

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** CS/HB 155 Defense Contracting

**SPONSOR(S):** Economic Development & Tourism Subcommittee and Smith

**TIED BILLS:** **IDEN./SIM. BILLS:** SB 596

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Economic Development & Tourism Subcommittee	9 Y, 2 N, As CS	Collins	West
2) Finance & Tax Subcommittee	17 Y, 1 N	Wolfgang	Langston
3) Economic Affairs Committee	11 Y, 2 N	Collins	Creamer

### SUMMARY ANALYSIS

The bill creates a new economic development tax incentive program to reward businesses receiving national security-related federal contracts for hiring more Florida-based subcontractors. Qualifying businesses may reduce the computation of adjusted federal income used to determine state corporate income tax liability by an amount equal to four percent of each subcontract awarded to a qualifying Florida-based subcontractor. To receive the incentive, a business must submit specified documentation regarding qualified subcontract awards to the Department of Economic Opportunity (DEO), which is responsible for certifying applicants.

The bill places caps on the amount of qualified subcontract awards DEO may certify for a single company in a single tax year and on the total amount of qualified subcontract awards DEO may certify in a single tax year program-wide.

DEO and the Department of Revenue (DOR) are granted rule-making authority to implement the bill.

The Revenue Estimating Impact Conference met on January 17, 2014, and estimated that the bill would have a negative impact on general revenues of \$3.3 million per fiscal year on a recurring basis and no impact on local government revenues or expenditures.

The bill has an effective date of July 1, 2014.

# FULL ANALYSIS

## I. SUBSTANTIVE ANALYSIS

### A. EFFECT OF PROPOSED CHANGES:

#### **Present Situation**

##### Florida's Defense Industry

Florida is home to three of ten unified combatant commands and hosts two of only four Navy deep water ports in the country with adjacent airfields, the military's only space launch facility on the east coast, the Marine Corps' only maritime prepositioning facility, and one of only three Navy Fleet Readiness Centers. The state also hosts several critical research, development, testing and evaluation centers. In addition, the Joint Gulf Range Complex connects test and training ranges that extend from Key West to northwest Florida and across the eastern Gulf of Mexico, and encompasses 180,000 square miles of Department of Defense-controlled airspace.<sup>1</sup>

The defense industry accounted for 9.4 percent of state gross domestic product in 2011. Defense-related spending, direct and indirect, added up to \$73.4 billion in 2011, \$12.4 billion of which was allocated for procurements.<sup>2</sup> In 2011, Florida businesses generated \$13.6 billion in U.S. Department of Defense (DOD) contract awards, ranking the state 5th in the nation. The state is home to many of the nation's leading defense contractors and a large pool of highly skilled workers and veterans.<sup>3</sup>

According to the federal government, 111,516 contracts have been awarded to prime contractors by DOD and the National Aeronautics and Space Administration (NASA) from federal fiscal year 2012 through the current federal fiscal year for work done in Florida. Combined, these contracts have a total value of more than \$24 billion. There have been 3,628 subcontracts awarded through those 111,516 prime contracts, valued at more than \$5 billion. Of those, 2,891 subcontracts, valued at \$3.9 billion, have been awarded to businesses located in Florida, which accounts for 79.7 percent of all subcontracts awarded by prime contractors who have received federal contracts for work to be done in Florida by DOD and NASA.<sup>4</sup>

##### Federal Contracting Overview

The typical federal procurement process involves an agency identifying the goods and services it needs, determining the most appropriate method for purchasing those items, and carrying out an acquisition process. Under most procurement processes, an agency posts a solicitation on the Federal Business Opportunities (FedBizOpps) website. Interested businesses prepare their offers in response to the solicitation, and agency personnel evaluate the offers. To be eligible to compete for government contracts, a business must first obtain a Data Universal Numbering System (DUNS) number and register with the System for Award Management (SAM). Many agencies provide assistance and services to potential and existing federal contractors.

Businesses may serve as subcontractors for other businesses awarded federal contracts, known as "prime contractors." Most federal agencies release information on their websites listing prime contractors that have been awarded federal contracts, which serves as a valuable resource for potential subcontractors. Other agencies, including the General Services Administration, Department of

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<sup>1</sup> Enterprise Florida, *Florida Defense Factbook*, January 2013.

<sup>2</sup> Enterprise Florida, *Florida Defense Industry Economic Impact Analysis*; January 2013.

<sup>3</sup> Enterprise Florida, *Defense and Homeland Security*, <http://www.enterpriseflorida.com/industries/defense-homeland-security/> (last accessed on February 27, 2014).

<sup>4</sup> United States Office of Management and Budget, *USASpending.gov*; <http://usaspending.gov/> (last accessed on January 21, 2014).

Homeland Security, and Small Business Administration provide more specific information regarding subcontracting opportunities with prime contractors on their websites.<sup>5</sup>

### Florida Corporate Income Tax

Florida levies corporate income tax on corporations of 5.5% for income earned in Florida.<sup>6</sup> The calculation of Florida corporate income tax starts with a corporation's federal taxable income.<sup>7</sup> After certain addbacks and subtractions to federal taxable income required by chapter 220, F.S., the amount of adjusted federal income attributable to Florida is determined by the application of an apportionment formula.<sup>8</sup> The Florida corporate income tax uses a three-factor apportionment formula consisting of property, payroll, and sales (which is double-weighted) to measure the portion of a multistate corporation's business activities attributable to Florida.<sup>9</sup> Income that is apportioned to Florida using this formula is then subject to the Florida income tax. The first \$50,000 of net income is exempt.<sup>10</sup>

### **Effect of Proposed Changes**

The bill creates s. 288.1046, F.S., the Defense Works in Florida Incentive, which encourages defense contractors receiving federal contracts to select Florida-based small business subcontractors. This incentive provides certified businesses a reduction in their corporate income tax. The bill defines the following terms:

- Florida Prime Contractor – A business entity operating in the state that is awarded a prime contract.
- Florida Small Business Subcontractor – A business entity that maintains its primary place of business in the state, has 250 or fewer employees, is awarded a subcontract from a Florida Prime Contractor, and has no subsidiary or affiliate business relationship to the prime contractor making the award.
- Prime Contract – A contract that is awarded directly from the federal government.
- Qualified Defense Work – A Prime Contract awarded after September 30, 2013, for manufacturing, engineering, construction, distribution, research, development, or other activities related to equipment, supplies, technology, or other goods or services that support national security or space-related activities.
- Qualified Subcontract Award – Qualified Defense Work subcontracted from a Florida Prime Contractor to a Florida Small Business Subcontractor which is executed in the state and meets the requirements of the bill.

The bill allows Florida Prime Contractors awarded a Prime Contract for Qualified Defense Work to reduce its computed adjusted federal income under s. 220.13, F.S., by an amount equal to four percent of any Qualified Subcontract Award it awards a Florida Small Business Subcontractor. To qualify for the incentive, a Florida Prime Contractor must apply to DEO and be certified that it is subject to chapter 220, has been awarded Qualified Defense Work, and has awarded a Qualified Subcontract Award of at least \$250,000. A Florida Prime Contractor may claim the incentive only for taxable years beginning on or after January 1, 2014.

Within 10 days of certifying an application, DEO is required to supply the Florida Prime Contractor with a letter of certification for each certified application, as well as a copy of such letter to DOR. Following certification, a Florida Prime Contractor may claim the incentive by applying separately to DEO for each Qualified Subcontract Award it has made to a Florida Small Business Subcontractor. Each application

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<sup>5</sup> L. Elaine Halchin, Congressional Research Service; *Overview of the Federal Procurement Process and Resources*; September 11, 2012.

<sup>6</sup> Section 220.11, F.S.

<sup>7</sup> Section 220.12, F.S.

<sup>8</sup> Section 220.15, F.S.

<sup>9</sup> Section 220.15, F.S.

<sup>10</sup> Section 220.14, F.S.

should contain documentation including copies of contracts, tax records, or employment records. For a multiyear Qualified Subcontract Award, DEO will certify the full amount of the award in the year it was awarded but the Florida Prime Contractor may only claim the incentive in the taxable year in which payment was made to the Florida Small Business Subcontractor.

DEO is permitted to certify up to \$250 million in aggregate Qualified Subcontract Awards for a single Florida Prime Contractor per tax year, resulting in no more than \$10 million in reduced taxable income and no more than \$550,000 in reduced taxes. The bill also includes a cap of \$2.5 billion in aggregate Qualified Subcontract Awards resulting in no more than \$100 million in reduced taxable income, and no more than \$5.5 million in reduced taxes for all certified applicants in a single tax year.

The bill also amends s. 220.13, F.S., to allow the incentive to be included among the list of adjusted federal income subtractions allowed under current law.

#### B. SECTION DIRECTORY:

Section 1: Creates s. 288.1046, F.S., the Defense Works in Florida Incentive, to provide a reduction in the computation of adjusted federal income as used to determine state corporate income tax liability for businesses receiving federal defense contracts who subcontract with certain Florida-based small businesses.

Section 2: Amends s. 220.13, F.S., to provide a subtraction to adjusted federal taxable income.

Section 3: Provides an effective date of July 1, 2014.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

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

##### 1. Revenues:

The Revenue Estimating Impact Conference met on January 17, 2014, and estimated that this bill would have a negative recurring impact on general revenues of \$3.3 million per year beginning in fiscal year 2014-2015.

##### 2. Expenditures:

None.

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

##### 1. Revenues:

None.

##### 2. Expenditures:

None.

#### C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill may have a positive effect on Florida-based defense industry small business subcontractors.

#### 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 require a reduction of the percentage of state tax shared with municipalities or counties.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

DEO and the DOR may adopt rules to administer this section.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

**IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES**

On February 4, 2014, the House Economic Development & Tourism Subcommittee adopted a strike-all amendment and passed the bill as a CS. The amendment:

- Amends s. 220.13, F.S. to allow the incentive to be included among the list of adjusted federal income subtractions in current law.
- Removes a provision from the bill that prevented work awarded locally by military installations from being included in the definition of “qualified defense work.”
- Adds a requirement to the bill that “qualified subcontract awards” must be at least \$250,000 in order to qualify for the incentive.
- Adds a provision which allows eligible businesses to claim the new incentive for taxable years beginning on or after January 1, 2014.
- Makes technical changes and drafting corrections to the bill.

The analysis has been updated to reflect the amendment.