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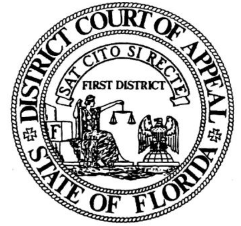

IN THE DISTRICT COURT OF APPEAL OF FLORIDA
FIRST DISTRICT

DCA CASE NO. 1D11-2174
L.T. CASE NO. 09-CA-1503

STATE OF FLORIDA, DEPARTMENT OF REVENUE,

Appellant,

v.

RUEHL NO. 925, LLC,

Appellee.

AMICI CURIAE BRIEF OF THE FLORIDA RESTAURANT & LODGING ASSOCIATION, INC., AND THE FLORIDA RETAIL FEDERATION, INC., IN SUPPORT OF RUEHL NO. 925, LLC

On Appeal From a Final Order of The Circuit Court of The Second Judicial Circuit, In and For Leon County, Florida

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IDENTITY AND INTEREST OF AMICI CURIAE

The Florida Restaurant & Lodging Association, Inc., and the Florida Retail Federation, Inc., have a substantial interest in this case, which centers on whether start-up remodeling costs ordered and paid for by a tenant to make a leased premises ready for the tenant's intended use should be considered additional "rent" on which the tenant must pay Florida sales tax.

The Florida Restaurant & Lodging Association, Inc. (FRLA) is a statewide, non-profit trade association originally founded in 1946 to represent the restaurant industry. Since that time, the scope of FRLA's representation has expanded to include the entire hospitality industry, including lodging establishments, restaurants, and thousands of suppliers to the industry. The mission of FRLA is to protect, educate, and promote the hospitality industry.

Florida's hospitality industry generates $57 billion annually, representing 20% of Florida's economy. The industry is Florida's largest employer, providing more than 900,000 jobs. Florida's hospitality businesses collect and remit more than $3.4 billion in sales tax annually to state and local governments.

FRLA represents the interests of over 10,000 members in this state, ranging from national chains to small family-run restaurants and hotels. The vast majority of FRLA's restaurant members operate their businesses on leased premises. Likewise, the vast majority of FRLA's lodging members operate their businesses

on leased premises and/or lease portions of their premises to tenants operating restaurants or retail stores.

The Florida Retail Federation, Inc. (FRF), is a statewide, non-profit trade association founded in 1937, which serves as the chief advocate for Florida's retailing industry. FRF represents the interests of the industry before local, state, and federal governmental bodies, with the overarching goal of making Florida's business environment a favorable and stable one where retailers and their suppliers can grow and prosper.

Retailing is the second largest industry in Florida. Florida retailers are responsible for providing more than $25 billion in annual wages and one in every five jobs in the state, and they collect and remit over $19 billion in sales and related taxes to Florida's state and local governments.

FRF has over 8,000 retailer members in this state, ranging from national chains to small "mom-and-pop" stores. The vast majority of these retailer members operate their businesses on leased premises.

This case will decide whether start-up remodeling costs ordered and paid for by a tenant to make a leased premises ready for the tenant's intended use should be considered additional "rent" on which the tenant must pay Florida sales tax. If the Court decides that tenants must bear this additional tax burden, it will add to the overall cost of starting a business (whether restaurant, retail, or

otherwise), increase the financing burden on the business owner, and diminish the viability of many new businesses, especially those in the restaurant and retail industries where profit margins are typically very low.

SUMMARY OF THE ARGUMENT

Where the value and scope of a tenant's start-up remodeling costs are determined by the tenant (not the landlord), based upon the tenant's assessment of the improvements needed to make the leased premises suitable for its intended use, and where the lease offers no credit or offset of rent for those remodeling costs, those remodeling costs cannot fairly be considered taxable "rent" charged by the landlord. Whether the tenant spends $10,000 or $10 million on remodeling, the tenant's monthly rental payments to the landlord do not change. The tenant-controlled remodeling costs cannot be considered part of the landlord's bargained-for consideration in entering into the lease, because the value of this remodeling to the landlord is entirely speculative. Indeed, the tenant's remodeling will likely reduce the future rental income the landlord may expect to derive from the property, because any new tenant will have to demolish those improvements to suit its own unique use and the "trade dress" of its business. A tenant is therefore not required to pay sales tax on such costs as if they were "rent" paid to the landlord under section 212.031(1)(c), Florida Statutes.

To the average small businessperson who has recently put their savings at risk and opened their doors, the very notion that remodeling costs could be considered taxable "rent" would be entirely alien and counter-intuitive. The unwelcome "surprise" of a sales tax levy on such costs could well sink a new restaurant or retail establishment as they struggle to make payroll during the early formative months of their business operations. Going forward, imposing sales tax on tenant-controlled remodeling under the circumstances presented in this case will increase the cost of opening a business and discourage the future small business start-ups that Florida communities depend upon to drive their economies. In turn, such a decision would reduce employment prospects for all Floridians and rob government at all levels of the greater tax revenues produced once those new businesses begin operating.

ARGUMENT

UNDER SECTION 212.031, FLORIDA STATUTES, START-UP REMODELING COSTS ORDERED AND PAID FOR BY A TENANT TO MAKE A LEASED PREMISES READY FOR THE TENANT'S INTENDED USE ARE NOT ADDITIONAL "RENT" ON WHICH THE TENANT MUST PAY FLORIDA SALES TAX.

Section 212.031, Florida Statutes, provides in relevant part:

> (1)(a) It is declared to be the legislative intent that every person is exercising a taxable privilege who engages in the business of renting, leasing, letting, or granting a license for the use of any real property . . .
>
> . . . .
>
> (c) For the exercise of such privilege, a tax is levied in an amount equal to 6 percent of and on the total rent or license fee charged for such real property by the person charging or collecting the rental or license fee. The total rent or license fee charged for such real property shall include payments for the granting of a privilege to use or occupy real property for any purpose and shall include base rent, percentage rents, or similar charges. . . . [1]

The Department has interpreted what constitutes such taxable "payments for the granting of a privilege to use or occupy real property" as the "total consideration, whether direct or indirect, payments or credits, or other consideration in kind, furnished by the lessee to the lessor." Fla. Admin. Code Rule 12A-1.070(19)(b).

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[1] All emphasis in quoted material is supplied by the undersigned unless otherwise noted.

Of course, as a matter of constitutional law, courts and agencies are bound to strictly construe tax laws in favor of taxpayers and against the government, with any ambiguities or doubts resolved in favor of taxpayers. *State, Dep't of Revenue v. Ray Constr. of Okaloosa County*, 667 So. 2d 859, 865 (Fla. 1st DCA 1996) ("Taxes may be collected only within the clear definite boundaries recited by the statute."); *Broward County v. Fairfield Resorts Inc.*, 946 So. 2d 1144, 1147 (Fla. 4th DCA 2006). As a natural corollary, the Department's rule cannot be read to broaden what is taxable under the statute. *See Golden West Fin. Corp. v. Fla. Dep't of Revenue,* 975 So. 2d 567 (Fla. 1st DCA 2008).

Applying the plain language of the statute to the particular circumstances of this case, Judge Lewis in the circuit court below correctly held that Ruehl's remodeling costs did <u>not</u> constitute "rent" under any common-sense reading of section 212.031, because these costs were not sums charged by the landlord in exchange for granting Ruehl the right to use the property. Rather, the remodeling costs were "simply an expense which the tenant [Ruehl] had to incur to get the premises in a condition that would be suitable for its intended purposes." [V2 338].

Key to Judge Lewis' decision were a number of salient facts: (a) the remodeling costs were a one-time start-up expense to ready the premises for Ruehl's particular use; (b) the leases in question do not provide that the remodeling

costs act as a credit towards the periodic rent or are in lieu of such rent; (c) the leases do not require Ruehl to spend any specific amount of money to remodel the property or to make any specific leasehold improvements as a condition of occupancy; (d) the scope and extent of the remodeling were matters to be determined by Ruehl, not the landlord; and (e) Ruehl's need to remodel was typical of any new tenant and evidenced no scheme to avoid paying taxable rent.

As Judge Lewis recognized, the mere fact that a lease contemplates the tenant's expenditure of certain funds does not automatically convert those funds into a payment of "rent" to the landlord. [V2 337]. Section 212.031 makes clear the legislature's intent to tax rental payments charged by the landlord, but it does not evidence the legislature's desire to extend that tax to start-up remodeling costs paid for by the tenant, the value and scope of which are within the tenant's control (not the landlord's) and deemed necessary by the tenant to make the property ready for the tenant's particular use.

Of course, it is perhaps understandable that the Department feels obliged to maximize state revenues and take an aggressive stance in taxing rental transactions. However, the Department puts forth what amounts to a one-part test for determining whether remodeling costs are taxable as in-kind rent -- is the landlord <u>requiring</u> the tenant to make any improvements as a condition of the lease? While this one-dimensional, "check-the-box" analysis may be more

convenient from the Department's perspective, it asks this Court to remain blind to the realities of the transaction.

In situations like the one in this case, the landlord is not requiring the tenant to make any particular improvements. Rather, the lease is acknowledging the tenant's position that it will require certain unspecified improvements for its intended use of the property, and the lease serves the landlord's interest by simply making clear that the tenant -- not the landlord -- is responsible for determining the scope and value of such improvements and paying for them. In turn, the only thing that the landlord typically requires is that the improvements comply with applicable building codes and maintain the architectural integrity of the existing structure, thus ensuring that the value of the landlord's property will not be diminished.

The payment of periodic "cash" rent obviously has a direct value to the landlord, which is part of the landlord's bargained-for consideration in the rental transaction. The same can be said of other cash payments typically made by a commercial tenant to a landlord and considered part of the taxable rent, like payments for common area maintenance and for the landlord's *ad valorem* taxes. The stated argument for taxing tenant improvements as "in-kind" rent paid to the landlord is that these improvements, since incorporated into the premises itself, typically become the property of the landlord upon termination of the lease.

But if the landlord does not control the value and scope of these improvements, the landlord can have no assurance that the improvements will be of any direct value to the landlord, or even that they will be of indirect value in that they would be useful to some future tenant. Any value to the landlord from such tenant improvements is speculative and outside the landlord's control – thus the landlord could not count such improvements as part of its bargained-for consideration under the lease, and the lease would contain no provision (and demonstrate no intent) to allow for a corresponding reduction in the periodic rent to be paid to the landlord.

The lack of consideration flowing to the landlord is especially acute where, as is frequently the case, the improvements are largely driven by the unique "trade dress" of the tenant or the tenant's franchisor, which would likely be demolished and replaced by any new tenant. In such circumstances, rather than adding to the value of the landlord's property, it can fairly be said that such improvements actually reduce this value by adding to any new tenant's remodeling costs and reducing the amount the new tenant is willing to pay in rent.

By contrast, other cash payments typically made by a commercial tenant to a landlord, e.g., payments for common area maintenance and for the landlord's *ad valorem* taxes, are of direct value to the landlord, part of the landlord's bargained-for consideration, and thus considered part of the taxable rent. While the precise

amount of these additional payments are not known at the time of lease execution, the landlord is certainly in a position to estimate them. If a tenant refused to agree to these additional payments in the lease, the landlord's consideration under the lease would be reduced by a cognizable amount, and the landlord would certainly seek a higher periodic rent.

But how could the landlord count the tenant improvements as part of the landlord's bargained-for consideration in the lease transaction when the value and scope of those improvements are controlled by the tenant? How could the landlord factor such improvements into the periodic rent it will charge the tenant when the tenant may choose to spend $10,000 or $10 million on those improvements?

Not only are such tenant-controlled remodeling costs not fairly considered "rent" under section 212.031, as held by Judge Lewis, but taxing these costs is contrary to establishing a prudent state tax policy that avoids adding layers of "double taxation" which suppress economic activity and rob the state of the much larger taxes flowing from new business operations, including taxes on the sales made by those businesses, corporate income taxes, employment taxes, etc.

A tenant's leasehold improvements subject the landlord's property to additional ad valorem taxation, which is why the landlord usually requires the tenant to make additional payments to defray those taxes. Further, the building materials, equipment, etc., used by the tenant are subject to sales tax. Against this

backdrop, if the Court determines that an additional sales tax burden must be imposed on tenant-controlled remodeling costs, such a decision would add to the overall cost of starting a business (whether restaurant, retail, or otherwise), increase the financing burden on the business owner, and diminish the viability of many new businesses, especially those in the restaurant and retail industries where profit margins are typically very low.

One need do no more than drive a few miles in any Florida city or town to recognize that the restaurant and retail industries have been crippled by the recent global economic crisis that has dragged on now for years. Vacant restaurant and retail space litters the Florida landscape, accelerating the decline in general economic activity and in tax revenues at all levels of government, depressing property values and exacerbating Florida's real estate crisis, and contributing to the generally poor economic outlook of most Floridians.

New restaurant and retail operations typically require significant financing for start-up improvements to their business premises, which are often driven by the "branding" of a particular restaurant or retail chain. In the face of the current economic malaise, those hard-working men and women who want to take the gamble of their lives and open a restaurant or retail operation face a credit market where lending to small businesses, especially new start-ups, is more difficult than ever.

Indeed, to the average small businessperson who has recently put their savings at risk and opened their doors, the very notion that remodeling costs could be considered taxable "rent" would be entirely alien and counter-intuitive. The unwelcome "surprise" of a sales tax levy on such costs could well sink a new restaurant or retail establishment as they struggle to make payroll during the early formative months of their business operations. Such a surprise would be particularly acute under the circumstances of this case, where the leases did not require the tenant to spend any specific amount on the initial remodeling and the leases provided no credit against the rent for these tenant expenditures. The average small businessperson would view such start-up remodeling as routine, rather than part of some elaborately orchestrated "rent avoidance" scheme engineered to avoid sales tax liability.

As Judge Lewis held, the Department's reliance upon *Department of Revenue v. Seminole Clubs, Inc.,* 745 So. 2d 473 (Fla. 5th DCA 1999), is unavailing, because the facts in that case are wholly distinct from the situation at hand. In *Seminole Clubs*, which involved the 67-year lease of a public golf course, the lease specifically required the tenant to use 5% of all gross revenues "annually on capital improvements, in lieu of rent, first to the golf course itself . . . and then to building improvement and additional structures." *Id.* at 474. If the tenant did not spend the required amount on improvements, the tenant was required to pay

this sum to the city as rent. *Id.* Under those circumstances -- where the recurring annual capital improvements were expressly made in lieu of rent, the court determined that they constituted "rental consideration flowing to the landlord" and were taxable as "rent in kind." *Id.* at 475.

Judge Lewis correctly determined that Ruehl's situation in the present case was materially different. Ruehl was not given the choice to make leasehold improvements in lieu of rental payments nor was Ruehl given a discount on its periodic rent based on the value of such improvements. Ruehl's rent was the same whether Ruehl chose to spend $10,000 or $10,000,000 on its remodeling of the premises. The one-time, start-up remodeling costs ordered and paid for by Ruehl to make the leased premises ready for Ruehl's particular retail business use could not fairly be considered a charge by the landlord for the use of its property and therefore could not be considered "rent" on which Ruehl must pay Florida sales tax.

In response, the Department chooses to ignore these key differences and instead urges this Court to myopically focus on just a few words from *Seminole Clubs* – "[t]he *holding* in *Seminole Clubs* is that 'capital improvements were made for the privilege of occupancy and, therefore, represented [taxable] 'rent in kind.'" *Appellant's Initial Brief* at 8 (emphasis in original). In doing so, the Department apparently seeks to make these words akin to a sweeping legislative

pronouncement on the matter, divorced from the case that was actually before the court. But, like any court, the *Seminole Clubs* court was applying the controlling law to the facts of that case -- and those facts matter.

The Department also argues that Judge Lewis' decision should be reversed because it would otherwise "invite landlords and tenants to disguise rent as leasehold improvements" and thus avoid paying sales tax. *Appellant's Initial Brief* at 2. This was certainly true in *Seminole Clubs*, where the landlord required the tenant to spend a prescribed amount on capital improvements, thus attempting to "disguise" this bargained-for consideration flowing to the landlord as something other than taxable rent. But it cannot be considered true in this case, where the landlord did not specify particular improvements or minimum expenditures deemed necessary or desirable by the landlord and then require Ruehl to provide them as a condition of its occupancy. On the contrary, the lease here acknowledges Ruehl's position that it will require some as yet undetermined improvements for its intended use of the property, and the lease serves the landlord's interest by simply making clear that Ruehl -- not the landlord -- is responsible for determining the scope and value of such improvements and paying for them. Here, there was no attempt to "disguise" consideration flowing to the landlord as something other than rent.

CONCLUSION

For the reasons expressed, Amici Curiae urge this Court to affirm the circuit court's final judgment.

Respectfully submitted,

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I HEREBY CERTIFY that the font used in this brief is the Times New Roman 14-point font and that the brief complies with the font requirements of Rule 9.210(a)(2).

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