Florida's Intangibles Tax:
The Case for Repeal

by
Randall G. Holcombe
DeVoe Moore Professor of Economics, Florida State University
and
Chairman, Research Advisory Board
The James Madison Institute

Policy Report #40
June 2003

Florida's Intangibles Tax: The Case for Repeal

by

Randall G. Holcombe

DeVoe Moore Professor of Economics, Florida State University

and

Chairman, Research Advisory Board

The James Madison Institute

Policy Report #40

May 2003

Table of Contents

Executive Summary 1

I. Introduction 2

II. History 2

III. The Intangibles Tax Base 3

IV. Avoiding the Tax 4

V. Reporting Requirements 5

VI. The Effects of the Intangibles Tax 6

VII. Does Florida Need an Intangibles Tax? 7

Executive Summary

- Florida's intangibles tax is a tax on certain financial assets, including stocks and bonds.

- The intangibles tax raises a relatively small amount of revenue. It is forecast to raise about $600 million in fiscal year 2003-04, out of a total state budget that will exceed $50 billion. Revenues from the intangibles tax finance about 1.2 percent of total state expenditures.

- A tax on intangible financial assets has some similarities to a tax on income from those assets. While income taxation is prohibited by the Florida Constitution, an intangibles tax gets around that restriction by taxing the wealth on which income is earned.

- The tax places a significant reporting burden on some individuals. This is the only Florida tax that requires individuals to fill out a tax form.

- The tax discriminates against those who earn investment income as opposed to labor income. This group includes wealthy people and retirees, who in general contribute more to the finances of Florida's government than they take away.

- Because it is a tax on investment, the intangibles tax discourages economic growth.

- If the tax were completely eliminated, state government expenditures would still increase because the revenues lost would be more than replaced by the normal growth in the state's other revenue sources.

- Florida's economy and its state government would fare better if the intangibles tax were repealed.

I. Introduction

Florida is one of only a few states that taxes intangible property.[1] The nature and amount of Florida's intangible property tax has changed significantly over the years, but presently the tax is set at 1 mill annually on stocks, bonds, limited partnerships, and certain other financial assets. There is an exemption of $20,000 for individuals and $40,000 for married couples filing jointly, which is scheduled to be increased to $250,000 per person effective in 2003. Businesses, which are also liable for the tax, have no exemption, but they are scheduled to receive a $250,000 exemption beginning in 2003. Money, bank deposits, and financial assets held in tax-deferred retirement accounts are not taxed. Mortgages are also taxed at a 2 mill rate, which is levied only once at the time the mortgage is recorded. The annual tax on financial assets raised $450 million in fiscal year 2001-02, and the one-time tax on mortgages raised another $333 million in that year.[2] Total revenue from the intangibles tax was $783 million in fiscal year 2001-02, but is forecast to decline to about $600 million in 2003-04 because of the scheduled increase in exemption levels. Revenue raised from the tax is well under 2 percent of Florida's total budget of more than $50 billion, and the revenues lost if the tax were entirely repealed would be more than replaced by the normal growth in other revenue sources—primarily the sales tax.

The burdens the intangibles tax places on Florida's economy are greater than the benefits from the revenue it generates.[3] The Florida legislature recognized this in 1999, when it agreed to a total repeal of the intangibles tax by phasing it out over four years. At that time, the rate stood at 2 mills, and the legislature approved lowering the rate by half a mill each year until the tax was eliminated. Two years into that phaseout, it was discontinued, and the rate now stands at 1 mill. The reasons the legislature decided to repeal the tax in 1999 remain valid, and the legislature should move forward to repeal the intangibles tax.[4]

II. History

Florida's intangibles tax has undergone significant changes since it was first implemented in 1931. The rate was set at 2 mills in 1931 and was reduced to 1 mill on stocks and bonds in 1941, but raised to 3 mills on mortgages. The rate on mortgages was reduced to 2 mills in 1951. The rate on stocks and bonds was raised to 2 mills in 1957, and then lowered to 1.5 mills in 1961 and to 1 mill in 1962. The current statute governing the intangibles tax was passed in 1971. The rate was increased to 1.5 mills in 1990, and increased again to 2 mills in 1992. The rate was reduced to 1.5 mills in 1999 and reduced again to 1 mill in 2000. In addition to the rate changes, there have also been numerous changes to the tax base.

When it was first enacted, money was included in the base and taxed at a rate of 1/20 mill. Money was eliminated from the tax base in 1971, and banks were exempted in

1998. Accounts receivable also were part of the tax base until they were exempted in 2000.

This brief history, which explains only some of the changes in the rates and tax base of the intangibles tax, shows that over the years, the tax base has continually been narrowed, but the rate has fluctuated substantially.

III. The Intangibles Tax Base

Stocks make up about 80 percent of the assets owned by individuals subject to the intangibles tax, with bonds making up the bulk of the remainder. These assets are the tax base upon which the intangibles tax is levied.[5]

Any tax discourages the taxed activity and in the case of the intangibles tax, its effect is to discourage the ownership of stocks, bonds, and other financial assets subject to the tax. The degree to which the tax discourages the taxed activity depends upon how hard the tax is to avoid and on the level of taxation. Higher rates have larger disincentive effects. The tax rate is especially relevant for intangible property because, unlike other assets, owners do not get much intrinsic enjoyment from those assets, but own them only to receive a financial return. For example, people get enjoyment and utility beyond any financial gain from the use of real estate, automobiles, and artwork, whereas the intrinsic enjoyment and utility of owning intangible assets is low in comparison. The rate of 1 mill is higher than it first appears, when one recognizes that for it to be profitable to hold intangible assets, the tax must be paid from the stream of income generated by those assets. A tax on income from an asset and a tax on the asset itself are closely related, as the following example shows.

Assume that a person owns a Treasury bill worth $100. The short-term yield of a U.S. Treasury bill with a maturity of one year is about 1.25 percent as this is being written in April, 2003, so such a Treasury bill worth $100 would pay $1.25 in interest every year. A 1 mill tax on this asset would be only $.10, or one one-thousandth of the value of the asset, but measured as a percentage of the $1.25 in income the Treasury bill generates, it is 8 percent of the asset's income. In this example, a 1 mill tax on the value of the asset is equivalent to an 8 percent tax on the income from the asset. The intangibles tax rate is higher than it first appears, because it is a tax on the value of the asset rather than being a tax on the income from the asset.

This example shows how Florida's intangibles tax actually applies to people now paying the tax on Treasury bills, but how high the tax is as a percentage of an asset's income depends upon the return earned on the asset. Higher returns make the income tax-equivalent rate lower. But some assets—such as stocks that pay no dividends—earn no current income, so the asset might have to be sold to pay the tax, even if the asset is increasing in value. The federal capital gains tax eventually taxes any gains, but only after the asset is sold, while the Florida intangibles tax taxes assets regardless of whether they are sold and regardless of whether they earn any current return. Over the past several

years when the stock market has been falling, Florida taxpayers have had to pay taxes on assets that have been losing value, adding to their losses. The fact that the intangibles tax collects tax on unrealized capital gains and on assets even when losses are incurred makes the intangibles tax look unfavorable when compared to an income tax collected at an equivalent rate.

A tax on income from intangible assets would treat Florida taxpayers more fairly than the intangibles tax. Florida already has a corporate income tax, so for corporations, income from intangible property is being taxed twice—once as corporate income and then as intangible property. At the personal level, income taxes on individuals are unconstitutional and this constitutional barrier is unlikely to be lifted. Essentially, the intangibles tax gets around the constitutional restriction against taxing personal income by taxing the assets that generate the income rather than the income itself.

IV. Avoiding the Tax

There are many ways that the intangibles tax can be legally avoided. The exemption of bank deposits creates an obvious possibility. Because the tax is levied on assets held January 1, one could avoid the tax altogether by selling all assets covered by the tax and placing the proceeds in the bank for that one day. This might not be worthwhile for stock owners, who would have to pay commissions on sales and federal capital gains taxes on any gains, but could be a profitable strategy for owners of other assets. As a service to their customers, many brokerage firms automatically withdraw Florida customers' money from money market accounts at the end of the year and place them in bank accounts for a few days, putting the funds back in the money market accounts at the beginning of the next year. Without taking any actions themselves, those customers then avoid any liability for intangibles taxes on those assets. Money taken out of any taxable asset on December 31 and placed in a bank account could be reinvested in that asset on January 2 and no intangibles tax would be due.

Another possibility is to create an out-of-state trust and move intangible assets to that trust at the end of the year. At the beginning of the next year, the assets can be moved back in state, avoiding intangibles taxation altogether. Setting up a trust like this requires some legal sophistication, making it worthwhile only for people who would owe several thousand dollars in intangibles taxes. This appears to be a paying proposition for people with intangible assets of about $6 million or more. The Florida Department of Revenue has ruled that establishing out-of-state trusts like this is a legal way to avoid intangibles taxation. Surely, few wealthy Floridians pay the intangibles tax because it can be avoided in this way. Because of the exemption, poor Floridians do not pay it either, so the tax falls on Floridians who have accumulated assets, but not enough to make it worthwhile for them to engage in this tax avoidance. Largely, this means retirees who have saved a nest egg for their retirement and now are having it chipped away by Florida's intangibles tax.

Perhaps policies that allow assets to be moved out of state for a short term could be modified, but intangible assets are easy to move across state lines and such measures are likely to be counterproductive. Not only will potential taxpayers look for new loopholes, but this may also discourage those with substantial intangible assets from moving to Florida. Because intangible assets are mobile across state lines, Florida should enact policies to attract these assets, rather than retaining policies that encourage wealthy individuals to choose other states for residence.

The intangibles tax can be legally avoided, but looking to Florida's future, the state would do better to eliminate the tax rather than to try to make avoidance more difficult.

V. Reporting Requirements

Florida's intangibles tax is the only state tax that requires an individual taxpayer to fill out a form. The form asks for a considerable amount of information from individuals—far beyond what they are required to report on their federal income tax forms. Taxpayers are asked to list the value of all of their stocks, bonds, and other taxable intangible assets. For some, this is a trivial task; for others, it is quite a burden. Taxpayers who have accounts with many different brokerage firms, perhaps owning small amounts of a large number of stocks and perhaps owning shares of the same company with different brokerage firms, find filling out the form an annoyance, to say the least. Taxpayers who own shares of closely held corporations have a challenge in just estimating the fair market value of their assets. While many taxpayers have little problem meeting the reporting requirements, for others it is a challenge. Many assets have clearly identifiable market values, such as stocks and bonds listed on exchanges, but others do not, and the value of an asset is more open to interpretation than the flow of income an assets produces.

Not only is it a nuisance to fill out the form, it is potentially an invasion of one's privacy. Individuals should be wary about turning over a detailed list of their financial holdings to anyone, even their government. The Department of Revenue tries to protect information sent to it, but the detailed reporting requirements might be enough to discourage some from owning intangible assets, or from reporting them if they are owned.

In addition to reporting asset holdings, as required of individuals, there are several additional reporting requirements for businesses to help the state monitor and enforce payment of intangibles taxes. For corporations doing business in Florida but whose stock is not regularly traded, shareholders must be informed by the corporation about the value of the stock they own so they can determine their tax liability. After the accounting scandals of the past several years, one can see, at a minimum, potential problems that might arise regarding such evaluations. Also, securities brokers registered in Florida must provide the Department of Revenue with a list of holdings of their Florida customers. The list must be submitted on a computer-readable magnetic medium, with certain exceptions allowed for hardships.

The burdens of recordkeeping, reporting requirements, and filing returns are costs to

taxpayers over and above the taxes they submit to the state. These costs would be avoided if the tax were repealed, as would the costs that the Department of Revenue incurs to collect the tax and enforce its provisions.

VI. The Effects of the Intangibles Tax

Any tax discourages the taxed activity. Because the intangibles tax taxes the holding of financial assets, it discourages the accumulation of those assets. It is a tax on saving and investment, so it discourages economic growth and discourages wealthy people from living in Florida. It also burdens older people more than young people, because they have saved more, and discourages people from accumulating assets for their retirement.

By design, Florida's intangibles tax is aimed at the state's wealthier residents and by increasing the exemption, it will become even more of a tax on the rich. Yet, as noted earlier, people with substantial assets can, at some expense, avoid the tax legally by transferring their assets out of state at the end of the year, so few of Florida's very wealthiest citizens will pay the tax. In reality, then, the tax hits those citizens who are financially well-off, but not prosperous enough to find it worthwhile to hire the legal help to avoid the tax. People with low levels of financial assets will not pay the tax, and it is likely that most of those who legally owe the tax but do not file a return are not the wealthiest Floridians.[6]

Because of this, Governor Jeb Bush has accurately referred to the intangibles tax as a tax on seniors and savers. The Floridians most likely to pay this tax are retirees who have saved during their working years to provide for their retirement. This saving behavior should be encouraged by the state, not taxed and discouraged. Seniors who pay the intangibles tax are the type of residents Florida should be trying to attract because they pay more in Florida taxes than they cost the state in expenditures. They do not have children in school and their wealth status keeps them from being a burden to the state's welfare programs. They are low demanders of government services. Meanwhile, they pay sales taxes and property taxes to finance government expenditures for the rest of us.

Because Florida does not have an income tax, seniors in Florida pay Florida taxes at about the same rate as working people. In states with income taxes, retirees get a break because they no longer have labor income on which income taxes are paid, but in Florida they pay sales taxes on their consumption, which for retirees will typically exceed their income. The tax discriminates against those who earn investment income rather than labor income, regardless of whether they are retired.

Migration of wealthy individuals is not the only issue involved in the intangibles tax or even the major one. Intangibles taxation creates a disincentive for all Floridians to invest in assets that will be taxed. This biases portfolios toward untaxed forms of intangible wealth and discourages investment. The intangibles tax is a tax on investment, and investment is the engine of economic growth, so the intangibles tax discourages Florida's economic growth.

VII. Does Florida Need an Intangibles Tax?

All taxes discourage economic activity and put a burden on the economy, but without taxes government could not function. The argument in favor of retaining the intangibles tax is that it provides revenue to finance state government expenditures. The state has a portfolio of taxes and in looking at Florida's tax structure, the intangibles tax is among the least desirable. It is a tax on saving and investment, which directly impacts the state's economic growth. In contrast, the sales tax is a tax on consumption but does not tax saving and investment. The analysis above shows that there are strong arguments for eliminating the intangibles tax, despite the short-term revenue loss.

If the tax were completely and immediately repealed, it would not cause a reduction in the state's budget. The intangibles tax is forecast to raise about $600 million in the 2003-04 fiscal year, but the budget will increase much more than that without the intangibles tax. A complete repeal would slow the growth of state government expenditures, but would still allow growth. In a budget in excess of $50 billion, $600 million is a small part of the state's total revenues. The tax on financial assets is the most harmful part of the intangibles tax and if only that part were repealed, leaving the one-time tax on mortgages, it would cost the state only about $300 million in revenues.

Revenues from the intangibles tax are not necessary for the state government's fiscal health and if the tax were repealed, the state would have better incentives for saving and investment and, as a result, more economic growth.

Ultimately, increases in Florida's tax revenues come from the state's economic growth, so even if one is concerned about the state government's revenues, tax policy should take a long-run view and orient itself toward creating a more prosperous private sector. In fiscal year 2001-02 Florida's state government took in $1,854 in tax revenues per person, while in 1990-91 the state took in $1,518 in tax revenue per person, adjusted for inflation. That represents an increase of more than 22 percent over that period.[7] That revenue growth was a direct result of the growth of Florida's economy.

Florida's tax revenues will continue to grow along with Florida's economy, but taking a long-run view, tax policy should be oriented toward maximizing the state's economic growth to generate future revenues. Eliminating the intangibles tax now would produce less revenue growth in the year the tax was eliminated, but would create a stronger economy with higher growth in the future and faster state revenue growth.

Florida's intangibles tax places a large burden on the state for a small return, and there are persuasive arguments for completing the repeal that the legislature began in the later 1990s.

Endnotes

[1] Other states with some form of intangible property taxes are Alabama, Kentucky, Pennsylvania, and West Virginia. West Virginia's intangible property tax is scheduled to be repealed.

[2] These facts and others about Florida's intangibles tax can be found in the *2003 Florida Tax Handbook* published by the Florida Senate, pp. 73-76.

[3] This position was taken by the author in *Florida's Intangibles Tax: A Large Burden for a Small Return*, James Madison Institute Backgrounder #15, 1994, which was updated as Backgrounder #20 and reissued in 1997.

[4] The arguments presented here apply primarily to the annual tax on financial assets. The one-time tax on mortgages is discussed only briefly.

[5] I tried to get detailed data on the composition of assets owned by taxpayers at various levels of wealth from the Florida Department of Revenue, but it appears that they do not have good statistics on the details of tax payments. I was told that they do not have the time to take the raw data they have and aggregate it into meaningful summary statements.

[6] In discussing Florida's intangibles tax with people, I have found that Floridians who do not pay the tax tend to be completely unaware that it exists. Undoubtedly, there are some Floridians who legally owe the tax but are unaware of their tax liability.

[7] For a more detailed analysis of Florida's state government revenue growth, see Randall G. Holcombe, "Florida Is Not Facing a Revenue Crisis," *The Journal of the James Madison Institute* (Winter 2003), pp. 20-27.