STATE OF FLORIDA
DIVISION OF ADMINISTRATIVE HEARINGS

DUNHILL INTERNATIONAL LIST CO., INC.,	)	
Petitioner,	)	
vs.	)	Case No. 02-3614
DEPARTMENT OF REVENUE,	)	
Respondent.	)	

RECOMMENDED ORDER

This case came before Administrative Law Judge John G. Van Laningham for final hearing by video teleconference on February 10, 2003, at sites in Tallahassee and Fort Lauderdale, Florida.

APPEARANCES

For Petitioner: Joseph C. Moffa, Esquire
Law Offices of Moffa & Gainor, P.A.
One Financial Plaza, Suite 2202
100 Southeast Third Avenue
Fort Lauderdale, Florida 33394

For Respondent: Carrol Y. Cherry, Esquire
Martha F. Barrera, Esquire
Assistant Attorneys General
Office of the Attorney General
Tax Section, PL-01, The Capitol
Tallahassee, Florida 32399-1050

STATEMENT OF THE ISSUES

The issues in this case are (1) whether mailing lists, when stored as digital data on magnetic tapes, constitute "tangible personal property" subject to the Florida sales and use tax, and, if so, then (2) whether a list reseller is entitled to claim the "sale for resale" exemption when it acquires a mailing list as digital data on magnetic tape but delivers the list to its customer either (a) as digital data on a different removable medium such as a diskette or (b) in alphabetic format, printed on pressure-sensitive labels, Cheshire labels, or 3 x 5 cards.

PRELIMINARY STATEMENT

Following an audit that began in April 2001, Respondent Department of Revenue assessed Petitioner Dunhill International List Co., Inc. for sales and use taxes totaling $68,598.56, plus interest and a penalty. This assessment was based on Respondent's determination that Petitioner had failed to pay sales tax on the price of mailing lists it had leased from list owners when, as often happened, such lists had been acquired as digital data on magnetic tapes and subsequently re-leased to Petitioner's customers on other media.

Petitioner timely protested the assessment and requested an administrative hearing. Respondent referred the matter to the Division of Administrative Hearings, where an administrative law judge was assigned to conduct the hearing.

The final hearing was held on February 10, 2003, as scheduled, with both parties present and represented by counsel. Respondent presented its prima facie case through the testimony of Robert Dunhill, Petitioner's president; Steven Genden, a tax auditor who works for Respondent; and James Kalfas, who is a senior tax specialist with Respondent. In addition, Respondent offered 19 exhibits, numbered 1 through 19, which were received. Petitioner called two witnesses during its case-in-chief: Robert Dunhill and Cindy Dunhill, who is the company's vice president. Petitioner's Exhibits 1 through 10 were also admitted.

The one-volume final hearing transcript was filed on March 7, 2003. Each side timely filed a proposed recommended order, and these papers were carefully considered.

FINDINGS OF FACT

The Parties

1. Petitioner Dunhill International List Co., Inc. ("Dunhill") is a Florida corporation having its home office and principal place of business in Boca Raton, Florida.

2. Respondent Department of Revenue ("Department"), an agency of the State of Florida, is authorized to administer the state's tax laws.

Dunhill's Business

3. Dunhill is engaged in the business of furnishing mailing lists to direct-mail marketers, telemarketers, and e-mail marketers. Instead of owning an inventory of mailing lists, Dunhill obtains them, as and when needed, from list owners and suppliers. Dunhill acquires the various lists its customers request pursuant to leases that customarily authorize a particular customer of Dunhill's to use the owner's list for just one mailing.[1] Essentially a middleman, Dunhill subleases the mailing lists, in which it has but a limited leasehold interest, to its customers.[2] Dunhill does not make personal use of the mailing lists it secures for and on behalf of its clients; to Dunhill, the lists are commodities.

4. At all times relevant to this case, Dunhill's suppliers (the list owners) frequently delivered the mailing lists to Dunhill as digital data stored on magnetic tapes from which the data could be transferred into Dunhill's computer.[3] Once the data comprising a particular mailing list were loaded into Dunhill's computer, Dunhill would cause the list to be printed in alphabetic format onto the medium of its customer's choosing, e.g. pressure-sensitive labels, Cheshire labels, or 3 x 5 cards. Sometimes Dunhill delivered a mailing list to its client as digital data stored on a diskette or other removable medium

besides magnetic tape. Occasionally, the magnetic tape itself was delivered to Dunhill's customer.

5. Dunhill's suppliers charged Dunhill a fee for the magnetic tape, which was payable in addition to the rent for use of the mailing list stored thereon. During the relevant period of time this fee was $25. Dunhill, in turn, charged its customers an additional fee for whichever medium was used to deliver them the lists they had ordered. For Dunhill and its suppliers, however, the commercially valuable properties that drove these transactions——the goods without which none of these deals would have occurred——were the mailing lists, not the magnetic tapes.

6. The parties have stipulated that Dunhill collected and remitted to the Department all sales taxes due and payable on the transactions between Dunhill and its customers. Dunhill did not, however, pay sales tax on any part of the cost of the mailing lists that it leased from its suppliers. Instead, Dunhill provided duly issued resale certificates to its suppliers, thereby relieving the suppliers of the obligation to collect sales taxes.

The Audit and Protest

7. Beginning in April 2001, the Department conducted a sales and use tax audit of Dunhill's business records for the period from March 1, 1996 through February 28, 2001. Due to the

voluminous nature of Dunhill's records, the parties agreed that the Department could employ a sampling method to calculate the amount of tax owed, if any, based on a representative sample of Dunhill's business documents.

8. On December 5, 2001, the Department issued a Notice of Proposed Assessment in which Dunhill was informed of the Department's conclusion that the aggregate amount of $69,481.00 was due and payable as a tax on the total consideration paid for each mailing list-containing magnetic tape that Dunhill allegedly had used and consumed in those transactions where, as often happened, Dunhill's customer was provided a mailing list via some medium besides magnetic tape. The Department also sought to collect $24,105.56 in interest through December 5, 2001, plus interest accruing after that date at the rate of $21.10 per day, and to impose a penalty of $34,740.57.

9. On January 31, 2002, Dunhill filed a letter with the Department protesting its liability for the proposed assessment.[4] This led the Department to issue a Notice of Decision, on July 9, 2002, which sustained the assessment in full. Thereafter, Dunhill timely initiated the instant administrative proceeding.

CONCLUSIONS OF LAW

Jurisdiction

10. The Division of Administrative Hearings has personal and subject matter jurisdiction in this proceeding pursuant to Sections 72.011(1)(a), 120.569, 120.57(1), and 120.80(14)(b), Florida Statutes.

The Parties' Respective Burdens of Proof

11. Although designated the "Respondent," the Department has the initial burden to prove, by a preponderance of the evidence, not only "that an assessment has been made against the taxpayer [but also] the factual and legal grounds upon which the . . . department made the assessment." Section 120.80(14)(b)2., Florida Statutes. If the Department meets its burden, then the taxpayer must establish, also by the greater weight of the evidence, that the assessment is incorrect. See IPC Sports, Inc. v. State Dept. of Revenue, 829 So. 2d 330, 333 (Fla. 3d DCA 2002).

12. In its Proposed Recommended Order, the Department asserts that its assessment is entitled to a presumption of correctness and that, therefore, Dunhill must prove the Department departed from the requirements of law or acted without any reasonable hypothesis of legality. The foregoing premise and conclusion, however, are both erroneous in this case.

13. In support of its contention that the assessment must be considered prima facie correct, the Department relies upon Section 212.12(5)(b), Florida Statutes.[5] This statute, in the Fifth DCA's words, "allows the Department to assess by guesstimates based upon selected available data, and then be afforded the presumption of correctness." Lloyd Enterprises, Inc. v. Department of Revenue, 651 So. 2d 735, 739 (Fla. 5th DCA 1995). The undersigned agrees with the district court (and is bound, in any event, to follow its decision) that the "best estimate provisions [of Section 212.12(5)(b)] should *not* come into operation unless the dealer or person to be charged has done something wrong or obstructive to prevent the Department from making a fair or ordinary audit." Id. Because Dunhill did not in any way interfere with the Department's audit, Section 212.12(5)(b), Florida Statutes, is inapplicable.[6]

14. Indeed, far from interfering, Dunhill affirmatively cooperated with the Department during the audit. In particular, Dunhill agreed in writing, pursuant to Section 212.12(6)(c), Florida Statutes, that the Department could review representative samples of Dunhill's "adequate but voluminous" records and make findings therefrom that would be projected over the entire audit period.[7] Section 212.12(6)(c) does not direct that projected findings derived through a sampling method as authorized thereunder must be considered prima facie correct.

15. The Department's reliance upon Straughn v. Tuck, 354 So. 2d 368, 371 (Fla. 1977), and Harris v. State Dept. of Revenue, 563 So. 2d 97, 99 (Fla. 1st DCA 1990), overruled on other grounds, Florida Dept. of Revenue v. Herre, 634 So. 2d 618 (Fla. 1994)——for the proposition that the taxpayer must prove the Department departed from the law's requirements or that the assessment was not supported by any reasonable hypothesis of legality——is also misplaced.

16. First, Straughn is one of many cases in which deference has been accorded a county tax assessor's valuation of property for ad valorem tax purposes. See also, e.g., Havill v. Scripps Howard Cable Co., 742 So. 2d 210, 212 (Fla. 1998)("A presumption of validity attaches to the property appraiser's assessment of property for ad valorem taxation purposes."); Powell v. Kelly, 223 So. 2d 305, 307-08 (Fla. 1969). But, since the instant case does not involve a county tax assessor, a property appraisal, or an ad valorem tax, Straughn and similar cases standing for the principle that an assessor's valuation is presumed correct are distinguishable and inapposite.

17. In the second case, Harris, the court upheld against constitutional challenge a statute——since repealed[8]——that imposed a tax on unlawful sales of marijuana and other controlled substances. See Section 212.0505, Florida Statutes (1987), repealed, Ch. 95-140, Laws of Florida. As one basis for

invalidating the statute, the taxpayer urged that then-Section 212.0505(5), which deemed drug tax assessments prima facie correct, violated procedural due process. 563 So. 2d at 99. In rejecting this argument, the court reasoned that a similar (and apparently valid) presumption of correctness applied in "analogous controversies" involving ad valorem tax assessments. Id.[9] It is clear, however, that such controversies as the court had in mind were analogous to the taxpayer contest then at bar only because the statute in question——Section 212.0505(5), Florida Statutes (1987)——deemed the taxing authority's assessment prima facie correct.[10] In contrast, ad valorem tax disputes are not analogous to contests such as this one where there exists no similar statutory presumption in favor of the particular tax assessment in controversy. Thus, Harris does not shed light on the issues at hand.

18. In sum, it is concluded that the Department must meet its initial burden of proof in this case without the assistance of a presumption of correctness. The Department's assessment, in other words, is not presumed to be correct or incorrect.[11]

The Department's Theory of the Case

19. The Department contends that Dunhill is obligated to pay a use tax on the price it paid for the limited right to use a mailing list in each instance where:

> (a) Dunhill leased a mailing list from a list owner;
>
> (b) the list owner transmitted the mailing list to Dunhill as digital data stored on a magnetic tape; and
>
> (c) when Dunhill re-leased (or subleased) the mailing list to a customer, it transmitted the mailing list to the customer as digital data stored on another medium, e.g. a diskette, or in an alphabetic format printed on media such as pressure-sensitive labels, Cheshire labels, or 3 x 5 cards.

The Department does not seek to levy the tax on transactions in which Dunhill leased a mailing list on magnetic tape and then re-leased the same list on magnetic tape.

20. The use tax is described in Section 212.05, Florida Statutes, as follows:

> **Sales, storage, use tax.**--It is hereby declared to be the legislative intent that every person is exercising a taxable privilege who engages in the business of selling tangible personal property at retail in this state, including the business of making mail order sales, or who rents or furnishes any of the things or services taxable under this chapter, or who stores for use or consumption in this state any item or article of tangible personal property as defined herein and who leases or rents such property within the state.
>
> (1) For the exercise of such privilege, a tax is levied on each taxable transaction or incident, which tax is due and payable as follows:
>
> * * *

> (b) At the rate of 6 percent of the cost price of each item or article of tangible personal property when the same is not sold but is used, consumed, distributed, or stored for use or consumption in this state[.]

(Emphasis added.)

21. Three concepts are critical to the operation of the use tax. One is that "tangible personal property" must be involved. Another is that this tangible personal property must be put to some "use" besides a sale at retail. The third is "cost price"——that is, the consideration given for the subject tangible personal property——which determines the amount of tax due and payable for its use.

22. The term "tangible personal property" is defined to mean and include:

> personal property which may be seen, weighed, measured, or touched or is in any manner perceptible to the senses, including electric power or energy, boats, motor vehicles and mobile homes as defined in s. 320.01(1) and (2), aircraft as defined in s. 330.27, and all other types of vehicles. The term "tangible personal property" does not include stocks, bonds, notes, insurance, or other obligations or securities; intangibles as defined by the intangible tax law of the state; or pari-mutuel tickets sold or issued under the racing laws of the state.

Section 212.02(19), Florida Statutes.

23. Pursuant to Section 212.02(20), Florida Statutes, the term "use" means and includes

> the exercise of any right or power over tangible personal property incident to the ownership thereof, or interest therein, except that it does not include the sale at retail of that property in the regular course of business. The term "use" does not include the loan of an automobile by a motor vehicle dealer to a high school for use in its driver education and safety program. The term "use" does not include a contractor's use of "qualifying property" as defined by paragraph (14)(a).

(Emphasis added.)

24. Section 212.02(4), Florida Statutes, sets forth the definition of "cost price." It provides:

> "Cost price" means the actual cost of articles of tangible personal property without any deductions therefrom on account of the cost of materials used, labor or service costs, transportation charges, or any expenses whatsoever.

25. The Department takes the position that a magnetic tape is a piece of tangible personal property whose character as such is not changed when a mailing list (as intangible digital data) is copied onto the tangible medium. The Department further posits that digital data, which it accepts are intangible, remain distinctly intangible even when copied onto a tangible medium. It is the Department's view, however, that when a tangible medium is used to store intangible data, the tangible storage medium defines the character of the whole for sales and use tax purposes, even though the whole is composed of distinct and separable tangible and intangible elements.

26. The Department does not dispute that a magnetic tape is more valuable when it contains marketable information such as a mailing list. For the Department, however, this reality means simply that, other things being equal, a tape containing a mailing list will be more expensive than a blank tape. Indeed, the Department's position implicitly rests on the premise that the purchase of a magnetic tape containing a valuable data file such as a mailing list is conceptually no different, for sales and use tax purposes, than the purchase of a blank tape; in either event, the purchaser is buying tangible personal property. According to the Department, then, if the purchaser of such magnetic tape does not thereafter resell that very same tape to another person in the regular course of business, then his purchase of the tape (regardless of what, if any, data it contained at the time) necessarily constituted a taxable "retail sale."[12]

27. It is undisputed that Dunhill did not pay sales tax to any of the list owners from whom it leased lists during the audit period.[13] It is also agreed that Dunhill frequently delivered mailing lists to its customers (sublessees) on media other than the magnetic tapes customarily used by list owners to convey the data to Dunhill. Based on these facts, the Department contends that when Dunhill copied data from magnetic tapes to other media before subleasing the mailing lists to its

customers, it "used" tangible personal property (i.e. the magnetic tapes) for purposes other than a sale at retail, effectively becoming the consumer of the tapes (even though it is undisputed that Dunhill did not use the mailing lists). The Department further asserts that the cost price of each magnetic tape so "used" is the total consideration that Dunhill paid to the list owner for the use of the mailing list (even though it is undisputed that the value of the limited right to use this data far exceeded the value of the tangible medium used to convey the data). The Department concludes that Dunhill is directly liable for the taxes (plus interest and penalties) allegedly due and payable on the cost price of each such magnetic tape. See Section 212.07(8), Florida Statutes ("Any person who has purchased at retail, used, consumed, distributed, or stored for use or consumption in this state tangible personal property

. . . and cannot prove that the tax levied by this chapter has been paid to his or her vendor, lessor, or other person is directly liable to the state for any tax, interest, or penalty due on any such taxable transactions.").

Dunhill's Theory of the Case

28. Dunhill attacks the Department's position on two fronts. First, Dunhill contends that the real object of the transactions at hand (in which Dunhill leased mailing lists from

list owners[14]) was not tangible personal property but intangible data. The magnetic tapes, Dunhill asserts, were merely incidental to the transactions. Dunhill thus maintains, as an initial matter, that the transactions fell outside the reach of the taxing statute.

29. Second, and in the alternative, Dunhill claims that the transactions at issue were exempt from the sales and use tax because in all instances Dunhill acquired the mailing lists for the purpose of reselling them at retail. Under this view, which assumes that tangible personal property was being acquired from the list owners (in the form of magnetic tapes containing digital data), Dunhill always acquired the subject property with the intent——which in fact was acted upon——to incorporate the commercially marketable part thereof (the data) as a material component in the tangible personal property that it leased to its customers, making the transactions at issue exempt from taxation as "sales for resale." See Rule 12A-1.039(1)(b)6., Florida Administrative Code. From this premise follows the conclusion that the magnetic tapes remaining in Dunhill's possession were essentially waste, a by-product to be discarded or perhaps sold as salvage.[15]

Did the Subject Transactions
Involve "Tangible Personal Property"?

30. The threshold question in this case is whether a mailing list, when stored in a digital data file located on a magnetic tape, constitutes "tangible personal property" as that term is defined in Section 212.02(19), Florida Statutes. If this question is answered in the negative, then the inquiry ends, for the use of intangible property is not taxable under Section 212.05(1)(b), Florida Statutes. If, on the other hand, the answer is "yes," then the transactions are taxable unless the "sale for resale" exception applies.

31. Included within the statutory definition of "tangible personal property" are things that "may be seen, weighed, measured, or touched in any manner perceptible to the senses, including electric power or energy . . . ." Section 212.02(19), Florida Statutes. Significantly, even the Department says that digital data files, in and of themselves, are not tangible property within the meaning of this definition. See Dept.'s PRO at 19 ("This case involves intangible data purchased on tangible tape, and later sold on other tangible media."); id. at 38 ("The case at bar . . . involves intangible mailing lists (data) stored on tangible magnetic tape."); accord, id. at 40.[16] This is important because if, as the Department intimates, digital data retain their individual identity as intangible property

even when stored on a tangible medium, then logically a magnetic tape containing digital data——which, for lack of a better term, will hereafter be referred to as a "smart tape"——must be viewed as a hybrid item of heterogeneous composition, i.e. an item comprising distinct (and separable) tangible and intangible elements. Thus, the threshold question can more precisely be framed as follows: In deciding whether a smart tape is "tangible personal property," is the defining characteristic the tangibility of the tape——or the intangibility of the data?

32. No statute speaks directly to this issue. The Department acknowledged at hearing, moreover, that it has not promulgated any rules on point. There are no Florida cases on all fours either; of the few that are somewhat analogous, none is close enough to be controlling. Thus, the immediate question is one of first impression.

33. The Department relies upon Florida Ass'n of Broadcasters v. Kirk, 264 So. 2d 437, 439 (Fla. 1st DCA 1972), wherein the court held that, because "the use of [motion-picture] film cannot be distinguished from the actual physical film," the right to broadcast scenes and sounds recorded on celluloid constitutes tangible personal property, and thus the amounts paid by broadcasters to rent films for use in Florida are subject to the sales and use tax. The Department urges that, likewise, intangible digital data stored on a magnetic

tape cannot be separated from the tape, and therefore, on the authority of Kirk, amounts paid for the use of such data should be taxable.

34. This analogy has facial appeal but is imperfect and ultimately unpersuasive. To be sure, a smart tape is somewhat like a film——and a book and a record (i.e. vinyl LP), the latter which are commonly regarded as tangible personal property whose purchases at retail are subject to sales tax. Each of these items is a tangible medium holding information content. But digital data are different than non-digital information because they are freely transferable from medium to medium without loss of quality. And the media that hold digital data are different than celluloid, paper, and vinyl because they are generally reusable; data can be added to or deleted from them without causing damage to or physically altering these media. In contrast, the information stored on a film, book, or record cannot be removed, erased, or overwritten without damaging, destroying, or physically altering the tangible medium.[17] The undersigned concludes, therefore, that the use of digital data can be distinguished from the physical media that store such data in a way that the use of celluloid film cannot be distinguished from the tangible film.[18]

35. Dunhill considers the decision in Department of Revenue v. Quotron Systems, Inc., 615 So. 2d 774 (Fla. 3d DCA

1993), instructive. In that case, the taxpayer ("Quotron") was in the business of electronically delivering financial news and information to its subscribers, who viewed the data on dedicated video terminals that Quotron supplied for this purpose.[19] Quotron's subscribers entered into separate agreements with the owners of the relevant financial information (e.g. the national stock exchanges) pursuant to which the owners billed the subscribers directly for the information that Quotron delivered to the subscribers via Quotron's "integrated electronic delivery system." Id. at 775.

36. The Department maintained that the transactions between Quotron and its customers were subject to sales tax because, according to the Department, Quotron was selling tangible personal property in the form of viewable images.[20] The trial court rejected the Department's position, however, holding for various reasons that the electronic images appearing on the subscriber's terminals were not clearly and unambiguously tangible personal property within the contemplation of Section 212.02(19), Florida Statutes. The third district affirmed. Id. at 777; accord, Henley Holdings, Inc. v. Department of Revenue, Fla. 2d Jud.Cir. Case No. 89-4381 (Summary Judgment, July 22, 1991), aff'd per curiam, 599 So. 2d 1282 (Fla. 1st DCA 1992).

37. Quotron is marginally helpful to Dunhill insofar as it holds that digital data are intangible property. But, as

mentioned, the Department now accedes to this proposition, as far as it goes; that is, the Department presently agrees that digital data per se are intangible and thus outside the sales tax's reach when delivered to the consumer "electronically" and not as a file stored on a portable medium such as magnetic tape. Because the data in question here were delivered to Dunhill "physically" through the use of a tangible removable medium rather than "electronically" as in Quotron, the Third DCA's decision is not contrary to the Department's immediate litigating position. It is indeed possible that the outcome of Quotron would have been different if the taxpayer had been delivering financial data to its subscribers on, for example, compact discs.

38. Quotron is further distinguishable because the subscribers there paid the owners separately for the subject financial data (in transactions the Department evidently did not consider taxable), whereas here Dunhill's clients subleased the mailing list data from Dunhill. If instead Dunhill's customers had paid the list owners directly for the right to use their data and compensated Dunhill separately for brokerage and reformatting services, then Quotron would have been a better match. Finally, the opinion does not tell whether Quotron paid the owners for the use of their proprietary data (as Dunhill did in this case) or in what format Quotron received the data from

the owners,[21] nor does it give any indication that the Department viewed the transactions between Quotron and the owners of the financial data——the transactions most analogous to those at issue here——as taxable events. All in all, Quotron is a near miss that is not as useful as it appears at first blush.

39. A case not cited by either party that nevertheless deserves mention is Gilreath v. General Elec. Co., 751 So. 2d 705 (Fla. 5th DCA), rev. denied, 837 So. 2d 409 (2000). In Gilreath, which involved a challenge to an ad valorem tax assessment, the court examined the question whether computer software is tangible or intangible personal property. This issue, which reached a Florida appellate court for the first time in Gilreath, had already been litigated in many foreign jurisdictions. Courts around the country, however, were then, as now, split on the issue; a majority view on the subject has yet to emerge.[22]

40. Before looking at Gilreath, the undersigned acknowledges straight away that the case is distinguishable because a) it concerned a different tax, b) software is arguably different from data, c) the Florida Legislature has spoken on how computer software is to be treated for ad valorem tax purposes, and d) the Department has promulgated a rule respecting the treatment of computer software for sales and use tax purposes.[23] Accepting these differences, the undersigned

believes that Gilreath still has some useful things to say about matters relevant to this case.

41. First, the fifth district found the reasoning of the courts that have characterized software as intangible personal property to be more persuasive than that of the courts holding otherwise. Id. at 709. Specifically, the Fifth DCA subscribed to the view that software is fundamentally a form of intellectual property whose essence is not tangible storage media, which are merely "tangential incidents," but rather intangible "binary impulses." Id. at 708-09. The undersigned likewise regards this position as more persuasive than the opposing view, which holds that software has corporeal qualities and is inextricably intertwined with a corporeal object. See, e.g., South Cent. Bell Telephone Co. v. Barthelemy, 643 So. 2d 1240, 1248 (La. 1994). Indeed, the undersigned considers the rationale adopted in Gilreath to be especially compelling as applied to digital data stored on removable, reusable media.

42. Second, the court cited with approval Spencer Gifts, Inc. v. Director, Division of Taxation, 440 A.2d 104 (N.J.Tax 1981), a case wherein it was held that mailing lists stored on magnetic tapes are not tangible personal property for sales and use tax purposes. 751 So. 2d at 708. Thus, the court raised the profile in Florida of, and at least implicitly endorsed, a New Jersey court's opinion whose holding is of obvious interest

in the present case. Conversely, in rejecting Barthelemy and other cases which have similarly concluded that software is tangible personal property, the Fifth DCA implicitly lessened the persuasive force of the out-of-state cases that, contrary to Spencer Gifts, have found mailing lists stored on magnetic tapes to be tangible personal property by analogizing smart tapes to computer software. (Spencer Gifts and other mailing list cases will be discussed separately below.)

43. Third, the court declared that the Florida Legislature expressly has endorsed the view that computer software is essentially intangible property. Id. at 708-09. The court was referring to Section 192.001(19), Florida Statutes, which the legislature enacted in 1997. This statute provides as follows:

> "Computer software" means any information, program, or routine, or any set of one or more programs, routines, or collections of information used or intended for use to convey information or to cause one or more computers or pieces of computer-related peripheral equipment, or any combination thereof, to perform a task or set of tasks. Without limiting the generality of the definition provided in this subsection, the term includes operating and applications programs and all related documentation. Computer software does not include embedded software that resides permanently in the internal memory of a computer or computer-related peripheral equipment and that is not removable without terminating the operation of the computer or equipment. Computer software constitutes personal property only to the extent of the value of the unmounted or uninstalled medium on or in which the

> information, program, or routine is stored or transmitted, and, after installation or mounting by any person, computer software does not increase the value of the computer or computer-related peripheral equipment, or any combination thereof. Notwithstanding any other provision of law, this subsection applies to the 1997 and subsequent tax rolls and to any assessment in an administrative or judicial action pending on June 1, 1997.

Section 192.001(19), Florida Statutes.

44. The court interpreted this statute to mean that physical media such as magnetic tapes, floppy diskettes, and CDs are tangible personal property, but digital data are not. Id. at 709; see also Department of Revenue v. Pepperidge Farm, Inc., 2003 WL 1237044, *1, 28 Fla.L.Weekly D784, ___ So. 2d ___ (Fla. 2d DCA Mar. 19, 2003)(computer software is intangible personal property pursuant to Section 192.001(19), Florida Statutes). Thus, the court concluded, the tangible medium constitutes taxable property, but the "information, program, or routine [stored thereon] is not subject to local taxation." 751 So. 2d at 709.

45. Section 192.001(19), Florida Statutes, is not directly relevant to the taxability of stored digital data pursuant to Chapter 212.[24] Section 192.001(19) is telling, however, because its existence testifies to the legislature's recognition that, given its dualistic nature, computer software does not fit neatly into the usual definitions of "intangible personal

property" and "tangible personal property," see, e.g., Sections 192.001(11)(b) and (d), Florida Statutes. Rather, software is sufficiently unique to merit its own definition. This, the undersigned concludes, is a point to keep in mind when considering whether the definition of "tangible personal property" set forth in Section 212.02(19) clearly and unambiguously embraces a hybrid property item such as the smart tapes at issue.

46. Courts in a handful of foreign jurisdictions have addressed the question whether smart tapes are tangible personal property subject to sales and use taxes. However, the undersigned has not found a single case——and the parties have cited none——in which the issue was examined in the context of an attempt to tax the transaction between list owner and list broker or reseller. Rather, in every case known to the undersigned, the taxing authority focused on the "retail-level" transactions occurring between list brokers and their direct-mailer customers as opposed to the "wholesale-level" transactions, such as those at issue here, whereby the broker or reseller obtained marketing lists for or on behalf of its customers.[25] This suggests the Department's position that Dunhill was an end-user or consumer of the smart tapes, while not necessarily wrong or unreasonable, is somewhat more

aggressive than the positions taken by taxing authorities in other states.

47. As it happens, the courts are evenly divided as to whether smart tapes are tangible personal property. It has been held in at least four jurisdictions that mailing lists are intangible personal property. See Globe Life and Acc. Ins. Co. v. Oklahoma Tax Com'n, 913 P.2d 1322, 1329 (Okl. 1996)(magnetic tapes encoded with lists specific to mailer's needs most closely approximate intellectual property and hence are intangible property not subject to a use-tax levy); Spencer Gifts, Inc. v. Director, Division of Taxation, 440 A.2d 104, 117-18 (N.J.Tax 1981)(when direct-mailer leases list, the real object of the transaction is intangible information, not the magnetic tape containing such information, which is only incidental to the transaction; thus, direct-mailer is not liable for sales tax on amount paid for use of list); Mertz v. State Tax Com'n of the State of New York, 89 A.D.2d 396, 397-98 (N.Y.A.D. 1982)(purchase of mailing list as a digital file is not a taxable sale of tangible personal property because magnetic tape is merely the means of transmitting information, which is the essence of the transaction; transactions involving computer tapes are taxable, however, under separate New York statute dealing with sales of information); Fingerhut Products Co. v. Commissioner of Revenue, 258 N.W.2d 606, 609 (Minn.

1977)(direct-mailer's use of typed mailing lists is not a taxable use of tangible property because the tangible medium is merely incidental to the use of incorporeal information contained in the lists; use of mailing labels, however, is taxable)

48. Courts in at least three other jurisdictions have reached the opposite conclusion. See American Business Information, Inc. v. Egr, 650 N.W.2d 251, 256-57 (Neb. 2002)(contrary to the taxing authority's contention, prospect lists and other business data delivered variously in alphabetic format on index cards and paper and also in digital format on diskettes and magnetic tape as well as via online transmission are tangible personal property); Mark O. Haroldsen, Inc. v. State Tax Com'n, 805 P.2d 176, 181-82 (Utah 1990)(sale of mailing list is taxable when the information is conveyed by tangible media such as printed sheets or magnetic tape[26]); Disclosure Information Group v. Comptroller of the Treasury, 530 A.2d 8, 12 (Md.App. 1987)(customer lists transferred via paper or magnetic tape are not symbolic or representative; like software, they are tangible personal property subject to sales tax[27]).

49. Having studied the foregoing cases and given a good deal of thought to the issues raised here, the undersigned concurs with the Oklahoma Supreme Court's observation that

> [d]etermining the legal nature of magnetic tapes, encoded with information *specific* to its purchaser, has perplexed both state and federal courts for several decades now. The difficulty is that these items, like computer software, are "neither fish nor fowl or good red herring." They possess the legal qualities of *both* tangible *and* intangible personal property. Products like [digitally stored mailing lists] purchased by [a direct-mailer] incorporate the designer's intellectual property or information as well as the physical media of transfer.

Globe Life, 913 P.2d at 1328 (footnote omitted; italics in original). The undersigned also shares the Gilreath court's concern——which was voiced even earlier in Spencer Gifts——about the "danger in applying tax responsibilities based on concepts developed at different times for different purposes, without a hint of the technological future." Gilreath, 751 So. 2d at 708. As the New Jersey Tax Court wrote back in 1981:

> Computer services, particularly software and information services, are different from other property rights. It is not sensible to apply concepts such as tangible and intangible, applicable to a very different world, to the computer world. Even the distinction between property and services is not helpful here where definitions appropriate to the subject matter of the tax are needed. Significant tax burdens should not be predicated on largely irrelevant concepts developed in different times for different purposes.

Spencer Gifts, 440 A.2d at 120 (emphasis added).

50. It is a black-letter common law principle that a statute is ambiguous when reasonable people can find different,

but reasonable, meanings in the same language. E.g. Forsyth v. Longboat Key Beach Erosion Control District, 604 So. 2d 452, 455 (Fla. 1992); Sobelman v. Sobelman, 541 So. 2d 1153, 1154 (Fla. 1989).

51. In this case, the smart tapes in question comprise both tangible and intangible elements, either of which, depending on one's perspective, could reasonably be viewed as the definitive characteristic. Consequently, when asked whether smart tapes are tangible or intangible property, some reasonable people (including appellate judges) will focus on the tangible elements and answer accordingly, while other reasonable people (including appellate judges) will focus on the intangible elements and answer correspondingly. As with the question whether the glass is half empty or half full, neither answer is unreasonable or incorrect.

52. The undersigned concludes, therefore, that on the question whether smart tapes fall within the statutory definition of "tangible personal property," Section 212.02(19), Florida Statutes, is ambiguous as a matter of law.

53. The conclusion that Section 212.02(19) is ambiguous as to whether the transactions at hand are within the reach of the sales and use tax is outcome determinative. The reason for this follows from the first principle that "taxes may be collected only within clear and definite boundaries recited by statute."

Maas Bros., Inc. v. Dickinson, 195 So. 2d 193, 198 (Fla. 1967); Florida S & L Services, Inc. v. Department of Revenue, 443 So. 2d 120, 122 (Fla. 1st DCA 1983)("Taxes cannot be imposed except in clear and unequivocal language. Taxation by implication is not permitted."). On this premise rests the robust rule that "tax laws are to be construed strongly in favor of the taxpayer and against the government, and that all ambiguities and doubts are to be resolved in favor of the taxpayer." Maas Bros., 195 So. 2d at 198; Lloyd Enterprises, Inc. v. Department of Revenue, 651 So. 2d 735, 739 (Fla. 5th DCA 1995); Florida Hi-Lift v. Department of Revenue, 571 So. 2d 1364, 1368 (Fla. 1st DCA 1990).[28]

54. Because Section 212.02(19), Florida Statutes, is ambiguous as to whether smart tapes are within the definition of "tangible personal property" subject to the sales and use tax, it must be concluded that these tapes are intangible personal property falling outside the scope of the relevant definition, for such a construction, which is neither fanciful nor strained but demonstrably reasonable, favors the taxpayer.[29]

55. Accordingly, it is concluded that the transactions at issue are not subject to the Florida sales and use tax.

Is the "Sale for Resale" Exemption Applicable?

56. The foregoing conclusion that smart tapes must be deemed intangible personal property beyond the scope of the

Florida sales and use tax due to statutory ambiguity renders moot the question whether the "sale for resale" exemption applies.

RECOMMENDATION

Based on the foregoing Findings of Fact and Conclusions of Law, it is RECOMMENDED that the Department enter a final order withdrawing the tax assessment against Dunhill.

DONE AND ENTERED this 27th day of May, 2003, in Tallahassee, Leon County, Florida.

JOHN G. VAN LANINGHAM
Administrative Law Judge
Division of Administrative Hearings
The DeSoto Building
1230 Apalachee Parkway
Tallahassee, Florida 32399-3060
(850) 488-9675 SUNCOM 278-9675
Fax Filing (850) 921-6847
www.doah.state.fl.us

Filed with the Clerk of the
Division of Administrative Hearings
this 27th day of May, 2003.

ENDNOTES

[1]/ The typical leasehold interest is thus extremely limited. The list owners protect their property by "seeding" each mailing list with a few names of employees who are responsible for reporting unauthorized uses, of which they would learn upon receipt of a second (or third, etc., as the case may be) solicitation from the marketer.

[2]/ Dunhill acts much like a broker in these transactions, except that its customers apparently deal only with Dunhill and do not enter into contractual relationships with the list owners.

[3]/ Advances in technology have rendered magnetic tapes largely obsolete for this purpose. These days the data are generally delivered via e-mail or similar computer-to-computer transmission, obviating the need for a removable storage medium.

[4]/ Dunhill denied, and continues to deny, that it owes any sales and use tax in consequence of the subject transactions; it has never contested the Department's sampling methodology or the amounts assessed. In other words, Dunhill does not dispute that assessed amounts would be correct if it were liable for the sales and use taxes that the Department contends are due and payable.

[5]/ Section 212.12(5)(b), Florida Statutes, provides as follows:

> In the event any dealer or other person charged herein fails or refuses to make his or her records available for inspection so that no audit or examination has been made of the books and records of such dealer or person, fails or refuses to register as a dealer, fails to make a report and pay the tax as provided by this chapter, makes a grossly incorrect report or makes a report that is false or fraudulent, then, in such event, it shall be the duty of the department to make an assessment from an estimate based upon the best information then available to it for the taxable period of retail sales of such dealer, the gross proceeds from rentals, the total admissions received, amounts received from leases of tangible personal property by such dealer, or of the cost price of all articles of tangible personal property imported by the dealer for use or consumption or distribution or storage to be used or consumed in this state, or of the sales or cost price of all services the sale or use of which is taxable under this chapter, together with interest, plus penalty, if such have accrued, as the case may be. Then

> the department shall proceed to collect such taxes, interest, and penalty on the basis of such assessment which shall be considered prima facie correct, and the burden to show the contrary shall rest upon the dealer, seller, owner, or lessor, as the case may be.

[6]/ In Department of Revenue v. Nu-Life Health and Fitness Center, 623 So. 2d 747, 751-52 (Fla. 1st DCA 1993), after making its dispositive rulings that a) Section 72.011(3), Florida Statutes, is constitutional and b) the trial court lacked subject matter jurisdiction as a result of the taxpayer's failure to comply with that statute, the First DCA noted in dicta that the sales tax assessment at issue was "prima facie correct" pursuant to Section 212.12(5)(b), Florida Statutes. On this particular point, however, Nu-Life is both unhelpful and unpersuasive because the court neither analyzed the language of Section 212.12(5)(b) nor explained why the statute should apply to the case at hand. (The opinion is silent as to whether the taxpayer had somehow prevented the Department from conducting an ordinary audit.)

[7]/ The Department states in its Proposed Recommended Order that the sampling of Dunhill's records was undertaken on the authority of Section 212.12(6)(b), Florida Statutes, but this assertion (which is quite possibly a typographical error) is plainly incorrect. In fact, the Audit Agreement that Dunhill and the Department executed on April 18, 2001, refers specifically and exclusively to Section 212.12(6)(c) as the enabling authority. While the undersigned does not mean to quibble, the two statutes are obviously distinct, and, to the point, one sends a quite different message than the other about the taxpayer. Section 212.12(6)(b) applies when the taxpayer has failed to maintain adequate records of its retail sales or purchases. Section 212.12(6)(c), in contrast, applies when the taxpayer does have adequate records, but those records are "voluminous in nature and substance." In fairness, it should be noted that Dunhill had adequate records in its possession and hence was not subject to a sampling audit pursuant to Section 212.12(6)(b).

[8]/ The legislature repealed Section 212.0505, Florida Statutes (1987), after the Florida Supreme Court, overturning Harris, had declared the measure unconstitutional. See Florida Dept. of Revenue v. Herre, 634 So. 2d 618, 621 (Fla. 1994).

[9]/ Implicit in the court's rationale was the unstated (and therefore undefended) premise that the presumption of correctness invoked in those analogous ad valorem tax contests was itself constitutional.

[10]/ The former statute provided, in pertinent part, that any "assessment made pursuant to this section shall be deemed prima facie correct in any judicial or administrative proceeding in this state." Section 212.0505(5), Florida Statutes (1987).

[11]/ Not to belabor the point, but the presumption of correctness, when applicable in a taxpayer contest involving a sales and use tax assessment, should attach to the amount of the delinquency as calculated by the Department, rather than, for example, to the Department's legal theory as to why the tax is owed. In this particular case, Dunhill denies liability for the alleged deficiency but does not otherwise contest the alleged amount thereof or the sampling method that the Department used to calculate it. That is, Dunhill maintains that the transactions at issue are not taxable and thus that the assessment is, not inflated, but invalid. Under these circumstances, it is at least debatable whether a presumption of correctness would be appropriate even if Straughn and Harris were apposite.

[12]/ The terms "retail sale" and "sale at retail" mean, at bottom, any "sale to a consumer or to any person for any purpose other than for resale in the form of tangible personal property or services taxable under [Chapter 212, Florida Statutes], and include[] all such transactions that may be made in lieu of retail sales or sales at retail." Section 212.02(14)(a), Florida Statutes.

[13]/ The list owners did not need to collect sales tax on these transactions because Dunhill provided them with resale certificates. See Section 212.07(1)(b), Florida Statutes; Rule 12A-1.039(5), Florida Administrative Code.

[14]/ The Department, recall, is not seeking to collect any taxes on the sublease transactions between Dunhill and its customers.

[15]/ The evidence does not establish what Dunhill actually did with the magnetic tapes. It is clear, however, that Dunhill had no use for the data contained on the tapes beyond leasing the

mailing lists (typically for a one-time use) to its customers who did.

[16]/ Digital data are, in fact, capable of being measured. The basic unit of measurement for digital data is the "byte." A byte is a unit of data that comprises eight binary digits. The storage capacities of computer hard drives and removable media such as tapes, diskettes, Zip disks, CDs, and DVDs are usually expressed in byte multiples, namely, the kilobyte (1,024 bytes), megabyte (1,048,576 bytes), and gigabyte (1,073,741,824 bytes). (This Recommended Order, when stored as digital data, is composed of approximately 94 kilobytes of data and fits comfortably on a standard floppy diskette, which holds about 1.4 megabytes.) Thus, it could be argued that digital data, being measurable, fall within the plain language of the "tangible personal property" definition. On the other hand, it could be counter-argued that digital data, not having intrinsic value but deriving their worth from that which they represent, constitute "intangible personal property" as that term is defined in Section 199.023(1), Florida Statutes, for purposes of the Florida intangibles tax, a proposition which, if accepted, would place digital data outside the Section 212.02(19) definition of "tangible personal property." At any rate, to decide the instant case based on an aggressive, pro-tax application of the statute (i.e. digital data are measurable and hence tangible) which contradicts the Department's description of the property involved would be manifestly unfair. The issue is noted only to underscore the significance of the Department's concession that digital data per se are intangible property.

[17]/ In this respect, "store-bought" music CDs and CDs containing software are more like non-digital films, books, and records than the smart tapes at issue. However, music and software CDs differ from films, books, and records——and resemble smart tapes——on the subject of transferability: absent special copyright protections, the digital data on music and software CDs are freely transferable to other tangible media without loss of quality. Noting this similarity, the undersigned recognizes, as a matter of common knowledge, that purchases at retail of music and software CDs, like similar purchases of books and records, are subject to the Florida sales tax. (Retail purchases of "pre-packaged" software are specifically deemed sales of tangible personal property pursuant to Rule 12A-1.032(4), Florida Administrative Code.) The undersigned does not believe that this settles the matter at hand, however, because he thinks (and more important concludes that many

reasonable people would concur) that "store-bought" music and software CDs are finished products comprising permanently wedded tangible and intangible elements in a way that, say, the floppy diskette containing this Recommended Order is not. And to the undersigned, the smart tapes in question are more closely analogous to the aforementioned diskette than to "store-bought" music and software CDs.

That said, the undersigned acknowledges that articulating the distinction between smart tapes and music CDs is not easy—— and indeed that reasonable people can and do disagree as to whether a meaningful distinction exists. See, e.g., South Cent. Bell Telephone Co. v. Barthelemy, 643 So. 2d 1240, 1244-45 (La. 1994). For this reason, the policy question whether to levy the sales tax against transactions involving reusable, removable media on which vendors of information temporarily (or even permanently) store such information as digital data, not to create a finished product (one where, e.g., the whole is more valuable than the sum of its parts) but simply to facilitate the transfer of such data from one computer to another, should probably be answered explicitly by the legislature or the Department through rulemaking.

[18]/ The undersigned routinely moves data files between computers on diskettes and Zip disks and officially recognizes that this is a quotidian practice in the early years of the twenty-first century. This Recommended Order, in fact, has resided in several different tangible media during its composition. In the undersigned's view, the digital data that represent this Recommended Order are distinguishable and separable from the tangible media that have from time to time contained them.

[19]/ Some subscribers used their own terminals, but the court found this fact to be immaterial.

[20]/ The Department also argued, in the alternative, that Quotron's provision of terminals to most of its subscribers subjected all of the consideration paid for Quotron's information delivery services to sales tax as "rent." This fallback, which has no analog here, was unavailing. Id. at 778.

[21]/ In Henley, intriguingly, the trial court pointed out that the taxpayer, which was in the same business as Quotron, "reformat[ed]" the data it received from the owners. Yet the Department apparently did not contend then, as it does here,

that the taxpayer's reformatting of the data amounted to a taxable "use" of such data.

[22]/ The Gilreath court wrote that "[t]he vast majority of cases cited by the parties and located by the court have concluded that software is not tangible personal property." Id. at 708. This statement notwithstanding, the courts seem to have split closer to the middle, a substantial minority, at least, having ruled that software is tangible property. See, e.g., South Cent. Bell Telephone Co. v. Barthelemy, 643 So. 2d 1240, 1244-45 (La. 1994) (collecting cases on both sides of the issue).

[23]/ See Rule 12A-1.032, Florida Administrative Code.

[24]/ Indeed, the undersigned has no doubt that whatever its intent with regard to the ad valorem tax, the legislature expects that sales tax will be collected on the full retail purchase price of "pre-packaged" computer software (rather than the "value of the unmounted or uninstalled medium," if different) as provided in Rule 12A-1.032(4), Florida Administrative Code.

[25]/ Being aware that the parties dispute whether Dunhill's dealings with its suppliers constitute retail transactions, the undersigned uses the terms "retail-level" and "wholesale-level" here in a non-technical sense, merely to distinguish linguistically, rather than legally, between the two sides of the transactions underlying the present controversy.

[26]/ In reaching this result, the court rejected Spencer Gifts and Fingerhut in favor of cases holding that computer software is tangible personal property, which it found more persuasive. Id. at 180 n.5 Recall, in contrast, that in Gilreath the Fifth DCA was persuaded not by the cases concluding that computer software is tangible personal property but by those reaching the opposite conclusion. The Gilreath court also cited Spencer Gifts with approval. See supra at paragraphs 41-42.

[27]/ The Maryland Court of Special Appeals rejected Spencer Gifts and Fingerhut as inconsistent with the decision in Comptroller of the Treasury v. Equitable Trust Co., 464 A.2d 248, 249 (Md. 1983), where the court had held that a computer program stored on a magnetic tape was tangible personal property subject to sales tax.

[28]/ As was true of the taxpayer in Hi-Lift, Dunhill is not seeking an exemption from a lawful tax (not, at least, when it argues that smart tapes are intangible personal property), but rather is challenging the validity of the tax. Therefore, the principle that exemptions are strictly construed against the taxpayer, see, e.g., State Dept. of Revenue v. Anderson, 403 So. 2d 397, 399 (Fla. 1981), is inapplicable in determining the reach of Section 212.02(19), Florida Statutes.

[29]/ It should be emphasized, to be clear, that the Department's contrary interpretation is not unreasonable. While the undersigned is persuaded that smart tapes are a kind of intangible personal property when, as in the transactions at hand, the real object being exchanged consists of digital data rather than the removable, reusable medium that happens to hold the data, he readily acknowledges that the opposite view is within the range of reasonable interpretations of the statutory term "tangible personal property." Since it is well known that an agency's interpretation of an ambiguous statute within the agency's regulatory jurisdiction is usually given great deference, e.g. State Dept. of Agriculture v. Sun Gardens Citrus, LLP, 780 So. 2d 922, 925-26 (Fla. 2d DCA 2001), the question arises: Why not here? The answer is: Because the specific rule that ambiguous tax statutes are construed liberally in favor of the taxpayer trumps the general principle of deference. State Dept. of Business and Professional Regulation, Div. of Pari-Mutuel Wagering v. WJA Realty Limited Partnership, 679 So. 2d 302, 306 (Fla. 3d DCA 1996)("If at the very least these statutes were deemed to be ambiguous, the great deference given to the [agency's] interpretation would have to yield way to the established principle that taxing statutes are to be construed liberally in favor of the taxpayer and against the tax collector."). Thus, to enforce its interpretation of an ambiguous tax statute, the Department should promulgate a clear and unambiguous rule interpreting the statute, which would eliminate the statutory ambiguity and put potentially affected taxpayers on notice of the tax statute's reach.

COPIES FURNISHED:

Joseph C. Moffa, Esquire
Law Offices of Moffa & Gainor, P.A.
One Financial Plaza, Suite 2202
100 Southeast Third Avenue
Fort Lauderdale, Florida 33394

Carrol Y. Cherry, Esquire
Martha F. Barrera, Esquire
Assistant Attorneys General
Office of the Attorney General
Tax Section, PL-01, The Capitol
Tallahassee, Florida 32399-1050

James Zingale, Executive Director
Department of Revenue
104 Carlton Building
Tallahassee, Florida 32399-0100

Bruce Hoffmann, General Counsel
Department of Revenue
204 Carlton Building
Tallahassee, Florida 32399-0100

NOTICE OF RIGHT TO SUBMIT EXCEPTIONS

All parties have the right to submit written exceptions within 15 days from the date of this Recommended Order. Any exceptions to this Recommended Order should be filed with the agency that will issue the Final Order in this case.