

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 1827 (PCB COM 04-04) Tax Exemption for Research and Development
SPONSOR(S): Commerce
TIED BILLS: **IDEN./SIM. BILLS:**

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) <u>Commerce</u>	<u>19 Y, 0 N</u>	<u>Winker</u>	<u>Billmeier</u>
2) _____	_____	_____	_____
3) _____	_____	_____	_____
4) _____	_____	_____	_____
5) _____	_____	_____	_____

SUMMARY ANALYSIS

The proposed committee bill removes the sales and use tax on research or development machinery and equipment, including molds, dies, machine tooling, and other accessories to machinery and equipment, testing equipment, test beds, computers and software, whether purchased or self-fabricated, and if self-fabricated, materials and labor for design, fabrication, and assembly.

The proposed committee bill authorizes a business to designate one or more state universities or community colleges as recipients of up to 100 percent of the amount of the exemption for which the business may qualify. For a university or community college to receive the amount of the exemption, the institution must provide a match of the funds in cash, programs, services, or other in-kind support on a dollar to dollar basis for research or development activities upon the request of a business. All rights to patents, royalties, or real or intellectual property will be vested in the business unless otherwise agreed to by the business and the university or community college.

The proposed committee bill has not been referred to the Revenue Estimating Conference. However, a similar proposal was analyzed in March 2003 and the revenue loss to the state was estimated to be \$13.5 million. This static revenue loss could be offset by expanded research or development and subsequent commercialization by existing businesses and new businesses which may spin off from the products derived from research or development activities.

The proposed committee bill is effective upon becoming law.

This document does not reflect the intent or official position of the bill sponsor or House of Representatives.

STORAGE NAME: h1827.com
DATE: March 29, 2004

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. DOES THE BILL:

- | | | | |
|--------------------------------------|---|-----------------------------|---|
| 1. Reduce government? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 2. Lower taxes? | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/> |
| 3. Expand individual freedom? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. Increase personal responsibility? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. Empower families? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

For any principle that received a "no" above, please explain:

B. EFFECT OF PROPOSED CHANGES:

The proposed committee bill removes the sales and use tax on research or development machinery and equipment, including molds, dies, machine tooling, and other accessories to machinery and equipment, testing equipment, test beds, computers and software, whether purchased or self-fabricated, and if self-fabricated, materials and labor for design, fabrication, and assembly.

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Current Situation

Section 212.052, F.S., provides for certain sales and use tax exemptions for research or development activities. The term "research or development" is defined in section (1) as research which has as one of its ultimate goals:

- Basic research in a scientific field of endeavor.
- Advancing knowledge or technology in a scientific field or technical field of endeavor.
- The development of a new product, whether or not the new product is offered for sale.
- The improvement of an existing product, whether or not the new or improved product is offered for sale.
- The development of new uses of an existing product, whether or not a new use is offered as a rationale to purchase the product.
- The design and development of prototypes, whether or not a resulting product is offered for sale.

Research or development does not include ordinary testing or inspection of materials or products used for quality control, market research, efficiency or consumer surveys, advertising and promotion, management studies, or research in connection with literary, historical, social science, psychological, or other similar non-technical activities.

Section 212.052(2), F.S., provides that any person, including an affiliated group as defined in s. 1504 of the Internal Revenue Code, who manufactures, produces, compounds, processes, or fabricates tangible personal property for the taxpayer's own use directly and solely in research or development shall not be subject to the tax imposed by chapter 212 upon the cost of the manufactured, produced, compounded, processed, or fabricated product. Subsection (3) provides that the tax exemption does not apply to any product of research or development which is used in the ordinary course of business.

Section 212.052(4), F.S., provides for a penalty of the payment of taxes due, together with penalties set forth in s. 212.085, F.S., for a person or affiliated group who makes a fraudulent claim under s. 212.052, F.S. Subsection (5) requires the Department of Revenue to promulgate rules governing the implementation of s. 212.052, F.S.

Section 212.08(j), F.S., provides for an exemption from sales and use tax for industrial machinery and equipment used in semiconductor technology facilities used to manufacture, process, compound, or produce semiconductor technology products for sale or use by the company. Such machinery and equipment must be used predominantly in semiconductor wafer research and development activities.

Tax on Research and Development in Florida

According to Enterprise Florida, Inc., (EFI) most of Florida's national competitors exempt or substantially discount taxes on machinery and equipment use for research and development activities.

For example, California has a research and development tax credit which is available to taxpayers under both the personal income tax and the corporation tax. To meet eligibility requirements, research activities must be related to the development of information which technological in nature, intended for application to the development of a new and improved business product, and performed in the state of California. Expenses associated research activity must be for employee compensation directly related to research activities, certain contract expenses paid to non-employees under contract for research activities, and the costs of non-depreciated personal tangible property use to conduct research. The tax credit amount is equal to 15 percent of the excess of qualified research and development expenditures during the current year over the calculated base amount which is calculated using the average annual gross receipts for the previous three years multiplies by a base-period percentage (13.6% in California).

According to a paper prepared by the Legislative Analyst's Office of the California Legislature, 31 states have research and development tax credits. Of the 31 states, all but Hawaii calculates the credit in the same manner as does California.

According to EFI, the level of research and development activity in Florida compared to other states is low. However, according to a 2002 publication by the American Association for the Advancement of Science, Florida is one of the top recipients of federal research and development funding. The following points are made in the publication:

- Florida received \$2.5 billion in federal R&D funding in FY 2000 which ranked Florida 8th among the 50 states.
- The Department of Defense provides almost two-thirds of Florida's federal R&D funds.
- The National Aeronautics and Space Administration is the second largest federal source of R&D funds in Florida.

- The Department of Health and Human Services is the largest sponsor of R&D at Florida universities.
- Industrial firms in Florida are the top recipients of federal R&D funds with more than half of the total federal R&D funds that went to the state. DOD is the largest source of federal R&D dollars to industrial firms and account for 83 percent of the total amount that went to the private sector in Florida.
- Florida ranks 26 in federal R&D funding per capita.

According to EFI, eliminating the sales and use tax on machinery and equipment for research or development activities has been identified as a key business climate issue by two Florida industry sectors; the aviation/aerospace and biomedical industries. Also, eliminating the sales and use tax on research or development machinery and equipment is consistent with EFI's policy statement regarding the taxation of inputs to production.

C. SECTION DIRECTORY:

Section 1: Amends subsection (2) and adds a new subsection (3) to s. 212.052; relating to research or development costs; providing for an exemption for sales and use tax on research or development machinery, equipment, labor, and materials; authorizing a business to designate one or more state universities or community colleges as recipients of up to 100 percent of the amount of the exemption for which the business may qualify; providing for a one-to-one match between the university or community college and the business; and providing that rights to patents, royalties, or real or intellectual property vests in the business unless otherwise agreed to.

Section 2: The bill becomes effective upon becoming law.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

See Fiscal Comments below.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

N/A

2. Expenditures:

N/A

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Businesses receiving tax exemptions for machinery and equipment used for research or development will receive a direct benefit from the proposed committee bill. Businesses may use the tax incentives provided for in the proposed committee bill to grow and expand their business which will add to and have a positive fiscal additive effect upon the economy of local communities and the state.

D. FISCAL COMMENTS:

The proposed committee bill has not been referred to the Revenue Estimating Conference. However, a similar proposal was analyzed in March 2003 and the revenue loss to the state was estimated to be \$13.5 million. This static revenue loss could be offset by expanded research or development and subsequent commercialization by existing businesses and new businesses which may spin off from the products derived from research or development activities.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

The bill does not require a municipality or county to expend funds or to take any action requiring the expenditure of funds. The bill does not reduce the authority that municipalities or counties have to raise revenues in the aggregate. The bill does not reduce the percentage of state tax shared with municipalities or counties.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The Department of Revenue would need to promulgate additional administrative rules to implement provisions in the proposed committee bill. Section 212.052(5), F.S., provides the department with authorization to promulgate rules governing the implementation and operation of the section to which the proposed committee is to be added.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE CHANGES

N/A