cases*, 72 (5 Wall.) U.S. 462, 471 (1866).

Direct taxes are valid only if apportioned. As a practical matter, this would mean setting different rate schedules in each state. For a discussion of the practical problems involved, see 1 B. BITTKER, *FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS* ¶ 1.2 (1981).

78. 158 U.S. 601 (1895).

79. *See* 1 B. BITTKER, *supra* note 77, at ¶ 1.2. (discussing history of constitutional restraints on federal income taxation).

Friends of the 1894 tax turned their attention to amending the United States Constitution, convinced that nothing short of amendment would permit the imposition of a broad-based income tax. They ultimately prevailed in 1913 when the sixteenth amendment was adopted, permitting Congress to levy an unapportioned tax on "incomes, from whatever source derived."<sup>80</sup> When Congress was empowered to levy an "income tax," the idea was to permit Congress to impose a tax like the one invalidated in *Pollock*.

During this era it was clear that a tax on earned income only was constitutionally different from the *Pollock*-type tax. Such a tax had been sustained in 1880 in *Springer v. United States*.<sup>81</sup> In the *Pollock* case itself, the Court intimated that a pure services tax was valid.<sup>82</sup>

When the Florida Constitution was amended in 1924<sup>83</sup> to prohibit imposition of a tax "on income," the federal constitutional issue was barely ten years old. The argument is that by using identical language in its constitution, Florida intended to prohibit exactly what Congress was prohibited from doing prior to the sixteenth amendment: imposition of a *Pollock*-type, broad-based tax reaching both earned income and investment income. The services tax now at issue in Florida is like the tax in *Springer*. Both reach only earned income. Neither is an "income tax" for constitutional purposes.

A related argument centers around deductions. The federal income tax has always used as its tax base the concept of "taxable income," that is, gross income less certain deductions.<sup>84</sup> There is a suggestion in early federal case law that deductions are a constitutionally indispensable feature of an income tax.<sup>85</sup>

80. U.S. CONST. amend. XVI.

81. 102 U.S. 586 (1880). *Springer* considered the Civil War income tax, Act of Mar. 3, 1865, ch. 78, 13 Stat. 469, 479.

82. *Pollock*, 158 U.S. at 635, 637.

83. Fla. SJR 135, 1923 Fla. Laws 483. The amendment was proposed by this joint resolution in 1923 and was passed by the voters in 1924 during the height of the Florida land boom.

A sampling of contemporary sentiment is found in the following excerpt from BENSON & NORTH, *FLORIDA REAL ESTATE PRACTICE AND LAW* 7 (1924): "[R]ich men are on the ground in Florida. They call Florida their home. The constitutional provision that Florida shall never levy either state income or inheritance taxes has attracted them as permanent residents." To the extent that this passage reflects the intention of the voters, it supports the argument that the services tax is not an income tax. The concern is for the very rich, those concerned with inheritance taxes and, presumably, living off investment income, not earnings.

84. I.R.C. § 63 (1985).

85. See *Stanton v. Baltic Mining Co.*, 240 U.S. 103 (1916). See also 1 B. BITTKER, *supra* note 77, at ¶ 5.4.

The Florida services tax offers, by its terms, no deductions. It is measured by "gross," not "net" income. In a very significant respect, therefore, the Florida services tax differs from a classical income tax. That difference, in tandem with the failure of the services tax to reach investment income, is sufficient to distinguish it from a prohibited income tax.

### C. *The Policy Arguments*

Proponents of the services tax could make at least two powerful fairness arguments. First, the services tax would be less regressive than the existing general sales tax.<sup>86</sup> Indeed, the regressivity question is one which the new study commission is to consider.<sup>87</sup> Second, a payroll tax would likely be deductible for federal income tax purposes.<sup>88</sup> Beginning January 1, 1987, a sales tax is not deductible for federal income tax purposes.<sup>89</sup> All things being equal, Floridians would benefit from the ability to deduct their tax payments for federal income tax purposes. Because the technical arguments for and against the constitutionality of the services tax are close, such policy arguments may indeed be the deciding factor.

## III.

*This fine trap was sprung in the semi-final round . . . .*<sup>90</sup>

In its efforts to increase state revenue, the Florida Legislature has broadened the tax base by enacting a statute which looks very much like an income tax. For the reasons stated in this Article, this tax may be legally enforceable despite the generally held notion that *any* tax measured by individual income is unconstitutional, whatever its form. It is disturbing that this "income" tax was passed without apparent deliberation or public debate, and that it will automatically become law unless contrary legislative ac-

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86. The experts, even though they are economists, seem to agree that general sales taxes are highly regressive, and proportional income taxes less so. See J. PECHMAN, *supra* note 25, at 255 et seq.

87. Ch. 86-166, § 9(3)(a)(3), 1986 Fla. Laws 816, 826.

88. The trick would be to argue that the services tax is an "income tax" within the meaning of Internal Revenue Code § 164(a)(3) but is not an "income tax" within the meaning of art. VII, § 5(a), FLA. CONST. See *supra* note 53 (discussion of deductibility of taxes similar to services tax).

89. See Tax Reform Act of 1986, Pub. L. No. 99-514, § 133, \_\_\_\_ Stat. \_\_\_\_ (amending I.R.C. § 164(a) (1985)). Section 133, effective in 1987, removes the present deduction for state and local sales taxes.

90. W. LOMBARDY, MODERN CHESS OPENING TRAPS 19 (1972).

tion is taken before July 1, 1987. A matter of such significance, marking such a substantial change from prior policy, deserves more deliberate treatment.

The creation of the study commission, while commendable, is hardly a failsafe device to prevent detonation of the services tax time bomb. The legislature will have the benefit of the study commission's report when it reconsiders the whole question of "sales tax exemptions" in 1987 and its action will, without doubt, attract greater popular attention than did enactment of chapter 86-166. If the legislature chooses to tax income, directly or indirectly, now or next year, it should do so only after the proposal has been fully aired and the difficult implementation issues explored. If it chooses to retreat from the full-blown services tax, it will have a golden opportunity. The resulting "Tax Reduction Act of 1987" would be the largest tax break in Florida history.