

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

Lower Taxes - The bill exempts from the state sales and use tax, machinery and equipment used predominantly for research and development activities. The bill also exempts from the state sales and use tax, machinery and equipment used by a space flight business in designing or creating a space flight vehicle or components of a space flight vehicle.

B. EFFECT OF PROPOSED CHANGES:

Present Situation

Research and Development

Note: The bill addresses two sections of statute. The first section of statute addressed by the bill, s. 212.052, F.S., utilizes the term “research or development” and the second section of statute, s. 212.08, F.S., utilizes the term “research *and* development.”

Section 212.052(2), F.S., provides that any person, including an affiliated group¹, 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. There is an exception, however, that 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 interpretation regarding the items exempted from tax by this section is the subject of recent litigation. In *State of Florida v. Lockheed Martin Corporation* (905 So.2d 1017), the First District Court of Appeals upheld the trial court ruling in favor of Lockheed. The Court found that sentence one and sentence two of s. 212.052(2), F.S., are not ambiguous. Tangible personal property **incorporated or fabricated** into a research and development end product or prototype is directly and solely used in research and development for purposes of the section, and thus is tax exempt. Tangible personal property, such as equipment that is used only in making a prototype, is not directly and solely used in research and development. Items listed as “employed in” research and development (i.e., purchase, rental, or repair of real property) cannot be incorporated or fabricated into a prototype and are therefore taxable.

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.

¹ 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.

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

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 212.08(5)(j), F.S., provides for exemption for machinery and equipment used in semiconductor (100 percent), defense (25 percent), or space (25 percent) technology production and research and development (R & D) from the following taxes: 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, computers, and software, whether purchased or self-fabricated, and, if self-fabricated, includes materials and labor for design, fabrication, and assembly. "Predominately" is defined as at least 50 percent of the time.

Paragraph (j) provides the following two exemptions for the semiconductor industry:

- Industrial machinery and equipment used in semiconductor technology facilities to manufacture process, compound, or produce semiconductor technology products for sale or use by these facilities are exempt from the tax imposed by this chapter.
- Machinery and equipment are exempt from the tax imposed by this chapter if used predominantly in semiconductor wafer research and development activities in a semiconductor technology research and development facility.

Paragraph (j) provides the following two exemptions for the defense and space industries:

- Industrial machinery and equipment used in defense or space technology facilities to manufacture, process, compound, or produce defense technology products or space technology products for sale or for use by these facilities are exempt from 25 percent of the tax imposed by this chapter.
- Machinery and equipment are exempt from 25 percent of the tax imposed by this chapter if used predominantly in defense or space research and development activities in a 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 is to notify the applicant, EFI, and the Department of Revenue of the certification. If OTTED determines that the applicant does not meet the requirements, it is to notify the applicant and EFI within 10 working days that the application was denied and 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

² See s. 212.052(1)(a), F.S.

³ See s. 212.08(5)(j)6., F.S.

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

Space Flight Business

A number of developments in recent years are significantly impacting space enterprises in Florida. In January 2004, President Bush committed the U.S. to a long-term human and robotic program to explore the solar system, starting with a return to the Moon that will ultimately enable future exploration of Mars and other destinations. The President's plan envisions completion of the International Space Station, retirement of the Space Shuttle by 2010, and the introduction of a new Crew Exploration Vehicle (CEV).

The President's new vision has significant implications for Florida. More than half of Florida's current space-related activities are linked to the Space Shuttle and International Space Station. The smaller CEV will require significantly fewer personnel at the Kennedy Space Center.

In June 2005, the Governor created the *Governor's Commission on the Future of Space and Aeronautics in Florida* (commission) to assess and make recommendations on how to strengthen Florida's role as a leader in space and aeronautics to maximize the economic development and job creation opportunities throughout the state.⁶ The commission's support of the space industry is exhibited in the *Executive Summary* of the final report:

During the next decade, Florida has the opportunity to broaden its existing leadership in civil and military launch activity, while also emerging as the nation's leader in new commercial space opportunities and the integration of space, aeronautics, and aviation technologies. If realized, this vision will position Florida for sustained economic growth and prosperity for decades to come. Attaining this vision will require a strong public and private commitment to a world-class space and aeronautics industry...Florida must capture a larger share of activity in aerospace research, technology, production, and commercial operations, while maintaining its historical leadership in space launch activities.⁷

Currently, there are no sales and use tax exemptions for machinery and equipment used by a space flight businesses in designing or creating a space flight vehicle or components of a space flight vehicle. "Space flight business" is defined in s. 212.031(1)(a)13., F.S., as the manufacturing, processing, or assembly of a space facility, space propulsion system, space vehicle, satellite, or station of any kind possessing the capacity for space flight⁸, or components thereof, and also means the following

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.

⁶ See http://www.myflorida.com/myflorida/government/governorinitiatives/space_commission/05-120.html.

⁷ *Governor's Commission on the Future of Space and Aeronautics in Florida Final Report*, January 2006, pp. ES1-ES2.

⁸ Section 212.02(23), F.S., defines "space flight" as any flight designed for suborbital, orbital, or interplanetary travel of a space vehicle, satellite, or station of any kind.

activities supporting space flight: vehicle launch activities, flight operations, ground control or ground support, and all administrative activities directly related thereto.

The commission recommended increasing the sales and use tax exemptions for space and defense research, development, and production machinery and equipment from 25 to 100 percent.⁹ The Governor's FY 2005-06 Budget Recommendations also include this proposed policy.

Proposed Changes

The bill removes the exception of purchase, rental or repair of real property or tangible personal property employed in research or development to the tax exemption previously explained. Section 212.052(2), F.S., refers to tangible personal property that is used **directly and solely** in research or development. Removing this exception ensures that s. 212.052(2), F.S., does not conflict with the proposed machinery and equipment sales and use tax exception created by Section 2. of the bill.

The bill provides a sales tax exemption for machinery and equipment used **predominantly** for R & D. The bill also exempts from the state sales and use tax, machinery and equipment used by a space flight business in designing or creating a space flight vehicle or components of a space flight vehicle. The bill defines "predominately" as at least 50 percent of the time.

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 Department of Revenue indicates that the lack of a definition may cause problems when implementing and administering the law's provisions.

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

The bill provides an administrative procedure for a purchaser of machinery and equipment to claim the sales and use 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 the penalties provided in s. 212.085, F.S.

Although the bill requires the affidavit process described above, the bill does not require the certification process which is currently required under s. 212.08(5)(j), F.S., for determination that the machinery and equipment will be used predominantly for R & D activities.

C. SECTION DIRECTORY:

Section 1 – Amends s. 212.052(2), F.S.; deletes an exception to a tax exemption.

Section 2 – Amends s. 212.08(5), F.S.; adds sales and use tax exemptions for machinery and equipment used predominantly for research and development or by a space flight business in designing or creating a space flight vehicle or components of a space flight vehicle.

Section 3 – Provides an effective date of July 1, 2006.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

⁹ *Governor's Commission on the Future of Space and Aeronautics in Florida Final Report*, January 2006, p. 3-15.

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

The Revenue Estimating Conference met on February 17, 2006, and made the following estimate:

	FY 2006-07	FY 2007-08
General Revenue	(\$26.8) million	(\$26.8) million
State Trust	(\$.1) million	(\$.1) million
Total State Impact	(\$26.9) million	(\$26.9) million

2. Expenditures:

The Department of Revenue estimates the following state government expenditures:

	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 met on February 17, 2006, and made the following estimate:

	FY 2006-07	FY 2007-08
Local Tax Impact	(\$6.1) million	(\$6.1) million

2. Expenditures:

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

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill reduces the tax burden on businesses purchasing machinery and equipment used predominately for R & D and space flight businesses designing or creating a space flight vehicle and its components.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Subsection (b) of s. 18, Art. VII, State Constitution, provides that except upon approval of each house of the legislature by two-thirds vote of the membership, the legislature may not enact, amend, or repeal any general law if the anticipated effect of doing so would be to reduce the authority that municipalities or counties have to raise revenue in the aggregate, as such authority exists on February 1, 1989.

The mandates provision may apply to this bill because it appears to reduce the authority that cities and counties have to raise revenues, in the aggregate, through local option sales taxes. Therefore, this bill may require a two-thirds vote of the membership for passage.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The bill provides the Department of Revenue with authorization to adopt rules that provide for administering and implementing the exemption.

C. DRAFTING ISSUES OR OTHER COMMENTS:

As discussed in the *Present Situation* section, the commission's final report proposed increasing the sales and use tax exemptions for space and defense research, development, and production machinery and equipment from 25 to 100 percent. These exemptions are also reflected in the Governor's FY 2005-06 Budget Recommendations and are presumed to be for the provisions of s. 212.08(5)(j), F.S. If s. 212.08(5)(j), F.S., is amended, consistent with the Governor's recommendation, the language in this bill may conflict.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES

None.