TAXED BY DESIGN? FLORIDA'S TAX ON INTERIOR DESIGN CONTRACTS AND WHAT TO DO ABOUT IT

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Florida sales and use tax can be full of surprises. Generally, sales and use tax applies to the sale or purchase of tangible goods, transient rentals, commercial leases, admissions, and a narrow list of specifically taxed services.[1] While most service-focused businesses believe sales and use tax does not apply to them, many are surprised to learn that their business model can create sales and use tax liability. Another surprise is that the businesses may be required to pay such taxes from their own funds, regardless of whether the taxes were ever collected from their customers.[2]

Interior designers are regularly caught by these surprises, as the Department of Revenue has an administrative rule directly addressing their services. The department's rule can result in an interior design professional having to collect and remit sales tax on the entire design fee charged to the customer if the transaction involves any sale of tangible personal property (TPP).[3]

This sales tax surprise is significant for interior design professionals, as the largest portion of a design fee often has nothing to do with sales of TPP. A typical interior design contract will have a flat fee or hourly fee for design services, and may include a markup on any goods or furniture the design professional purchases on behalf of the client. The department's rule provides that in a mixed contract, a contract that includes the sale of both goods and services, the full amount charged for design services becomes taxable when TPP is also sold to the customer.

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To take this example to the extreme, the administrative rule can cause the following result: 1) Design services fee: $20,000; 2) Tangible personal property sold (one throw pillow): $20; 3) Sales tax base: $20,020; 4) Sales tax due: $1,201.20 at the state rate of 6% (plus any applicable county discretionary surtax).

This article examines the provisions of this rule, the dangers of the rule for interior design professionals, and potential options for dealing with the impact of Florida sales tax. This article also discusses whether the rule goes beyond the statutes that it implements, and how the rule itself may be vulnerable to challenge.

The Interior Design Tax Rule

The department's rule on taxation of interior design contracts is found at Fla. Admin. Code Rule 12A-1.001(2)(a). Though the general focus of Rule 12A-1.001 is on specific exemptions from sales and use tax, subsection (2)(a) imposes sales and use tax on interior design contracts.

The rule states that it applies to fees charged by an interior decorator.[4] The rule does not define the term, "interior decorator." A distinction is made elsewhere in the Florida statutes over "interior decorator services" and "interior design."[5] Though the rule does not use the term "interior design," the department applies the rule to professionals who perform both types of services. Therefore, the authors refer to "interior design contracts" as those to which the department applies Rule 12A-1.001(2)(a).[6]

• *What Does the Rule Say?* — The department's rule on interior design services states that any transaction where an interior designer sells TPP to a customer results in the entire transaction becoming taxable. The rule states in pertinent part as follows:

> *(a)1. An interior decorator's so-called fee is taxable as a part of the selling price under Section 212.02(16), F.S., or as a part of the cost price under Section 212.02(4), F.S., and cannot be exempted as a professional or personal service charge when the transaction involves the sale of tangible personal property. This is true when the so-called fee is paid in the form of a trade discount, as is the case when a supplier grants the decorator a trade discount and the decorator in turn bills the client for the full list price. The decorator fee is also taxable when it appears as an amount added to the decorator's cost when billed to the client for tangible personal property on a cost plus basis.*[7]

The key takeaway from this portion of the rule is that if an interior designer provides *any* TPP to a client, the designer's entire fee can be made subject to Florida sales tax. The illustration of this set forth above is worth repeating: An interior designer that charges $20,000 in design fees along with a $20 throw pillow would have to charge sales tax on $20,020. This illustration is not a hypothetical; the department takes this position with taxpayers.

• *What if No TPP Is Sold?* — However, if an interior design professional does not sell any TPP to a customer, then the design fee will not be subject to tax. The rule states:

> *2. If the decorator's fee is solely for designing the interior and exterior decorative scheme or for advising his clients and recommending colors, paints, wallpaper, fabrics, brands, sources of supply, etc., and there is no sale of tangible personal property involved, then such fee would be exempt as a professional or personal service transaction.*[8]

Thus, an interior designer that seeks to fit within this portion of the rule would be advised not to provide any tangible personal property at all — not even as a pass-through cost with no markup.

• *Can the Design Fee be Separated From Sales of TPP?* — Nevertheless, the rule leaves the door open for a design fee that is truly separate from the sale of TPP. The rule reads:

> *3. In some instances, the decorator may receive a fixed sum, which is not in any way contingent upon the sale of tangible personal property, as a so-called decorator fee. Then, in other completely unrelated transactions, he may sell tangible personal property to the same client. In such cases the decorator's fee cannot be considered as a part of the selling price of the property sold because there is no connection between the transactions.*[9]

The difficulty in applying this subsection of the rule is the reference to "completely unrelated transactions." Determining whether or not a design fee is completely unrelated to a separate sale of TPP requires a facts and circumstances analysis of each particular contract. Practically, this means that an auditor could disagree with an interior design professional on whether this subsection applies to a particular set of facts. An interior design professional would be advised to not rely on this subsection of the rule alone to shield a transaction from tax.[10]

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• *What Happens if Tax Is Not Collected?* — If an interior design professional does not collect tax in accordance with the rule, the department can assess tax, penalty, and interest for the unpaid amounts. The normal audit period is three years, so the numbers add up quickly.[11]

The tax liability portion of an assessment will include both the state-level 6% tax, as well as local option discretionary surtax rates that vary by county. The penalty and interest portions of the assessment will be calculated based on the amount of tax assessed. The interest rate through December 31, 2024, is 12% per year.[12]

The Rule in Context of General Florida Sales Tax Law

To understand the rule in context, it helps to discuss Florida's general sales and use tax framework. In broad terms, Florida imposes sales and use tax on transactions involving the sale, purchase, lease, or use of TPP.[13] The sales and use tax applicable to the sale of TPP consists of two separate tax levies: a 6% state-imposed tax, and discretionary surtaxes that can be levied by Florida counties.[14] In 2023, these county-imposed discretionary surtax rates ranged from 0% to 1.5% across the state.[15] However, these locally-imposed discretionary surtaxes vary by county and could go as high as 5.5% in some counties if the voters were to approve all eligible surtaxes allowed by current law.[16]

Service transactions, by contrast, are generally not subject to Florida sales and use tax. Florida experimented with a broad-based tax on numerous services in 1987, but that experiment quickly ended after intense opposition from national advertisers and other groups.[17] The general services tax lasted only six months before it was repealed.[18] Despite the repeal, a small number of services remain specifically subject to sales and use tax today. These include detective services, burglar protection services, and other protection services, nonresidential building pest control services, and nonresidential cleaning services.[19]

The interior design rule is unique in that it operates to transform otherwise non-taxable services (interior decorating or design) into fully taxable services if the governing contract involves any sale of tangible personal property. Within this framework, the first question a lawyer representing an interior design professional should ask is whether the rule is valid under Florida law. That is, whether the rule simply implements existing statutes, or whether it goes beyond the statutory authority for imposing tax on Florida businesses. The second question is what structuring options might be available for Florida businesses to work around the rule as it is written.

Is the Rule Within the Scope of the Statutes It Implements?

Like other administrative agencies, the Department of Revenue does not have inherent authority to make rules. Instead, the department is granted rulemaking authority by statute "to adopt rules pursuant to ss. 120.536(1) and 120.54 to implement provisions of the revenue laws."[20]

Under this grant of authority, the department is limited in the scope of the rules that it can adopt. Specifically, F.S. §120.536(1) contains the following requirements for any rule adopted by the department: 1) "[A] specific law to be implemented" is required for every rule; 2) rules may only "implement or interpret the specific powers and duties granted by the enabling statute"; 3) rules cannot simply be "reasonably related to the purpose of the enabling legislation."[21]

If an administrative agency like the department goes beyond these requirements in adopting a rule, such action may constitute an invalid exercise of delegated legislative authority as that term is defined in section F.S. §120.52(8). Under §120.52(8), a rule is an invalid exercise of delegated legislative authority if any of the following applies:

> *(a) The agency has materially failed to follow the applicable rulemaking procedures or requirements set forth in [Ch. 120];*

> *(b) The agency has exceeded its grant of rulemaking authority, citation to which is required by s. 120.54(3)(a) 1.;*

> *(c) The rule enlarges, modifies, or contravenes the specific provisions of law implemented, citation to which is required by s. 120.54(3)(a)1.;*

> *(d) The rule is vague, fails to establish adequate standards for agency decisions, or vests unbridled discretion in the agency;*

> *(e) The rule is arbitrary or capricious. A rule is arbitrary if it is not supported by logic or the necessary facts; a rule is capricious if it is adopted without thought or reason or is irrational; or*

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> *(f) The rule imposes regulatory costs on the regulated person, county, or city which could be reduced by the adoption of less costly alternatives that substantially accomplish the statutory objectives.*[22]

A challenge to the department's rule on taxation of interior design contracts would therefore focus on whether the rule is beyond the scope of the enabling statute, arbitrary, or capricious. With this background, we return to the question of how the rule at issue could turn a non-taxable service into a taxable one. Recall that the first sentence of the rule states that "[a]n interior decorator's so-called fee is taxable *as a part of the selling price under Section 212.02(16), F.S., or as a part of the cost price under Section 212.02(4), F.S.*, and cannot be exempted as a professional or personal service charge when the transaction involves the sale of tangible personal property."[23] The relevant analysis is, therefore, what the statutes cited in the rule (§§212.02(16) and 212.02(4)) might allow the department to implement through its rule.[24]

The first statutory section cited in the rule is the definition of "sales price" in F.S. §212.02(16), which states:

> *"Sales price" means the total amount paid for tangible personal property, including any services that are a part of the sale, valued in money, whether paid in money or otherwise, and includes any amount for which credit is given to the purchaser by the seller, without any deduction therefrom on account of the cost of the property sold, the cost of materials used, labor or service cost, interest charged, losses, or any other expense whatsoever. "Sales price" also includes the consideration for a transaction which requires both labor and material to alter, remodel, maintain, adjust, or repair tangible personal property.*[25]

The statutory provision above begins with the presumption that the sale at issue is the sale of TPP, and any services that are part of the sale of such TPP are included in the sale for tax purposes.[26] The statute does not state that non-taxable services become taxable by virtue of including some nominal amount of TPP in the transaction.

Despite the plain language of §212.02(16) that addresses sales of TPP that involve services that are a part of such sales, Rule 12A-1.001(2)(a)1 flatly states that an interior decorator's fee — referred to in the rule as a "so-called fee" — is "part of the selling price" under §212.02(16). Stated differently, the rule creates a presumption that every interior design fee that is accompanied by even an incidental amount of TPP is actually the sale of TPP rather than a non-taxable service.[27]

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The second statute cited in Rule 12A-1.001(2)(a)1, F.S. §212.02(4), provides the definition of "cost price" for tax purposes. This statute states that "'[c]ost 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."[28]

Section 212.02(4) says nothing whatsoever about services. Despite this, Rule 12A-1.001(2)(a)1 requires design professionals to include the entire amount of the fee for services into the cost price for determining sales or use tax liability.[29] Whatever relevance §212.02(4) may have for calculation of sales or use tax liability for particular items of TPP, it provides no support for including the price charged for a non-taxable service in the amount subject to sales and use tax for the sale of TPP.

While the focus of this article is on interior design contracts, the dynamic created by Rule 12A-1.001(2)(a) is similar to other industries that commonly include mixed sales of non-taxable services and taxable sales of TPP. The prime example is the repair of automobiles, which involves a non-taxable service (repair labor) and the sale of TPP (any materials used during the repair). The department has long taken the position that an automobile repair shop must collect tax on all labor charges if even a single drop of oil is added to the customer's vehicle.

It is telling that in the automobile repair industry, the department's rules specifically allow repair shops to affirmatively establish that no TPP was furnished to the customer in order for service-only charges to be exempt from sales tax.[30] No similar provision is included in Rule 12A-1.001(2)(a).[31]

To further confuse the issue, Florida's sales and use tax law expressly exempts certain professional services from tax when sales of small amounts of TPP are included in the service charge, including "professional, insurance, or personal service transactions that involve sales as inconsequential elements for which no separate charges are made."[32] While the department's administrative rule recognizes that interior designers provide processional or personal services to their customers,[33] the department's rule completely ignores the statutory language regarding inconsequential elements of TPP. Instead, the department's rule concludes that the charges cannot be exempt when the transaction includes any sale of TPP.

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What Options Do Taxpayers Have?

The issues set forth above indicate that Rule 12A-1.001(2)(a) may go beyond the scope of the statutes it implements and may be arbitrary or capricious in light of how the interior design industry operates. Thus, taxpayers faced with application of this rule to their businesses must decide what they should do as a practical matter in their industry.

• *Option 1: Compliance and Structuring* — An interior design professional could simply decide to comply with the rule by charging tax on all fees charged to customers. This necessarily raises the cost to customers, but it is the fastest way for a design professional to insulate itself from audit liability.[34]

Another option is for an interior design professional to split up its services between at least two separate legal entities. "Entity 1" would provide only design services, while "Entity 2" would only provide tangible personal property to customers. In this scenario, Entity 1 would not collect tax as it only provides design services, while Entity 2 would collect and remit sales and use tax on sales of TPP.

The justification for this split is Rule 12A-1.001(2)(a)3, as discussed above, that allows TPP sales to be separate from the design fee as a result of "completely unrelated transactions." Splitting the transaction between two entities is one way to make the transactions unrelated.[35]

• *Option 2: Challenging the Rule* — For the reasons set forth above, Rule 12A-1.001(2)(a) may well be an invalid exercise of delegated legislative authority pursuant to §120.52(8). A taxpayer that is impacted by the rule would have standing to bring a challenge to the rule under F.S. §120.56.[36] Such a rule challenge could come within the context of an administrative challenge to an assessment by the department, or as a stand-alone action.[37]

Conclusion

Interior design professionals should carefully review Rule 12A-1.001(2)(a) as it applies to their operations. Careful planning before an audit can help in avoiding or minimizing potential liability. If a design professional is faced with an assessment, a challenge to the rule may be warranted as part of an overall plan to contest the assessment.

[1] Specifically taxed services include detective, burglar protection, nonresidential cleaning, and nonresidential pest control services. Fla. Stat. §212.05(1)(i). ▲

[2] *See* Fla. Stat. §212.06(1)(a) (sales tax "shall be collectible from all dealers as herein defined on the sale at retail, the use, the consumption, the distribution, and the storage for use or consumption in this state of tangible personal property or services taxable under this chapter").

[3] The rule in question is Fla. Admin. Code R. 12A-1.001(2)(a).

[4] Fla. Admin. Code R. 12A-1.001(2)(a)1.

[5] *See* Fla. Stat. §481.203.

[6] In an appropriate case, the distinction between the definitions of "interior decorator services" and "interior design" may prove useful to a taxpayer. This article does not focus on the issue other than to note the differing definitions of the terms in Fla. Stat. §481.203 (Comparing Fla. Stat. §481.203(9) with Fla. Stat. §481.203(10)).

[7] Fla. Admin. Code R. 12A-1.001(2)(a)1 (emphasis added).

[8] Fla. Admin. Code R. 12A-1.001(2)(a)2 (emphasis added).

[9] Fla. Admin. Code R. 12A-1.001(2)(a)3 (emphasis added).

[10] The final subsection of the rule addresses pass-through of labor costs for persons working for an interior design professional. Such costs will be treated for tax purposes based on the type of labor or service performed (Fla. Admin. Code R. 12A-1.001(2)(a)4). While this factor should be kept in mind by design professionals, this issue is not directly relevant to the overall taxation of interior design contracts.

[11] The three-year period corresponds with the statute of limitations on tax assessments under Fla. Stat. §95.091(3)(a)1.b.

[12] Florida Department of Revenue, *Tax Information Publication No. 24ADM-01* (May 15, 2024), *available at* **https://floridarevenue.com/taxes/tips/Documents/TIP_24ADM-01.pdf**.

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[13] Fla. Stat. §212.05 ("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 or facilitating remote sales; 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.").

[14] Fla. Stat. §212.05(1)(a), (1)(b) (6% state sales and use tax); Fla. Stat. §212.054 (discretionary surtax).

[15] *See* Florida Department of Revenue, *Discretionary Sales Surtax Information for Calendar Year 2023*, *available at* **https://floridarevenue.com/Forms_library/current/dr15dss.pdf**. The department generally updates this surtax publication each year to show the current rates. Discretionary surtax generally only applies to the first $5,000 of any taxable sale. Fla. Stat. §212.054(1)(b)1.

[16] *See* Florida Revenue Estimating Conference, *2023 Florida Tax Handbook* 229-236, *available at* https://edr.state.fl.us/Content/revenues/reports/tax-handbook/taxhandbook2023.pdf.

[17] *See* Vicki L. Weber, *Florida's Fleeting Sales Tax on Services*, 15 Fla. St. U. L. Rev. 613 (1987). This article contains an excellent overview of the structure of the short-lived general services tax, the political backlash against it, and the results of its repeal.

[18] *Id*. at 613, n.1. (service tax was imposed beginning on July 1, 1987, and was repealed effective January 1, 1988).

[19] Fla. Stat. §212.05(1)(i). This article does not address Florida's Communications Services Tax (CST), as the services at issue with CST do not involve persons directly performing services for others. CST is instead imposed on "the transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals, including video services, to a point, or between or among points, by or through any electronic, radio, satellite, cable, optical, microwave, or other medium or method now in existence or hereafter devised, regardless of the protocol used for such transmission or conveyance." Fla. Stat. §202.11(1) (definition of "communications services").

[20] Fla. Stat. §213.06(1). ▲

[21] *See* Fla. Stat. §120.536(1); Fla. Stat. §120.54, under which the department also has rulemaking authority under §213.06(1), sets forth general procedures for the rulemaking process. Discussion of the procedural aspects of rulemaking is outside the scope of this article.

[22] Fla. Stat. §120.52(8) (emphasis added).

[23] Fla. Admin. Code R. 12A-1.001(2)(a)1 (emphasis added).

[24] The statutes cited by Rule 12A-1.001 as the law implemented by its terms are Fla. Stat. §§212.05, 212.08(7)(f), (h), (q), (v), (x), (cc), 212.085, 213.255(2), (3), 213.37, and 215.26. None of these listed statutory sections address the interior design contract taxation issues addressed by subsection (2)(a) of the rule. Therefore, the authors take the position that the relevant statutes to analyze as to the scope of the law implemented by subsection (2)(a) are those cited within subsection (2)(a) itself, namely Fla. Stat. §§212.02(16) and 212.02(4).

[25] Fla. Stat. §212.02(16) (emphasis added).

[26] *Id*.

[27] The authors note that the insertion of the department's use of the term "so-called fee" in the rule appears to indicate the skepticism with which the department views interior design fees. This appears to be the case even when the design fee charged to a client dwarfs the amount charged for any sale of TPP.

[28] Fla. Stat. §212.02(4).

[29] *See id*.

[30] Fla. Admin. Code R. 12A-1.006(4).

[31] The authors have, however, found department personnel receptive to proof from interior design professionals that particular transactions did not involve sales of TPP.

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[32] Fla. Stat. §212.08(7)(v).

[33] Fla. Admin Code R. 12A-1.001(2)(a)2.

[34] The practical difficulty in taking this approach is that design professionals that charge tax on their design fee may lose business to competitors that do not. This issue is particularly acute in the interior design industry, as many businesses are simply unaware that Rule 12A-1.001(2)(a) exists.

[35] This type of corporate split has been approved by the department in other contexts. *See* Technical Assistance Advisement 05A-040 (Oct. 13, 2005) (taxpayer can create a related LLC to purchase TPP tax-free from taxpayer where related LLC purchases such TPP for export); Technical Assistance Advisement 09A-012 (Mar. 19, 2009) (taxpayer is not manufacturing TPP for its own use where taxpayer sells TPP to related LLC, and related LLC installs such TPP at customer locations).

[36] Fla. Stat. §120.56(1)(a) ("Any person substantially affected by a rule or a proposed rule may seek an administrative determination of the invalidity of the rule on the ground that the rule is an invalid exercise of delegated legislative authority.").

[37] *See* Fla. Stat. §72.011(1)(a) (taxpayer may contest legality of an assessment under the provisions of Ch. 120, including rule challenges under §120.56). A full discussion of the rule challenge process is outside the scope of this article. The authors note that such an action is often cost-prohibitive to interior design professionals in light of the normal dollar amount of assessments against them. This may be a key reason that the validity of Rule 12A-1.001(2)(a) has not been the subject of an administrative law decision as of the date of this article.

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This column is submitted on behalf of the Tax Section, Mark Scott, chair, and Charlotte A. Erdmann, Daniel W. Hudson, and Angie Miller, editors.

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