

The Florida Senate
BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Committee on Military and Veterans Affairs, Space, and Domestic Security

BILL: CS/SB 596

INTRODUCER: Commerce and Tourism Committee and Senator Evers

SUBJECT: Defense Contracting

DATE: March 18, 2014

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Siples</u>	<u>Hrdlicka</u>	<u>CM</u>	Fav/CS
2.	<u>Ryon</u>	<u>Ryon</u>	<u>MS</u>	Pre-meeting
3.	_____	_____	<u>AFT</u>	_____
4.	_____	_____	<u>AP</u>	_____

Please see Section IX. for Additional Information:

COMMITTEE SUBSTITUTE - Substantial Changes

I. Summary:

CS/SB 596 creates the Defense Works in Florida incentive program, which allows a national security-related prime contractor to reduce its taxable income by an amount of 4 percent for each subcontract it awards to a qualifying Florida-based subcontractor. To receive the incentive, the business must submit an application to the Department of Economic Opportunity (DEO) for certification that the subcontract award meets the requirements of the bill. Eligible businesses may claim the incentive for taxable years beginning on or after January 1, 2014.

The bill caps the amount of qualified subcontract awards that may be awarded to each contractor by the DEO each calendar year. The bill also limits the total amount of certifications the DEO may certify for the incentive program each calendar year.

The bill gives the DEO authority to develop forms and procedures to implement the incentive program and provides rule-making authority to the DEO and the Department of Revenue (DOR).

II. Present Situation:

Florida's Defense Industry

Florida is home to three of ten unified combatant commands and hosts two of only four Navy deep-water ports in the country with adjacent airfields, the military's only space launch facility on the east coast, the Marine Corps' only maritime prepositioning facility, and one of only three Navy Fleet Readiness Centers. The state also hosts several critical research, development, testing

and evaluation centers. In addition, the Joint Gulf Range Complex connects test and training ranges that extend from Key West to Northwest Florida and across the eastern Gulf of Mexico, and encompasses 180,000 square miles of Department of Defense-controlled airspace.¹

Defense spending in Florida was directly or indirectly responsible for \$73.4 billion, or 9.4 percent, of gross state product in 2011.² In 2011, Florida businesses generated \$13.6 billion in U.S. Department of Defense (DoD) contract awards, ranking the state 5th in the nation.³ Total defense spending also accounts for more than 758,000 jobs around the state.⁴

According to the federal government, 61,075 contracts have been awarded to prime contractors by DoD and National Aeronautics and Space Administration from federal fiscal year 2013 through the current federal fiscal year for work done in the State of Florida.

Combined, these contracts have a total value of over \$12 billion. There have been over 2,000 subcontracts awarded through those 61,075 contracts, valued at over \$2 billion.⁵

Federal Contracting Overview

The typical federal procurement process involves an agency identifying the goods and services it needs, determining the most appropriate method for purchasing those items, and carrying out an acquisition process. Under most procurement processes, an agency posts a solicitation on the Federal Business Opportunities website. Interested businesses prepare their offers in response to the solicitation, and agency personnel evaluate the offers. To be eligible to compete for government contracts a business must first obtain a Data Universal Numbering System (DUNS) number, and register with the System for Award Management (SAM). Many agencies provide assistance and services to potential and existing federal contractors.

Businesses may also serve as subcontractors for other businesses (known as “prime contractors”) that have been awarded federal contracts. Most federal agencies typically release information on their websites listing prime contractors that have been awarded federal contracts, which can be a valuable resource for potential subcontractors. Other agencies, including the General Services Administration, Department of Homeland Security, and Small Business Administration provide more specific information regarding subcontracting opportunities with prime contractors on their websites.⁶

¹ Enterprise Florida, Inc. (EFI), *Florida Defense Factbook*, January 2013, available at <http://www.floridadefense.org/documents/HAAS%20Study%202013/Factbook%202013%20FINAL.pdf> (last visited March 17, 2014).

² EFI, *Florida Defense Industry Economic Impact Analysis*, January 2013, available at <http://www.floridadefense.org/documents/HAAS%20Study%202013/Impact2013FinalSubmission3.26.13.pdf> (last visited March 17, 2014).

³ EFI, *Defense and Homeland Security*, available at http://www.enterpriseflorida.com/wp-content/uploads/MB_Homeland_Security1.pdf (last visited March 17, 2014).

⁴ EFI, *Florida Defense Factbook*. Direct employment includes 61,189 military personnel, 24,705 civilian personnel, and 12,449 National Guard personnel.

⁵ United States Office of Management and Budget, USASpending.gov (information may be obtained by using search criteria for Department of Defense, prime contracts, performed in Florida, and by fiscal year), available at <http://usaspending.gov/> (last visited March 17, 2014).

⁶ L. Elaine Halchin, Congressional Research Service, *Overview of the Federal Procurement Process and Resources*, September 11, 2012, available at <https://www.fas.org/sgp/crs/misc/RS22536.pdf> (last visited Feb. 20, 2014).

Corporate Income Tax in Florida

Florida began imposing an income tax on corporations in 1972.⁷ The initial tax rate was 5 percent, but that rate was increased to 5.5 percent in 1984.⁸

Currently, Florida's corporate income tax is comprised of two separate 5.5 percent taxes and a 3.3 percent alternative minimum tax.⁹ The primary component of the tax is the 5.5 percent tax that applies to "corporations," as defined in s. 220.03, F.S.¹⁰ The second 5.5 percent tax is referred to as the "franchise tax" and is imposed on Florida banks and savings institutions, as defined in s. 220.62, F.S.¹¹

Regardless of which 5.5 percent tax applies to a taxpayer, if the taxpayer is subject to the federal alternative minimum tax (AMT), then the taxpayer could be subject to Florida's AMT.¹² If so, the taxpayer must pay the greater of the 5.5 percent tax or the 3.3 percent AMT.¹³

Florida's corporate income tax is imposed on a taxpayer's "net income."¹⁴ Net income is determined through the following process:

1. **Begin with Federal Taxable Income.** Rather than requiring the taxpayer to fully recalculate all of its income and deductions for Florida purposes, Florida taxpayers use their federal taxable income as the starting point for determining how much tax is owed Florida.
2. **Make Certain Statutory Adjustments.** These adjustments are generally known as "additions and subtractions,"¹⁵ and they relate to various items that Florida treats differently than the federal government. The income remaining after these additions and subtractions is known as "adjusted federal income."
3. **Apportion and Allocate.** Multi-state taxpayers must determine what portion of their adjusted federal income is properly taxable in Florida – a process generally referred to as "apportionment." Within this process, the taxpayer first determines what portion of its income is from business operations and what portion of its income is non-business.¹⁶ Its

⁷ See Ch. 71-984, L.O.F. Florida began imposing a corporate income tax after a constitutional amendment was adopted in 1971. Currently, the Florida Constitution does not permit an income tax on natural persons. See Art. VII, Sec. 5, Fla. Const.

⁸ See s. 21, 84-549, L.O.F. The Florida Constitution requires a 3/5 vote of the membership of each house of the Legislature in order to impose a tax in excess of 5 percent. See Art. VII, Sec. 5, Fla. Const.

⁹ Only 1 of these 3 tax components can apply to a taxpayer in a given year.

¹⁰ This component of the tax is imposed by s. 220.11(1), F.S. Only a fraction of total Florida businesses are considered "corporations" subject to the Florida corporate income tax. Sole proprietorships, partnerships, limited liability companies, and S corporations are not subject to the tax except under limited circumstances. See s. 220.03(1)(e), F.S.

¹¹ The franchise tax is imposed by s. 220.63(1), F.S.

¹² More information about the AMT for corporations is available from many sources, but a concise explanation was prepared by the nonpartisan Tax Policy Center, an affiliate of The Brookings Institute and the Urban Institute. The article is available at <http://www.taxpolicycenter.org/publications/url.cfm?ID=1000515> (last visited March 17, 2014).

¹³ See s. 220.11(4), F.S. Although the AMT is a lower nominal rate compared to the 5.5 percent tax, the AMT can result in a higher tax due because it uses a different definition of "taxable income."

¹⁴ See s. 220.12, F.S.

¹⁵ See generally s. 220.13, F.S.

¹⁶ Nonbusiness income is certain income that does not arise from transactions and activities in the regular course of the taxpayer's trade or business. See s. 220.03(1)(r), F.S.

business income is then “apportioned”¹⁷ among the states where it does business and its non-business income “allocated” to the state where the transactions or activities that gave rise to the non-business income occurred.¹⁸

Florida generally uses a three-factor apportionment formula determined by the taxpayer’s payroll, sales, and property. The formula compares the taxpayer’s total payroll, sales, and property in all states with the taxpayer’s payroll, sales and property in Florida. The ultimate result of this calculation will be a fraction. A multi-state taxpayer’s business income is then apportioned to Florida based upon that fraction.

4. **Subtract the Exemption.** Lastly, Florida grants an exemption for the first \$50,000 of income that would otherwise be taxable in Florida.¹⁹ Accordingly, after apportionment and allocation are applied to determine a taxpayer’s income that is properly taxable in Florida, the taxpayer subtracts \$50,000 before applying the tax rate. The amount of income remaining after subtraction of the \$50,000 exemption is known as “net income” and is the amount subject to Florida corporate income tax.

III. Effect of Proposed Changes:

Section 1 creates s. 288.1046, F.S., the Defense Works in Florida incentive program to provide an incentive to certain defense contractors to reduce the taxable corporate income.

The bill defines the following terms:

- “Florida prime contractor” as a business entity that is awarded a prime contract. “Florida small business subcontractor” is defined as a business entity that maintains a primary place of business in this state, has fewer than 250 employees at the time the subcontract award is made, is awarded a subcontract from a Florida prime contractor, and has no subsidiary or affiliate business relationship with the Florida prime contractor awarding the subcontract.
- “Prime contract” is defined as one that is awarded directly from the federal government.
- “Qualified defense work” is defined as a prime contract awarded for goods or services that directly or indirectly support the United States Armed Forces or that can be reasonably determined to support national security, including space-related activities. However, the term does not include contracts awarded prior to October 1, 2013.
- “Qualified subcontract award” refers to qualified defense work, in part or in whole, subcontracted from a Florida prime contractor to a Florida small business subcontractor, executed in this state and valued at more than \$250,000.

The bill provides that a Florida prime contractor may apply to the DEO to certify that the contractor may reduce the computation of its adjusted federal income by an amount equal to 4 percent of the subcontract award if it meets certain conditions. To qualify for the reduction, the Florida prime contractor must be subject to ch. 220, F.S., be awarded qualified defense work, and must award a qualified subcontract award. The incentive may be claimed for each qualified subcontract award. However, the Florida prime contractor must apply separately for each

¹⁷ See s. 220.15, F.S.

¹⁸ See s. 220.16, F.S.

¹⁹ The Florida Constitution requires an exemption of at least \$5,000. See Art. VII, Sec. 5, Fla. Const. See also s. 220.14, F.S.

qualified subcontract award for taxable years beginning on or after January 1, 2014, providing the DEO with any required documentation.

Within 10 days of certification, the DEO must provide a letter certifying a qualified subcontract award to the applicant to use when filing taxes and a copy of the letter to the DOR. For each Florida prime contractor, the DEO may certify up to \$250 million in aggregate qualified subcontract awards, equaling \$10 million in reduced taxable income and \$550,000 in reduced taxes per calendar year. The maximum amount of certifications the DEO may certify in a calendar year is \$2.5 billion in aggregate qualified subcontract awards, equaling \$100 million in reduced taxable income and \$5.5 million in reduced taxes.

For multi-year contracts, the DEO shall certify the full amount of the award in the calendar year the contract was awarded; and the Florida prime contractor may claim the incentive in the taxable year in which the payment is made to the Florida small business subcontractor.

The bill grants the DEO the authority to develop any necessary forms and processes needed to implement the incentive program. The DEO may consult with Enterprise Florida, Inc., and the Florida Defense Support Task Force, as necessary.

Section 2 amends s. 220.13(b)(1), F.S., to include the incentive created by this bill as an allowable subtraction in the computation of the adjusted federal income.

Section 3 provides an effective date of July 1, 2014.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

The Revenue Estimating Conference reviewed the impact of this bill on January 17, 2014.²⁰ The bill is estimated to have a recurring negative impact of \$3.3 million to general revenue each year.

²⁰ Revenue Estimating Conference Impact Conference Results from January 17, 2014, available at <http://edr.state.fl.us/Content/conferences/revenueimpact/archives/2014/pdf/Impact0117.pdf> (last visited March 17, 2014).

In adopting this estimate, the conference determined there would be sufficient qualified defense activity to meet the cap of \$100 million in deductions to the adjusted federal income, but the apportionment to Florida would result in less tax impact than the total \$5.5 million tax cap.

B. Private Sector Impact:

The bill may have a positive fiscal impact on defense industry prime contractors that will be able to reduce corporate tax liability and may encourage Florida prime contractors to award subcontracts to small business within the state.

C. Government Sector Impact:

The DEO indicates that the fiscal impact is insignificant and any administrative costs will be absorbed by the DEO.²¹ The DOR indicates that there will be an insignificant fiscal impact.²²

VI. Technical Deficiencies:

None.

VII. Related Issues:

The bill provides rulemaking authority to the DEO and the DOR to administer the provisions of the bill.

VIII. Statutes Affected:

This bill substantially amends section 220.13 of the Florida Statutes.

This bill creates section 288.1046 of the Florida Statutes.

IX. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS by Commerce and Tourism on March 3, 2014:

The committee substitute:

- Clarifies that a “Florida small business contractor” must have 250 employees or less at the time the subcontract award is made to qualify for the incentive.
- Removes the provision that prevented work awarded locally by military institutions from being included in the definition of “qualified defense work.”

²¹ DEO, *2014 Agency Legislative Bill Analysis, Senate Bill 596*, (Jan. 15, 2014) (on file with Senate Commerce and Tourism Committee).

²² DOR, *Legislative Bill Analysis, Senate Bill 596* (Feb. 3, 2014) (on file with the Senate Commerce and Tourism Committee).

- Adds a requirement that “qualified subcontract award” must be valued at more than \$250,000 to qualify for the incentive.
- Requires the DEO, within 10 days of certification, to provide a letter certifying a qualified subcontract award to the applicant and to the DOR.
- Allows eligible businesses to claim the incentive for taxable years beginning on or after January 1, 2014.
- Makes technical changes recommended by the DOR, including changing the term “taxable year” or “tax year” to “calendar year,” as needed.
- Amends s. 220.13, F.S., to include the incentive created by this bill as an allowable subtraction in the computation of the adjusted federal income.

B. Amendments:

None.