HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 415 CS Tax on Sales, Use, and Other Transactions
SPONSOR(S): Quinones and others
TIED BILLS: **IDEN./SIM. BILLS:** SB 962

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) Spaceport & Technology Committee	4 Y, 0 N	Whittier	Saliba
2) Finance & Tax Committee	9 Y, 0 N, w/CS	Noriega	Diez-Arguelles
3) State Infrastructure Council	9 Y, 0 N, w/CS	Whittier	Havlicak
4)			
5)			

SUMMARY ANALYSIS

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

The bill increases sales and use tax exemption for industrial machinery and equipment used for the production of space or defense technology products from 25 percent to 100 percent. Also, the bill expands this production exemption to include the design or assembly of space or defense technology products. In addition, the bill amends the definition of space technology products by adding space flight vehicles and components of any of the items covered by the definition.

The Department of Revenue is authorized to promulgate rules to implement the exemption for machinery and equipment used for research and development.

The Revenue Estimating Conference has estimated that this bill will have a negative fiscal impact of $24.8 million to state government and $6.1 million to local governments in FY 2006-07, and of $27.1 million to state government and $6.1 million to local governments in FY 2007-08.

This bill appears to be a mandate that requires a 2/3 vote of the membership of each house to pass.

The bill has an effective date of July 1, 2006.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

Ensure Lower Taxes: The bill exempts the purchase of machinery and equipment used predominantly for research and development activities from the state sales and use tax, and eliminates the sales tax on the purchase of machinery and equipment used to produce space and defense technology products.

B. EFFECT OF PROPOSED CHANGES:

Current Situation

Section 212.052(2), F.S., provides that any person, including an affiliated group,[1] 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. This includes the cost of the manufactured, produced, compounded, processed, or fabricated product. However, taxes are due on the purchase, rental, or repair of real property or tangible personal property employed in research or development which is subject to the tax.

The term "research or development" is defined as research which has one of the following as its ultimate goal:

- 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 the new product is offered for sale;
- The improvement of an existing product, whether the new or improved product is offered for sale;
- The development of new uses of an existing product, whether a new use is offered as a rationale to purchase the product; or
- The design and development of prototypes, whether 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 promotions, management studies, or research in connection with literary, historical, social science, psychological, or other similar non-technical activities.[2]

The tax exemption does not apply to any product of research or development which is used in the ordinary course of business, other than for research or development, except and to the extent that the knowledge, technology, science, design, plan, patent, or understanding which is derived from the product of research or development is applied in the ordinary course of business. In addition, this section does not apply to any product of research or development that is tangible personal property which is offered for sale.

Section 212.08(5)(j), F.S., provides exemptions for machinery and equipment used in semiconductor (100 percent exemption), defense (25 percent exemption), or space (25 percent exemption) technology production and research and development (R & D) from sales tax on the following: sales, rental, use, consumption, distribution, and storage. Machinery and equipment includes molds, dies, machine tooling, other appurtenances or accessories to machinery and equipment, testing equipment, test beds,

[1] Section 212.052(2), F.S., As defined in s. 1504 of the Internal Revenue Code of 1954, an "affiliated group" is generally defined as one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation.
[2] See s. 212.052(1)(a), F.S.

computers, and software, whether purchased or self-fabricated, and, if self-fabricated, includes materials and labor for design, fabrication, and assembly. “Predominately,” where used, is defined as at least 50 percent of the time.

The two exemptions for the semiconductor industry are:

- Industrial machinery and equipment used in semiconductor technology facilities certified to manufacture, process, compound, or produce semiconductor technology products for sale or use by these facilities are exempt from the tax imposed by chapter 212, F.S.; and

- Machinery and equipment are exempt from the tax imposed by chapter 212, F.S., if used predominantly in semiconductor wafer research and development activities in a certified semiconductor technology research and development facility.

The two exemptions for the defense and space industries are:

- Industrial machinery and equipment used in defense or space technology facilities certified to manufacture, process, compound, or produce defense technology products or space technology products for sale or use by these facilities are exempt from 25 percent of the tax imposed by chapter 212.F.S.; and

- Machinery and equipment are exempt from 25 percent of the tax imposed by chapter 212, F.S., if used predominately in defense or space research and development activities in a certified defense or space technology research and development facility.

In all of the above cases, a business entity must apply to Enterprise Florida, Inc. (EFI), to certify that machinery and equipment purchased are used consistent with the requirements described above. Once the application is determined to be complete, EFI evaluates the application and recommends approval or disapproval of the application to the Office of Tourism, Trade, and Economic Development (OTTED) within 10 working days. Upon receipt, OTTED has 5 working days to certify those applicants who are found to meet the requirements of s. 212.08, F.S., and must notify the applicant, EFI, and the Department of Revenue of the certification, which is valid for one year. If OTTED determines that the applicant does not meet the requirements, it must notify the applicant and EFI within 10 working days that the certification application was denied, along with the reasons for denial.[3]

According to EFI, Florida’s sales tax treatment of R & D equipment constitutes a distinct competitive disadvantage for manufacturers and other target industries in Florida, as many competitor states have either abolished or significantly reduced their sales tax on equipment used in R & D. EFI reports that the level of R & D activity in Florida is low relative to the size of its economy and that eliminating the sales and use tax on machinery and equipment used in R & D activities is key to encouraging expansion in two Florida industry sectors: the aviation/aerospace and biomedical industries. Also, eliminating the sales and use tax on R & D machinery and equipment is consistent with EFI’s 2006 Strategic Plan for Economic Development.[4]

The Florida Chamber of Commerce, along with the Manufacturing Advisory Council, asserts that, “A missing ingredient to a successful business climate in the state is the elimination of the sales and use tax on R & D equipment. The elimination of this tax would encourage business investment and expansion, make Florida more competitive with other states and promote the creation of higher quality jobs for Floridians.” The Chamber echoes EFI’s claims that most of the states that are Florida’s competitors for recruiting and developing new businesses, such as California, Massachusetts, New York, Virginia, and Washington, have exempted or substantially discounted taxes on R & D equipment.[5]

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[3] See s. 212.08(5)(j)6., F.S.
[4] *Roadmap to Florida’s Future*, 2006 Annual Report, Enterprise Florida, Inc., p. 25.
[5] *Where We Stand: Research and Development Tax Exemption*, Florida Chamber of Commerce.

Proposed Changes

The bill provides an exemption from the sales and use tax for machinery and equipment used predominantly for R & D. The bill defines "predominantly" as at least 50 percent of the time. The exemption applies to all businesses domiciled in the state.

The bill defines "machinery and equipment" to include, but not be limited to, molds, dies, machine tooling, and other appurtenances or accessories to machinery and equipment, testing and measuring equipment, test beds, computers, and software, whether purchased or self-fabricated, and, if self-fabricated, includes materials and labor for design, fabrication, and assembly. The term "other appurtenances or accessories" is not defined in the bill.

The bill also defines the term "research and development," using the current definition contained in s. 212.052(1), F.S. (See *Current Situation* section).

The bill removes the exception from the tax exemption set forth in s. 212.052(2), F.S., for the purchase, rental or repair of real property or tangible personal property employed in R & D. Removing this exception ensures that s. 212.052(2), F.S., does not conflict with the proposed machinery and equipment sales and use tax exemption created by Section 2 of the bill.

The bill changes the amount of the exemption for industrial machinery and equipment used for the production of space or defense technology products from 25 percent to 100 percent. The bill expands this production exemption to include the design or assembly of space or defense technology products. In addition, the bill amends the definition of space technology products by adding space flight vehicles and components of any of the items covered by the definition.

The bill increases the certification period for tax exemption, from one year to two years, for a business that uses industrial machinery and equipment in the manufacturing or production of semiconductors, space, or defense technology. It also provides that the certificate can be renewed biennially by submitting a statement to OTTED that there has been no material change in conditions, as declared in the original certificate.

The bill provides an administrative procedure for a purchaser of machinery and equipment to claim the R & D sales tax exemption. The purchaser must furnish the vendor with an affidavit stating that the machinery and equipment will be used predominantly for R & D activities. Persons claiming the exemption by refund must include the affidavit with the refund application. Any person who fraudulently furnishes an affidavit is subject to a mandatory penalty of 200 percent of the tax, payment of the tax itself, a fine of up to $5,000, and a term of imprisonment of up to five years.[6]

C. SECTION DIRECTORY:

<u>Section 1</u>. Amends s. 212.052(2), F.S., by removing an exception to the tax exemption.

<u>Section 2</u> . Amends s. 212.08(5)(j) by eliminating R & D language for semiconductors, space, and defense; changes the amount of the exemption for industrial machinery and equipment used for the production of space or defense technology products; amends the definition of space technology products by adding space flight vehicles and components of any of the items covered by the definition; adds s. 212.08(18), F.S., which provides sales and use tax exemptions for machinery and equipment used predominantly for R & D.

<u>Section 3</u>. Provides an effective date of July 1, 2006.

[6] Section 212.085, F.S.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   The Revenue Estimating Conference estimates that the provisions of this bill will have the following impact on state revenues:

	FY 2006-07	FY 2007-08
General Revenue	($24.7) million	($27.0) million
State Trust	($0.1) million	($0.1) million
Total State Impact	**($24.8) million**	**($27.1) million**

2. Expenditures:

   The Department of Revenue estimated the following state government expenditures before the Finance & Tax Committee adopted a strike-all amendment to the bill:

	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
Recurring	$43,262	$55,548	$55,548	$55,548
FTE	1			
Salaries	$36,859	$49,145	$49,145	$49,145
Expenses	$6,403	$6,403	$6,403	$6,403
Non-Recurring	$4,843			
Expenses	$3,343			
OCO	$1,500			
Total	**$48,105**	**$55,548**	**$55,548**	**$55,548**

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   The Revenue Estimating Conference estimates that the provisions of this bill will have the following impact on local revenues:

	FY 2006-07	FY 2007-08
Revenue Sharing	($0.9) million	($0.9) million
Local Gov't. Half Cent	($2.6) million	($2.6) million
Local Option	($2.6) million	($2.6) million
Total Local Impact	**($6.1) million**	**($6.1) million**

2. Expenditures:

   The bill may reduce local government expenditures to the extent the local government revenues are reduced.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill eliminates the tax burden on businesses purchasing machinery and equipment used predominately for R & D, or used for the production of space or defense technology products.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

This bill will reduce the authority of counties to raise revenues in the aggregate through local option sales taxes by $2.6 million, as estimated by the Revenue Estimating Conference. As such, the mandates provision appears to apply to this bill and it does not seem to qualify for an exemption. Therefore, the bill must be adopted by a 2/3 vote of the membership of each house.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The bill provides the Department of Revenue with authority to adopt rules that provide for administering and implementing the R & D exemption.

C. DRAFTING ISSUES OR OTHER COMMENTS:

The Department of Revenue indicates that the lack of a definition for "other appurtenances or accessories" may cause problems when implementing and administering the law's provisions.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES

On March 22, 2006, the Finance & Tax Committee adopted one amendment to the bill. The amendment changed the subsection of chapter 212, F.S., where the new exemption for R & D was placed.

In addition, the amendment increased the amount of the exemption for industrial machinery and equipment used for the production of space or defense technology products from 25 percent to 100 percent. Also, the amendment clarified this production exemption to include the design or assembly of space or defense technology products, and included space flight vehicles and a variety of components to the definition of space technology products.

This analysis reflects the changes contained in the amendment adopted by the Finance & Tax Committee.

On April 4, 2006, the State Infrastructure Council adopted one amendment to the bill which increased the certification period for tax exemption, from one year to two years, for a business that uses industrial machinery and equipment in the manufacturing or production of semiconductors, space, or defense technology. The bill was passed favorably with council substitute.