COMMENT LETTER

May 6, 2019

ICI Comment Letter: FL Sales Tax on Services (pdf)

Electronic Delivery May 1, 2019 The Honorable Amy Mercado 406 House Office Building 402 South Monroe Street Tallahassee, FL 32399-1300 RE: HB 1377 –Sales Tax on Services Dear Representative Mercado: The Investment Company Institute1 -- on behalf of its Florida-based members and all Florida-resident shareholders in all funds, including mutual funds, registered under the Investment Company Act of 1940 – strongly opposes HB 1377. Any extension of sales tax to services purchased by investment funds (hereafter “funds”) and their advisers operating in Florida would: impose additional costs on all investors (including Floridians) seeking to save for their retirement and other long-term needs through mutual funds; place Florida-based mutual fund firms operating in this nationwide industry at a competitive disadvantage; and be extraordinarily difficult (if not impossible) to administer efficiently and fairly. 1 The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI’s members manage total assets of US$22.6 trillion in the United States, serving more than 100 million US shareholders, and US$6.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC. ICI Letter Opposing HB 1377 May 1, 2019 Page 2 of 4 If enacted, the sales tax must exempt services purchased by funds and their advisers. Background A fund pools money from individuals and invests in a diversified portfolio of stocks, bonds or other securities in the United States and around the world. Each investor in a fund is a shareholder of the fund. Each share represents a proportionate ownership in all the fund’s underlying securities. The securities are selected by a professional investment adviser to meet a specified financial goal, such as growth or income. Funds typically are distributed nationally. Investors often purchase their shares through intermediaries (e.g., brokers) rather than directly from the fund. Shares purchased through an intermediary often are registered with the fund in the intermediary’s name in a so-called “street name” account. Funds often will have little or no information about the intermediary’s customers holding through these accounts. This information typically can be procured from third parties; this information, however, is neither immediately available nor free. Funds with a common investment adviser (sometimes called a “manager”) are often referred to as a mutual fund “family” or “complex.” Funds with a common investment adviser (sometimes called a “manager”) are often referred to as a mutual fund “family” or “complex.” Competition between fund complexes and their advisers is intense. This competition has led to a steep drop in fees that managers charge for investment advisory services.2 As a result, managers are increasingly sensitive to state and local taxes that may place them at a competitive disadvantage. Sales Tax Should Not Be Imposed on Fund Shareholders and the Act of Saving Mutual funds, the investment vehicle of choice for moderate-income investors, have democratized our capital markets in ways that could not have been imagined just a generation or two ago. The typical fund investor is a middle-class American with a median household income of $100,000 and modest holdings.3 More than half of all American households have become investors as a result of mutual funds and now depend on their mutual fund investments to buy a home, finance a child's education, support aging parents or extended family, and prepare for retirement. 2 Asset-weighted average expense ratios for equity, bond, and hybrid mutual funds fell in 2016 to their lowest levels in at least 20 years. For example, in 2016, the expense ratios that fund shareholders paid for holding equity mutual funds were, on average, 39 percent lower than in 1996. https://www.ici.org/viewpoints/view_17_trends_01. 3 The most recent ICI data show median mutual fund assets of $125,000 per household in four accounts. https://www.ici.org/pdf/2017_factbook.pdf, Figure 6.2. ICI Letter Opposing HB 1377 May 1, 2019 Page 3 of 4 Imposing a sales tax on the investment advisory services provided to funds and their shareholders will increase the cost of saving for retirement and other long-term needs. Given the increased responsibility that individuals have for ensuring their own retirement security, the legislature should be creating incentives to encourage rather than discourage saving. Florida-Based Fund Managers Should Not Be Placed at a Competitive Disadvantage Fund advisers can be (and in fact are) located virtually anywhere. Many important ones have operations in or purchase services in Florida. The two most important requirements for managing a fund are well-educated employees and ready access to modern technology. Physical plant requirements are minimal/non-existent. The potential market for a fund manager's products is nationwide in scope. Because investors can communicate with a mutual fund manager through the mail, over the phone, or electronically, a mutual fund's shareholders can be (and generally are) located in all 50 states. A "local" mutual fund manager has no inherent advantage over "non-local" managers in attracting new investor dollars. Extending the sales tax to services consumed by Florida-based fund managers could place them at a distinct competitive disadvantage vis-à-vis fund managers located elsewhere. These flaws in the sales tax cannot be corrected by technical modifications to the legislation; imposing a sales tax on the mutual fund industry would always have this anti-competitive effect. As Florida-based fund managers in this highly mobile business provide exactly the kind of good jobs that states covet, the legislature should be creating incentives to encourage fund managers to locate in Florida. Extending the sales tax to the purchase of services by fund managers operating in Florida could have the opposite effect. Subjecting the Fund Industry to a Sales Tax Would Be Most Problematic A sales tax on services theoretically could be assessed either against the fund itself or against the fund's individual shareholders. Presumably, the tax would be assessed based upon the location of (1) the fund manager, if the fund were treated as the consumer, or (2) the fund shareholder, if the shareholder were treated on a look-through basis as the consumer. If a service were treated as provided based upon the location of the fund manager, the tax would be chargeable only to funds managed by Florida asset managers and would be based upon the full cost of the service. Such a result, however, would increase the expense only of funds managed in Florida and would put these funds (and their managers) at a distinct competitive disadvantage both in the US market and globally. If a service instead were treated as provided based upon the location of the fund's investors, the tax at least theoretically could be charged to all funds regardless of whether they were managed in Florida or ICI Letter Opposing HB 1377 May 1, 2019 Page 4 of 4 elsewhere. Three problems would arise from this approach. First, significant difficulties likely would arise in collecting tax from fund managers located outside of Florida. Second, fund managers often do not know, as explained above, the residence states of their funds' shareholders. Determining residence would result in additional costs—all of which would be borne by the funds' individual shareholders. Third, even if the tax could be charged to, and collected from, fund managers nationwide based upon the residence states of their funds' shareholders, the tax would not be borne only by the funds' Florida resident shareholders. Funds, unlike partnerships, cannot "specially allocate" expenses based upon residence—unless all such residents are members of a single share class; funds, however, do not create separate classes for shareholders based upon residence. Although the tax might be "charged" for services "provided" in Florida, the tax burden would fall equally on all investors – irrespective of the state or country in which they reside. Finally, even if shareholder-specific recordkeeping systems could be developed, a sales tax most likely could be collected only from those Florida investors who purchase shares of funds managed by Florida- based managers. Thus, such a tax also would have the effect of disadvantaging Florida-based fund managers vis-à-vis fund managers located elsewhere. Recommendation The Institute strongly recommends, on behalf of its Florida-based members and all Florida-resident shareholders, that the sales tax not be extended to any services consumed by funds and their advisers. * * * * * * * The Institute appreciates your consideration of our concerns. Please do not hesitate to contact the undersigned at (202) 326-5826 if you have any questions regarding this letter or would like any additional information regarding the organization, operation, or taxation of investment companies and/or their shareholders. Sincerely, Katie Sunderland Assistant General Counsel – Tax Law

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