

**The Florida Senate**  
**BILL ANALYSIS AND FISCAL IMPACT STATEMENT**

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

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Prepared By: The Professional Staff of the Appropriations Subcommittee on Finance and Tax

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BILL: CS/CS/SB 596

INTRODUCER: Appropriations Subcommittee on Finance and Tax; Commerce and Tourism Committee;  
and Senator Evers

SUBJECT: Defense Contracting

DATE: April 3, 2014

REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Siples</u>	<u>Hrdlicka</u>	<u>CM</u>	<u>Fav/CS</u>
2.	<u>Ryon</u>	<u>Ryon</u>	<u>MS</u>	<u>Favorable</u>
3.	<u>Babin</u>	<u>Diez-Arguelles</u>	<u>AFT</u>	<u>Fav/CS</u>
4.	_____	_____	<u>AP</u>	_____

**Please see Section IX. for Additional Information:**

COMMITTEE SUBSTITUTE - Substantial Changes

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**I. Summary:**

CS/CS/SB 596 allows a defense industry contractor to reduce its federal taxable income used in the calculation of Florida corporate tax liability by an amount equal to 4 percent of a subcontract worth more than \$250,000 that is awarded to a Florida small subcontractor with its primary place of business in Florida.

The Revenue Estimating Conference has determined that the bill reduces general revenue by \$3.3 million in Fiscal Year 2014-2015 and future years.

**II. 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>

Defense spending in Florida was directly or indirectly responsible for \$73.4 billion, or 9.4 percent, of gross state product in 2011.<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.<sup>3</sup> Total defense spending also accounts for more than 758,000 jobs around the state.<sup>4</sup>

According to the federal government, 61,075 contracts have been awarded to prime contractors by the DoD and the National Aeronautics and Space Administration from federal fiscal year 2013 through the current federal fiscal year for work done in the State of Florida.<sup>5</sup> Combined, these contracts have a total value of over \$12 billion. There have been over 2,000 subcontracts awarded through those 61,075 contracts, valued at over \$2 billion.<sup>6</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 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 obtain a Data Universal Numbering System number and register with the System for Award Management. Many agencies provide assistance and services to potential and existing federal contractors.

Businesses may also serve as subcontractors for other businesses (known as “prime contractors”) that have been awarded federal contracts. Most federal agencies typically release information on their websites listing prime contractors that have been awarded federal contracts. Other agencies, including the General Services Administration, Department of Homeland Security, and Small Business Administration provide more specific information regarding subcontracting opportunities with prime contractors on their websites.<sup>7</sup>

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<sup>1</sup> Enterprise Florida, Inc. (EFI), *Florida Defense Factbook*, January 2013, available at <http://www.floridadefense.org/documents/HAAS%20Study%202013/Factbook%202013%20FINAL.pdf> (last visited March 27, 2014).

<sup>2</sup> EFI, *Florida Defense Industry Economic Impact Analysis*, January 2013, available at <http://www.floridadefense.org/documents/HAAS%20Study%202013/Impact2013FinalSubmission3.26.13.pdf> (last visited March 27, 2014).

<sup>3</sup> EFI, *Defense and Homeland Security*, available at [http://www.enterpriseflorida.com/wp-content/uploads/MB\\_Homeland\\_Security1.pdf](http://www.enterpriseflorida.com/wp-content/uploads/MB_Homeland_Security1.pdf) (last visited March 27, 2014).

<sup>4</sup> EFI, *Florida Defense Factbook*. Direct employment includes 61,189 military personnel, 24,705 civilian personnel, and 12,449 National Guard personnel.

<sup>5</sup> United States Office of Management and Budget, USASpending.gov (information may be obtained by using search criteria for Department of Defense, prime contracts, performed in Florida, and by fiscal year), available at <http://usaspending.gov/> (last visited March 27, 2014).

<sup>6</sup> United States Office of Management and Budget, USASpending.gov (information may be obtained by using search criteria for Department of Defense, prime contracts, performed in Florida, and by fiscal year), available at <http://usaspending.gov/> (last visited March 27, 2014).

<sup>7</sup> L. Elaine Halchin, Congressional Research Service, *Overview of the Federal Procurement Process and Resources*, September 11, 2012, available at <https://www.fas.org/sgp/crs/misc/RS22536.pdf> (last visited Mar. 27, 2014).

## Corporate Income Tax in Florida

Florida imposes a 5.5 percent income tax on corporations doing business in Florida.<sup>8</sup> The tax is generally referred to as the “corporate income tax” and is imposed on a taxpayer’s “net income.”<sup>9</sup> Net income is determined using the following process:

- Determine the taxpayer’s taxable income on its federal return,
- Make certain statutory adjustments (additions and subtractions),
- Determine Florida’s portion of the taxpayer’s total income (apportionment), and
- Subtract Florida’s statutory exemption, which is currently equal to \$50,000.

A taxpayer’s corporate income tax liability is determined by multiplying the taxpayer’s net income by the applicable tax rate, which is normally 5.5 percent.<sup>10</sup>

Florida provides several incentives that will reduce the amount of corporate income tax owed.<sup>11</sup> Generally, these incentives are granted in the form of tax credits, which are applied after the taxpayer’s corporate income tax liability is determined through the process outlined above. In some instances, Florida grants incentives in the form of alternative apportionment methods.<sup>12</sup>

### III. Effect of Proposed Changes:

**Section 1** creates s. 288.1046, F.S., the Defense Works in Florida Incentive. The incentive allows certain contractors to reduce their adjusted federal taxable income by an amount equal to 4 percent (4 percent subtraction) of the value of subcontracts awarded to certain subcontractors. The subtraction will be taken at the stage in the calculation where the taxpayer makes certain statutory adjustments to the income determined from the federal return.

#### Requirements to Qualify for the 4 percent Subtraction

*Prime Contractor.* The bill requires that the prime contractor be a business entity operating in Florida that is awarded a contract directly from the federal government.

Only contracts that include qualified defense work qualify for the 4 percent subtraction. Qualified defense work means “contracts involving manufacturing, engineering, construction, distribution, research, development, or other activities related to equipment, supplies, technology, or other goods or services that directly or indirectly support the United States Armed Forces or that can be reasonably determined to support national security, including space-related activities.”

*Subcontractor.* The bill requires the subcontractor to have its primary place of business in Florida, have less than or equal to 250 employees at the time the subcontract is made, and have no subsidiary or affiliate relationship to the prime contractor.

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<sup>8</sup> Section 220.11, F.S.

<sup>9</sup> See s. 220.12, F.S.

<sup>10</sup> The tax rate can be 3.3 percent in some limited situations due to the Alternative Minimum Tax.

<sup>11</sup> See generally ss. 220.153 – 220.196, F.S.

<sup>12</sup> See s. 220.153, F.S.

*Subcontract.* The 4 percent subtraction is only available for subcontracts worth more than \$250,000 and that include “qualified defense work,” but excludes subcontracts executed before July 1, 2014.

### **Claiming the 4 Percent Subtraction**

The bill provides that the prime contractor claims the 4 percent subtraction by applying to the Department of Economic Opportunity (DEO). The prime contractor may claim more than one qualified subcontract; however, each subcontract requires a separate application. The bill authorizes the DEO to establish processes for application approval, appeal and accountability, as necessary. The DEO is also authorized to consult with Enterprise Florida, Inc., and the Florida Defense Support Task Force.

Within 10 days of certification, the DEO must provide a letter certification to the applicant and a copy of the letter to the Department of Revenue. For multi-year contracts, the DEO shall certify the full amount of the award in the calendar year the contract was awarded and the Florida prime contractor may claim the incentive in the taxable year in which the payment is made to the Florida small business subcontractor.

The bill allows the prime contractor to claim the 4 percent subtraction in the taxable years in which payments are made to the subcontractor.

### **Limitations on Certifications by DEO**

The bill limits each prime contractor to \$250 million in aggregate awards.

The maximum amount of certifications the DEO may certify in a calendar year for all contractors is \$2.5 billion in aggregate awards.

**Section 2** amends s. 220.13(b)(1), F.S., to include the 4 percent subtraction as an allowable subtraction in the computation of adjusted federal income used in the calculation of Florida corporate tax liability.

**Section 3** provides an effective date of July 1, 2014.

## **IV. Constitutional Issues:**

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

**V. Fiscal Impact Statement:**

A. Tax/Fee Issues:

The Revenue Estimating Conference has determined that CS/CS/SB 596 will reduce General Revenue Fund receipts by \$3.3 million in Fiscal Year 2014-2015 and future years.<sup>13</sup>

B. Private Sector Impact:

The bill may have a positive fiscal impact on defense industry prime contractors that will be able to reduce corporate tax liability and may encourage Florida prime contractors to award subcontracts to small businesses within Florida.

C. Government Sector Impact:

The DEO indicates that the fiscal impact on the department is insignificant and any administrative costs will be absorbed by the DEO.<sup>14</sup>

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**VIII. Statutes Affected:**

This bill substantially amends section 220.13 of the Florida Statutes.

This bill creates section 288.1046 of the Florida Statutes.

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<sup>13</sup> Revenue Estimating Conference Impact Conference Results from January 17, 2014, available at <http://edr.state.fl.us/Content/conferences/revenueimpact/archives/2014/pdf/Impact0117.pdf> (last visited March 27, 2014).

<sup>14</sup> DEO, *2014 Agency Legislative Bill Analysis, Senate Bill 596*, (Jan. 15, 2014) (on file with Senate Commerce and Tourism Committee).

**IX. Additional Information:**

- A. **Committee Substitute – Statement of Substantial Changes:**  
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

**Recommended CS/CS by Appropriations Subcommittee on Finance and Tax  
Finance and Tax on April 2, 2014:**

The CS/CS:

- Removes the limitation that the program only applies to contracts awarded on or after October 1, 2013, and inserts a limitation that the program only applies to subcontracts executed on or after July 1, 2014.
- Inserts a requirement that the prime contractor may only take a 4 percent subtraction in the taxable year that the prime contractor makes a payment to the subcontractor.
- Replaces the term “subcontract award” with the defined term “qualified subcontract award.”
- Removes unnecessary language regarding the effects of the limitations on awards by DEO.

**CS by Commerce and Tourism on March 3, 2014:**

The CS:

- Clarifies that a “Florida small business contractor” must have 250 employees or less at the time the subcontract award is made to qualify for the incentive.
- Removes a provision that prevented work awarded locally by military institutions from being included in the definition of “qualified defense work.”
- Adds a requirement that “qualified subcontract award” must be valued at more than \$250,000 to qualify for the incentive.
- Requires the DEO, within 10 days of certification, to provide a letter certifying a qualified subcontract award to the applicant and to the DOR.
- Allows eligible businesses to claim the incentive for taxable years beginning on or after January 1, 2014.
- Makes technical changes recommended by the DOR, including changing the term “taxable year” or “tax year” to “calendar year,” as needed.
- Amends s. 220.13, F.S., to include the incentive created by this bill as an allowable subtraction in the computation of the adjusted federal income.

- B. **Amendments:**

None.