

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 81 CS

Tax On Sales, Use, and Other Transactions

SPONSOR(S): Quinones

TIED BILLS:

IDEN./SIM. BILLS: SB 582

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) <u>Economic Development, Trade & Banking Committee</u>	<u>13 Y, 0 N, w/CS</u>	<u>Sheheane</u>	<u>Carlson</u>
2) <u>Finance & Tax Committee</u>	<u>5 Y, 0 N, w/CS</u>	<u>Diez-Arguelles</u>	<u>Diez-Arguelles</u>
3) <u>Education Appropriations Committee</u>	<u></u>	<u></u>	<u></u>
4) <u>Commerce Council</u>	<u></u>	<u></u>	<u></u>
5) <u></u>	<u></u>	<u></u>	<u></u>

SUMMARY ANALYSIS

The bill exempts machinery and equipment used predominantly for research and development activities from the sales and use tax.

The bill authorizes a business to designate one or more state universities or community colleges to receive from the business 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 the 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 Revenue Estimating Conference has estimated that the provisions of this bill will reduce state revenues by \$29.4 million and local revenues by \$6.1 million in FY 2005-2006 and by \$33.0 million and \$6.9 million, respectively, in FY 2006-2007.

The provisions of this bill reduce the authority that cities and counties have to raise revenue through local option sales taxes. Therefore, the constitutional mandates provision is applicable and this bill requires a two-thirds vote of the membership for passage.

The bill has an effective date of July 1, 2005.

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 Code¹, 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. 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 equal to the taxes due, together with the penalties set forth in s. 212.085, F.S.,² for a person or affiliated group who makes a fraudulent claim under s.212.052, 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,

¹ 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.

² 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.

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 ranks³ 26 in federal R&D funding per capita³.

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.

³ 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 provides a sales tax exemption for machinery and equipment used predominantly for research and development. Section 212.08 (5) (j), F.S., defines “predominantly” to mean fifty percent of the time.

The bill defines “machinery and equipment” to include, but not be limited to, molds, dies, machine tooling, and other accessories to machinery and equipment, testing and measuring 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 also redefines the term “research and development,” set forth in s. 212.08(5)(j), F.S., by replacing the current definition contained in that section with the statutory language set forth in s. 212.052(1), F.S. (See Present Situation, above)

The bill provides the administrative procedure for a purchaser of machinery and equipment to claim the exemption. In order to claim the exemption, the purchaser must furnish the vendor an affidavit stating that the machinery and equipment will be used predominantly for research and development. Persons claiming the exemption by a refund application must furnish the affidavit to the Department of Revenue with the refund application. Any person who fraudulently furnishes an affidavit is subject to a penalty of 200 percent of the tax and to the penalties applicable for a conviction of felony of a third degree, as provided in s. 212.085, F. S.

The bill provides for the Office of Program Policy Analysis and Government Accountability and Enterprise Florida, Inc., to conduct a study by July 1, 2015, and recommend to the Governor and the legislature whether the exemption should be retained.

The bill authorizes a business to designate one or more state universities or community colleges to receive from the business 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, F.S

Section 2: Amends s. 212.08, F.S.

Section 3: Provides an effective date of July 1, 2005.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

The Revenue Estimating Conference met on February 4, 2005 and made the following estimate (in millions of dollars):

	FY 2005-06	FY 2006-07
General Revenue	(29.3)	(32.9)
State Trust	<u>(.1)</u>	<u>(.1)</u>
Total State Impact	(29.4)	(33.0)

2. Expenditures:

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

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

The Revenue Estimating Conference met on February 4, 2005 and made the following estimate (in millions of dollars):

	FY 2005-06	FY 2006-07
Revenue Sharing	(.9)	(1.1)
Local Gov't Half Cent	(2.6)	(2.9)
Local Option	<u>(2.6)</u>	<u>(2.9)</u>
Local Tax Impact	(6.1)	(6.9)

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.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

The mandates provision applies to this bill because it reduces the authority that cities and counties have to raise revenues, in the aggregate, by the imposition of local option sales taxes. The bill does not qualify for an exemption or exception; accordingly the bill must have a two-thirds vote of the membership of each house.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The bill provides the department with authorization to promulgate rules governing the administration of the exemption.

DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES

On February 8, 2005, the Economic Development, Trade and Banking Committee adopted a strike-all amendment to the bill. The amendment:

- Defines “predominantly” as “fifty percent of the time” when explaining the tax exemption for machinery and equipment used for research and development activities.
- Broadens the definition of “machinery and equipment” by adding a “but is not limited to” clause to address the Department of Revenue’s concern regarding the narrowness of the definition.
- Includes “measuring equipment” in the definition of “machinery and equipment” to clarify that such equipment is included in the exemption.
- Clarifies that the exemption is an outright exemption.

On April 15, 2005, the Finance and Tax Committee adopted an amendment which placed the exemption in s. 212.08, F.S., instead of in s. 212.052, F.S. The amendment also added requirements for a purchaser’s affidavit, defined the terms “machinery and equipment” and “research and development,” and provided for a study of the exemption. The analysis reflects the amendment.