



## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. HOUSE PRINCIPLES ANALYSIS:

Lower Taxes- The bill removes the sales and use tax on the purchase, rental or repair of machinery and equipment used predominantly for research and development activities.

#### B. EFFECT OF PROPOSED CHANGES:

##### **Present Situation**

Section 212.052(2), F.S., provides that any person, including an affiliated group as defined in s. 1504 of the Internal Revenue Code<sup>1</sup>, 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.

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(4), F.S., provides for a penalty of the payment of taxes due, together with penalties set forth in s. 212.085, F.S.,<sup>2</sup> for a person or affiliated group who makes a fraudulent claim under s.212.052, F.S.

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<sup>1</sup> An "affiliated group" is generally defined as 1 or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation.

<sup>2</sup> The penalties include payment of the tax plus a mandatory penalty of 200 percent of the tax, a fine and punishment as provided by law for a conviction of a felony of the third degree, as provided in s. 775.082, s. 775.083, or s. 775.084, F.S.

Section 212.08(5)(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.

Section 212.08(j)8., F.S., provides that businesses certified to receive the exemption may elect 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 they may qualify. To receive these funds, the institution must agree to match the funds so earned with equivalent cash, programs, services, or other in-kind support on a one-to-one basis in the pursuit of research and development projects as requested by the certified business. The rights to any patents, royalties, or real or intellectual property must be vested in the business unless otherwise agreed to by the business and the university or community college.

### **Tax on Research and Development in Florida**

According to Enterprise Florida, Inc. (EFI), Florida's sales tax treatment of research and development equipment constitutes a distinct competitive disadvantage for manufacturers and other target industries in Florida, as 21 competitor states including Maine, New York, Ohio, Pennsylvania, South Carolina, and Virginia have either abolished or significantly reduced their sales tax on research and development equipment. EFI reports that the level of research and development activity in Florida is low relative to the size of its economy.

However, a 2002 publication by the American Association for the Advancement of Science showed that 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<sup>3</sup>.

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.

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<sup>3</sup> American Association for the Advancement of Science, State of Florida R&D Profile (2002), which may be found at <http://www.aaas.org/spp/rd/fl00.pdf>

## **Proposed Changes**

The 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 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.

### **C. SECTION DIRECTORY:**

Section 1: Amends 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: Provides an effective date of July 1, 2005.

## **II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT**

### **A. FISCAL IMPACT ON STATE GOVERNMENT:**

#### **1. Revenues:**

The bill has not been referred to the Revenue Estimating Conference. However, a similar proposal was addressed in an Impact Conference held during the 2004 Session. They found that the bill would have a total impact on state and local revenue of \$32.5 million. Of that amount \$27.3 was General Revenue.

#### **2. Expenditures:**

The bill is not expected to have an effect on state government expenditures.

### **B. FISCAL IMPACT ON LOCAL GOVERNMENTS:**

#### **1. Revenues:**

The bill has not been referred to the Revenue Estimating Conference. However, a similar proposal was addressed in an Impact Conference held during the 2004 Session. They found that the bill would have a total impact on state and local revenue of \$32.5 million. Of that amount \$27.3 was General Revenue, leaving an impact on local governments of \$5.2 million.

#### **2. Expenditures:**

The bill is not expected to have an effect on local government expenditures.

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 bill. Businesses may use the tax incentives provided for in the 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. The bill may also help Floridians find jobs through the creation or expansion of manufacturing businesses.

D. FISCAL COMMENTS:

None.

### 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 may need to promulgate additional administrative rules to implement provisions in the 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 bill is to be added.

C. DRAFTING ISSUES OR OTHER COMMENTS:

The bill does not define "predominantly" when explaining the tax exemption for machinery and equipment used for research and development activities. This may lead to confusion over whether the exemption applies.

The definition of "machinery and equipment" may be too narrow for the purposes of this bill. The Department of Revenue has expressed concerns regarding the clarity of the definition. In the definition, reference is made to "other appurtenances or accessories to machinery and equipment," which may prove difficult to administer without guidance in their meaning.

The bill utilizes language from Section 212.08(5)(j), F.S., which provides an exemption for both production and research and development activities engaged in by "certified" semiconductor, space, and defense businesses. Certification for these businesses is obtained through an application process that is jointly administered by Enterprise Florida, Inc., and the Office of Tourism, Trade, and Economic Development. By retaining the language "A business certified to receive this exemption..." in paragraph (3)(b) of the bill, there is an implication that the same or similar certification process is required to receive the exemption proposed by the bill. However, the bill does not create a certification process.

The language in subparagraph 8. of s. 212.08(5)(j), F. S., for designation of a university or community college to receive exempted funds, applies to qualifying purchases of machinery and equipment and certain purchases of building materials. When using this language in the bill to amend Section 212.052, F.S., it is unclear whether a business that elects to designate exempt funds is limited to the amount of

tax exempted on qualifying machinery and equipment or whether the amount to be designated should also include exempt research and development labor costs.

According to representatives with the Department of Revenue, generally, exemption provisions within Chapter 212, Florida Statutes, relating to purchases of "machinery and equipment" require the issuance of an affidavit, purchaser's certificate of exemption, or tax exemption permit to the selling dealer. As with a resale certificate and a direct pay permit, these documents provide the documentation that a selling dealer will need to document exempt sales. The bill has not provided for documentation of the proposed exemption.

#### **IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES**

N/A