POLICY BRIEF

Reducing the Burden of Sales Taxes in Florida

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Executive Summary

Florida is a national leader when it comes to economic freedom, human flourishing, and reducing poverty. While there are many reasons for this, the foundation providing this is the institutional framework of limited government that has a long record of success in Florida and in other places that practice it. Even with this success, there are ways to improve so that the burdens of government on taxpayers can be reduced and allow more ways to let people prosper.

Florida is blessed without personal income, wealth, or state property taxes, which are reasons why people move to the Sunshine State at a rate of 800-1,000 every day. The dominant source of tax collections is from final sales and use taxes, the least burdensome form of taxation. Nevertheless, Florida should not rest on its laurels and should continue to press forward to reduce the government bur-

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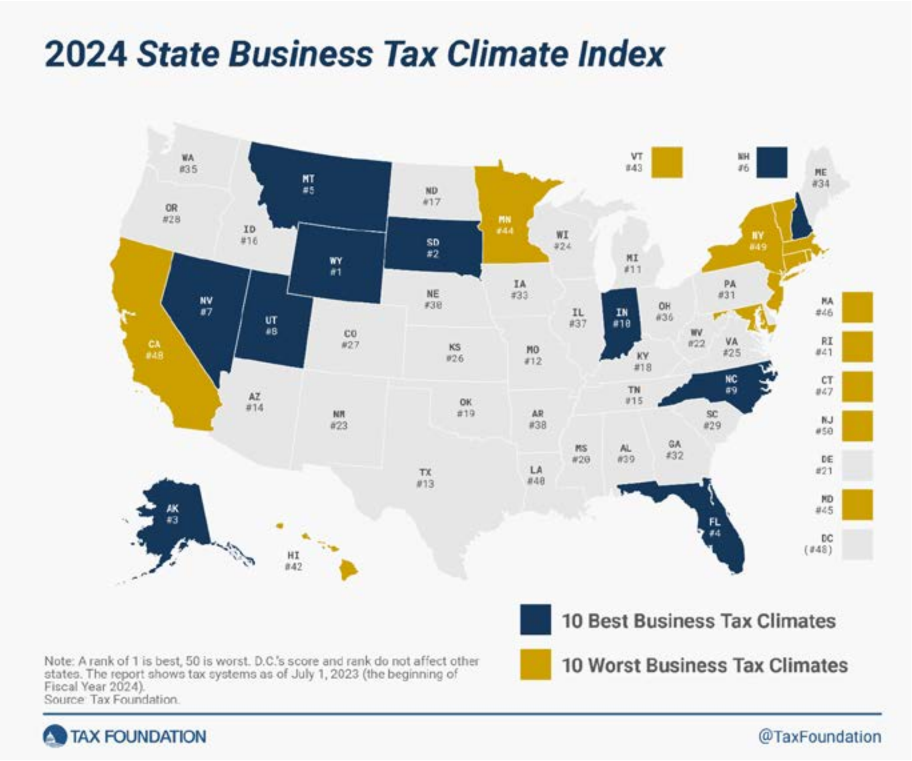
den on businesses and citizens. This includes reducing the burden of final sales taxes on individuals and vendors.

This report by the James Madison Institute considers Florida's institutional framework, tax system, and ways to reduce these burdens from final sales taxes. This includes but is not limited to reforms of ensuring spending restraint, keeping the sales tax base as broad and rate as low as possible, and raising the sales tax collection allowance for vendors. The latter point is especially important given vendors' high direct and indirect costs of complying with the tax code, reducing their profitability and ability to expand and hire workers. Florida can take further steps to lead the country in sound economic policy by implementing these reforms.

Figure 1. Tax Foundation's Index Shows Florida Ranks Fourth Best



Institutions Matter

Institutions matter for the structure and change of societies and economies throughout human history. These include economic institutions like capitalism and socialism; social institutions like families, charities, and churches; and political institutions like democracies and authoritarianism. Historically, a combination of these institutions comprised of those with free-market capitalism, vibrant civil society, and constitutional republic help create a framework for the best path to let people prosper. This path is what Florida has long been on. While there have been extraordinary successes on this path, there remain ample opportunities for improvement.

Table A in the **Appendix** compares the country's four largest states in population and economic activity (i.e., California, Texas, Florida, and New York). It also includes Florida's two neighboring states, Alabama and Georgia. These comparisons show overwhelmingly that Florida and Texas—which tend to practice conservative state governance—are leaders in economic freedom and other variables, while California and New York—which tend to practice progressivism—are near last in every major category. Other variables could be considered but the evidence will continue to show that institutions that promote limited government and support economic freedom provide ways that let people prosper. And Florida is the overwhelming leader among these states.

One of the critical parts of the strong institutional framework in Florida is its relatively low government spending and taxes. Moreover, the lack of costly personal income, wealth, and state property taxes is a big reason why the state continues to be a leader. There are shortcomings that need to be addressed when it comes to excessive government initial appropriations that result in too much spending and too burdensome sales taxes. There have been efforts to start improving these in recent years, but there is more to do.

Florida's Tax System

Florida's tax system structure is friendly to individuals and businesses. A valuable measure of a state's tax system that covers the major types of taxes imposed by state and local governments is the Tax Foundation's State Business Tax Climate Index. **Figure 1** shows how states compare according to this index, with Florida ranking as the country's fourth-best state but the best-ranked state of any of the large states (Texas is 13th).

The Tax Foundation calculates scores for its business tax climate index and rankings based on corporate, individual, property, unemployment insurance, and sales taxes. In Florida, the top corporate income tax rate is 5.5 percent, ranking fourth best in the index. Not having an individual income tax ranks the state first in the country. Florida's property taxes rank 13th in the index. Other measures of property taxes in the state from the Tax Foundation rank it 26th in property taxes when considering the property taxes paid as a percentage of owner-occupied housing value is 0.91 percent and 29th for state and local property tax collections per capita at \$1,541. The unemployment insurance tax paid by businesses ranks 4th in Florida per the index.

The index ranks Florida as 19th for sales taxes. Sales taxes dominate the taxes collected to pay for government spending at the state level with its six percent state sales tax rate (ranks 17th) and max local sales tax rate of two percent for a max combined rate of eight percent. But not every local government hits the max sales tax rate, resulting in an average local sales tax rate of 1.019 percent for a combined rate of 7.02 percent (ranks 24th), as noted in **Figure 2**.

Considering the burden of state and local taxes on taxpayers, Florida ranks 11th best in the country. This high ranking along with the state business tax climate index ranking helps incentivize people to move for a better standard of living, affordability to start a family, or opportunities to start a business in Florida.

Details of Florida's Sales Tax System for Vendors

In Florida, sales taxes contribute to the costs of running a business in Florida. This is particularly true for the gig economy, small businesses, and micro-businesses that have tight profit margins. Ultimately, the cost of compliance with sales taxes is high and adds a barrier to growing a business and economy as those costs distort profitability and are often passed along to consumers.

One way that Florida and 26 other states help reduce the cost of compliance is through allowing businesses to "keep" a portion of what they collect. In most states this is referred to as a sales tax discount. In Florida, it is termed the sales tax collection allowance. Both terms refer to the amount of sales tax collections that a business can retain to help them with the cost of collecting and paying sales taxes to the state government.

In Florida, the sales tax collection allowance is 2.5 percent of the first $1,200 in sales taxes due, with a maximum of $30 per monthly submitted report (a maximum of $360 per year). Table 1 provides the thresholds for required reporting.

Table 1

Sales Tax Filing Requirement by Collection Threshold

ANNUAL SALES TAX COLLECTIONS	RETURN AND PAYMENT FILING REQUIREMENT
More than $1,000	Monthly
$501 - $1,000	Quarterly
$101 - $500	Semiannual
$100 or less	Annual

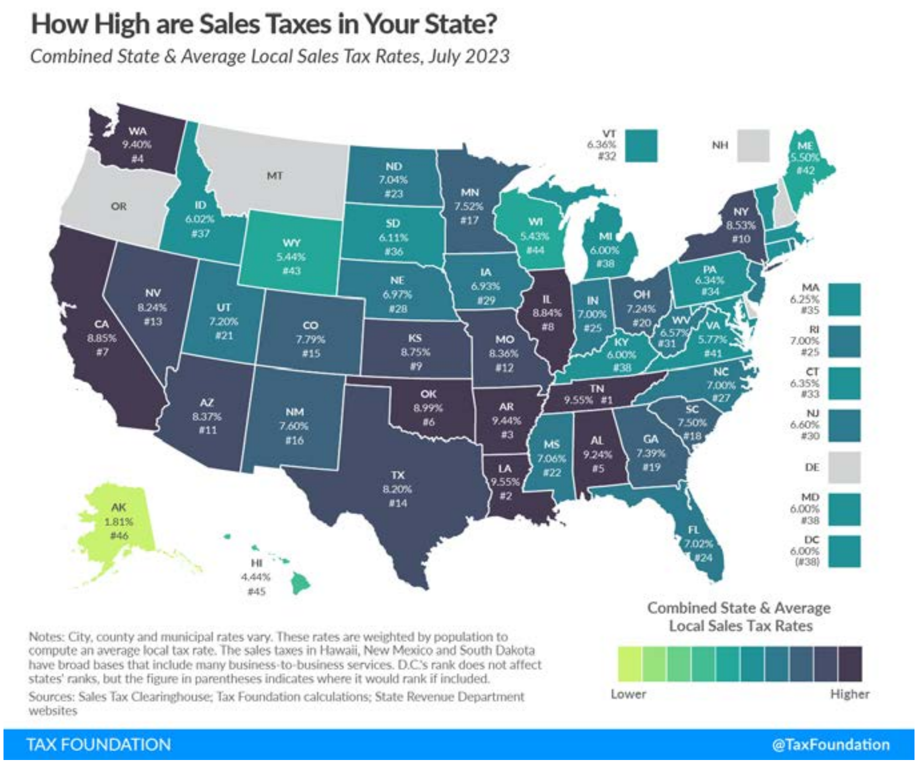
While the concept of a sales tax allowance is a completely reasonable method of addressing the cost of compliance, there are some notable challenges within the ways Florida's system functions.

Businesses that remit more than $200,000 in sales tax are required to make "estimated sales tax payments" during the following calendar year. Estimated tax is equal to 60 percent of the tax due each monthly with multiple methods for compliance. Businesses with irregular cash flow from cyclical or seasonal sales may find themselves with challenges in complying with the estimated regular payments.

In addition, the allowance in Florida is substantially below those of nearby states of South Carolina, Louisiana, Arkansas. The allowance in Florida, and in most other states, does not cover the large direct and indirect costs of complying with and paying sales taxes, which is why it was created. These costs include, but are not limited to, expenditures related to technology, consulting, risk exposure to sales tax audits, and other factors. While these costs vary depending on the type of business, small businesses are particularly hit hard as they have smaller profit margins, so less room to cover these costs.

The complexity of the sales tax payments and the challenges that the Florida Department of Revenue (DOR) forces on businesses are large. Reasons include if taxes paid do not match what the Department estimates, taxes are not paid on time, or other issues when often not

Figure 2. Florida Ranks 24th in State and Local Sales Taxes



the fault of businesses but a faulty government collection system. This is a reason businesses are forced to employ tax accountants and legal services to cover costs related to complying with sales tax requirements and other taxes.

For large businesses, the requirement to remit regular tax payments, especially when exceeding a threshold of sales tax collections, can pose financial challenges. For larger corporations, the scale of operations often means dealing with high transaction volumes. The administrative burden of ensuring compliance with tax remittance could be substantial. They might need to invest in sophisticated accounting systems or hire additional personnel solely dedicated to tax compliance, adding to operational costs.

Moreover, fluctuating sales figures could make predicting tax obligations challenging. In cases of economic expansions or seasonal fluctuations, businesses might find themselves regularly well above the threshold, triggering compulsory remittance and causing financial strain. The timing of tax payments can also be crucial. Meeting tax deadlines while managing other financial obligations might lead to liquidity issues, potentially requiring businesses to seek external financing or dip into reserves to fulfill their tax liabilities. In essence, while tax remittance ensures revenue for the state, it can be a complex and costly endeavor for large businesses in Florida, impacting their financial stability, cash flow, and operational flexibility. This obligation may prompt them to strategize around sales and tax management to minimize the impact on their bottom line.

In Florida, these costs include tax accountants, who have an average salary of $78,497, and legal counsel, who have an average salary of $113,427, according to Indeed.com. Employing just two of these individuals costs a business at least $200,000. This is a very conservative estimate of the compliance cost for sales taxes as this estimate does not include all other costs that vary by business. For a company large enough to have employee internal compliance, this is more than 550 times greater than the sales tax allowance max of $360 per year.

And while most large-scale businesses may consider audit compliance a cost of doing business (and simply pass the cost on to consumers), small businesses do not have that luxury. A recent study by Avalara showed that hiring a professional, paying tax, penalty, and interest can easily be over $100,000. In fact, according to their study, an average sales tax audit costs around $115,000.

While sales taxes tend to be the least burdensome form of taxes in an economy, as every tax has a cost, these compliance cost burdens are excessive. People ultimately pay higher costs to businesses through higher prices, lower earnings, and fewer jobs available. There should be a move to lower these costs so that not only are consumers realizing the benefits, but so that Florida continues to be the single best destination to build and grow a business in the United States.

Compliance

According to data from the Florida Department of Revenue, approximately 80 percent of the state's $205 billion in revenue is derived from sales tax collections – $164 billion.

Hidden in the mandates for businesses who collect and remit sales tax on purchases is the cost of compliance, both direct and indirect. Whether time spent completing online forms and ensuring that all the numbers are accurate and on-time, or resources expended undergoing an audit, sales tax collection and remittance ultimately bears a burden in time, talent, and treasure complying with the statutes governing the process.

These costs are inevitably borne in different ways, depending on the size of the business, the level of complexity in operations, the industry, and the amount of money in sales taxes collected. Existing data on the cost of compliance by business size are somewhat spotty, providing an opportunity to model this in a few ways.

Compliance is ultimately a cost born to mitigate the risk of an audit failure. A recent analysis conducted by consulting firm Aberdeen Strategy and Research indicated that among a sample of 500 "emerging small businesses," categorized as a business with between $100,000 and $5 million in annual revenue, more than 70 percent have been audited within the past five years, and 69 percent of those audited have been audited more than once. In addition, 3/4 of those audited report an audit time of between one and four months.

A 2020 survey of businesses included information on how much money companies set aside for an audit in a reserve. Among the companies that did in fact designate money in an audit reserve, the average figure for small businesses was $10,000 while the average figure among mid-size businesses was $457,000 (it is important to note that this is not the cost of an audit, but the amount the companies had set aside specifically in case of an audit).

Compliance methods used by emerging small businesses surveyed included the following:

- Manual calculations
- Sales tax software
- Contract accountant
- CPA firm
- Tax attorney
- Bookkeeper
- Custom tool built into platform

It is notable that roughly eight percent of companies employ no method for compliance – not a very good strategy considering the costs in penalties and fees for a failed audit.

Over the past three years, several attempts at discerning the direct and indirect costs of sales tax compliance have yielded varying results and figures. According to some estimates, a mid-sized retailer will spend approximately $17,000 per month in compliance, with a high range of $24,000 per month for some larger retailers.

In 2021, the research firms Avalara and Potentiate collaborated on a large-scale study to estimate compliance costs among emerging small businesses as well as small to mid-size businesses.

According to the Avalara study, emerging small businesses generally expended 0.05 percent of monthly revenue on compliance – roughly $500 per month per million in revenue. However, the analysis also showed that small-mid size businesses (those between 20 and 500 employees), amounts ranging from $17,000 and up to $24,000 per month are not anomalies. Using the Avalara figures, extrapolating this to business size thresholds would result in the following examples:

Emerging Small Business A
10 employees
$4 million in revenue
$23,376 in annual compliance costs

Emerging Small Business B
3 employees
$1 million in revenue
$5,712 in annual compliance costs

Small-Mid Size Business C
18 employees
$9 million in revenue
$52,596 in annual compliance costs

Small-Mid Size Business D
50 employees
$30 million in revenue
$20,880 in annual compliance costs

Large Business E
1,000 employees
$500 million in revenue
$21,000 per month /
$252,000 in annual compliance costs

From these estimates, a noteworthy conclusion is reached: emerging small businesses (under 20 employees) expend more of a share of their revenue on compliance than much larger companies. approximately 0.05 percent of their revenue on compliance with state sales tax regulations. Sales tax compliance costs are ultimately regressive in nature.

Given the cost of compliance, the question remains: is the sales tax allowance adequate? With an annual allowance of $360 ($30 per month), clearly the answer is no. Even a small business with just three employees and $1 million in annual revenue would face a compliance cost of more than $5,700.

One other way to illustrate how problematic the allowance amount is to consider the cost of an audit. On average, a sales tax compliance audit will cost approximately $115,000 (factoring in all direct and indirect costs of going through the audit), however that cost will vary with business size.

Examining data provided by the U.S. Small Business Administration, there are slightly more than three million businesses in the state of Florida, with over 99 percent of them categorized as small businesses. The SBA considers a small business as having less than 500 employees – not a useful benchmark for analysis. However, within that designation, SBA breaks down data further:

- Sole Proprietorship – 2.5 million establishments
- Under 20 employees – 426,000 establishments
- 20 – 499 employees – 39,200 establishments

Setting aside sole proprietorships, the average size of a business with under 500 employees in the state is 17 employees. Applying the average audit cost to businesses that size and adjusting 50 percent (above and below), a low-high range for undergoing an audit is $57,500 on the low range and $172,500 on the high.

If a business were to set aside its entire allowance each month to prepare a reserve to address the cost of an audit, on the low end, it would take 160 years to accumulate a reserve sufficient to offset the cost. On the high end, it would take 479 years.

Recommendations

The high cost of the sales tax burden on individuals and businesses in Florida could be reduced by:

- Passing conservative budgets that increase by no more than the rate of population growth plus inflation, as outlined by the James Madison Institute and Americans for Tax Reform.

- Limiting government spending will contribute to surpluses that should be returned to taxpayers through lowering tax rates, which could be done with sales taxes, corporate income taxes, school property taxes, or other taxes.

- Broadening the sales tax base as much as possible to have the lowest tax rate possible.
  - ◊ While Florida has been exempting items from sales taxes over the last few years, this has narrowed the sales tax base and will keep the tax rate higher than otherwise if spending continues to rise excessively.
  - ◊ However, if spending is appropriately restrained, there can be an argument for not taxing as many things thereby leaving more money in taxpayers' pockets.

- Reducing the cost to vendors of collecting and remitting sales taxes by streamlining the collection process by the Department of Revenue, including making the delivery of tax liabilities and payments electronically.
  - ◊ This will help prevent the tax due notices from being lost in the mail or being late to the business, thereby contributing to some businesses being late with their payments and forced to pay penalties.

- Raising the sales tax collection allowance for businesses to at least double what is offered now - to 2.5 percent of the first $2,400 collected or five percent of the first $1,200 collected. This would result in a max sales tax allowance of $60 per month or $720 per year. Considering that nearby states have an allowance of as much as $10,000 in South Carolina, there is good reason to substantially increase Florida's allowance to remain competitive.
  - ◊ This higher allowance is only a fraction of what the cost of compliance is of hiring tax accountants, legal services, and other factors.
  - ◊ This may necessitate a much larger sales tax allowance to reduce this burden and support more productive activities, especially for smaller businesses with tighter profit margins.
  - ◊ According to the National Federation of Independent Businesses: "Small businesses rely on cash flow to pay day-to-day expenses like wages, benefits, and utilities. 50 percent of small businesses regularly face cash-flow problems; for 20 percent, the problem is continuous."
  - ◊ A large and consistent allowance across all businesses is best to avoid picking winners and losers as these costs are ultimately paid by people.

Effects of Sales Taxes on Small Businesses

Lowering sales tax costs can support increased consumer spending, more investment, and faster economic growth. More economic activity and spending restraint can help offset any reductions in tax revenue. Lowering sales tax costs can have substantial implications for small businesses, enhancing their competitiveness, investments, innovation, hiring, and more opportunities for expansion.

Cutting sales tax costs in Florida would attract more gig workers, characterized by independent workers in short-term engagements. This would help foster a vibrant gig economy and increase employment opportunities in this sector and many other sectors, especially those with small businesses. Microbusinesses, often operating with very few employees or even a single individual, can struggle with compliance and administrative costs associated with sales tax collections. The concept of split ticket sales tax collections, where some items are subject to sales tax while others are not (think grocery stores), presents both challenges and opportunities. The administrative burden of complying with sales taxes and related compliance costs increases for micro-businesses involved in split-ticket transactions. Simplifying tax collection procedures and offering guidance or tools for compliance could alleviate these challenges, enabling smoother operations for such businesses.

Conclusion

Florida is an economic leader because it has practiced pro-growth policies for years. Compared with many other states, these pro-growth policies of relatively lower government spending, taxes, and regulation have made Florida attractive to employers and families. This strong institutional framework must continue. As the economy evolves, there will inevitably be room for improvement, as outlined here regarding restraining spending, reducing sales tax costs to vendors, and other areas. Spending should grow by no more than the rate of population growth plus inflation, as

Table A. Comparison of States for Measures of Economic Freedom and Outcomes

MEASURE	U.S.	FLORIDA	TEXAS	GEORGIA	ALABAMA	CALIFORNIA	NEW YORK
Economic Freedom of North America Index (2021)	5th (World)	2nd 7.80	4th 7.64	6th 7.31	24th 6.40	48th 4.27	50th 4.09
State Migration Trends, Net Migration (2022)	--	1st +1.9%	4th +1.6%	12th +1.2%	20th +0.5%	41st -0.3%	50th -0.9%
State Business Tax Climate Index (2024)	--	4th 6.84	13th 5.48	32nd 5.01	39th 4.60	48th 3.64	49th 3.57
State Economic Outlook (2023)	--	9th	13th	12th	24th	45th	50th
State & Local Spending Per Capita (2022)	$12,923	46th $10,228	37th $11,507	48th $10,008	39th $11,089	4th $18,760	2nd $20,761
S&L Spending on K-12 Education Share of Income & Per Pupil (2023)	3.3% $14,660	2.0% $10,442	3.2% $11,144	3.4% $12,417	3.1% $10,916	3.0% $15,398	4.8% $29,271
S&L Spending on Public Welfare Per Capita (2021)	$2,597	48th $1,524	42nd $1,741	49th $1,352	45th $1,588	4th $3,870	1st $4,249
S&L Tax Burden Share of Income (2022)	11.2%	11th 9.1%	6th 8.6%	8th 8.9%	20th 9.8%	46th 13.5%	50th 15.9%
S&L Property Tax Collections Per Capita (2020)	$1,810	29th $1,541	11th $2,216	32nd $1,336	49th $632	15th $1,955	4th $3,118
Composite Cost of Living Index (2023:Q3)	100	30th 101.0	18th 93.0	11th 90.9	5th 88.2	48th 136.4	47th 126.5
State Economic Performance (2011-21)	--	1st	7th	8th	20th	18th	31st
Avg. U-3 Unemployment Rate (2003-22)	6.0%	5.6%	5.6%	6.3%	5.9%	7.3%	6.2%
Avg. Labor Force Participation Rate (2003-22)	64.0%	60.6%	65.2%	64.4%	58.8%	63.5%	61.5%
Avg. Annual Nonfarm Payroll Growth (2003-22)	0.6%	1.4%	1.8%	1.1%	0.6%	1.0%	0.6%
Official Poverty Rate (2020-22)	11.5%	13.1%	13.7%	13.0%	14.8%	11.4%	12.4%
Supplemental Poverty Rate (2020-22)	9.8%	12.7%	11.3%	10.1%	10.9%	13.2%	11.9%

Notes. Dates in parentheses are for that year or the average of that period. Data shaded in blue indicate "best," and in red indicate "worst" per category by state.

outlined by the James Madison Institute's Conservative Florida Budget, if it grows at all. This will provide more opportunities to cut taxes.

Raising sales tax allowances and modernizing the sales tax system in Florida holds the potential to yield positive impacts across many business sectors. It would support more private investment and entrepreneurship and benefit the gig economy and other small businesses. It would also help reduce administrative hurdles that are a high cost for many small businesses.

These pro-growth, sensible policies would support an environment conducive to economic growth, innovation, and sustainable business development across the state. Doing so will move The Sunshine State into an even more vibrant population and robust economy, providing more opportunities for all Floridians to flourish.

Appendix: A Brief Look at How Institutions Matter in Florida and Key States?

Table A shows how Florida compares with the other largest states in the country (i.e., California, Texas, and New York) and neighboring states (i.e., Georgia and Alabama) based on measures of economic freedom, government largesse, and economic outcomes. The ordering of these states is 25 on their rankings in the Fraser Institute's Economic Freedom of North America index calculated with data on government spending, taxes, and labor market regulation for each state.

These rankings show that Florida is the best in terms of economic freedom and many other measures compared with these other states, and almost all states in the country. The data show that states with less economic freedom (e.g., New York, California, and Alabama) tend to perform economically worse. On the other hand, those states with more economic freedom (e.g., Florida, Texas, and Georgia) tend to perform economically better. While New York and California have lower official poverty rates than Florida, Texas, and Georgia, this measure has problems. This measure is improved in some ways by the supplemental poverty measure that accounts for some regional cost-of-living differences (i.e. housing), after-tax income, and transfer payments, though this measure also has problems. Given these comparisons, Florida provides many opportunities for human flourishing with its institutional framework of limited government, but there is always room for improvement.

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