

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 529 Defense Contracting
SPONSOR(S): Smith
TIED BILLS: **IDEN./SIM. BILLS:** SB 980

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Economic Development & Tourism Subcommittee	11 Y, 0 N	Collins	Duncan
2) Finance & Tax Committee			
3) Economic Affairs Committee			

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 February 18, 2015, and estimated that the bill would have a negative impact on general revenues of \$5.5 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, 2015.

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.¹

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.² 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.³

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 Homeland Security, and Small Business Administration provide more specific information regarding subcontracting opportunities with prime contractors on their websites.⁴

Federal Contracts Awarded in Florida

According to the federal government, 168,312 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 projects located in Florida. Combined, these contracts have a total value of more than \$35.5 billion.

There have been 7,062 subcontracts awarded through those 168,312 prime contracts, valued at more than \$8.3 billion. Of those, 6,013 subcontracts, valued at over \$7 billion, have been awarded to

¹ Enterprise Florida, *Florida Defense Factbook*, January 2013; can be found at: <http://www.enterpriseflorida.com/wp-content/uploads/Factbook-20133.pdf>; (last accessed on Mar. 5, 2015)

² Enterprise Florida, *Florida Defense Industry Economic Impact Analysis*; January 2013; can be found at: <http://www.enterpriseflorida.com/wp-content/uploads/Haas-Study-20131.pdf>; (last accessed on Mar. 5, 2015)

³ Enterprise Florida, *Defense and Homeland Security*, <http://www.enterpriseflorida.com/industries/defense-homeland-security/> (last accessed on Mar. 3, 2015).

⁴ L. Elaine Halchin, Congressional Research Service; *Overview of the Federal Procurement Process and Resources*; September 11, 2012.

businesses located in Florida, which accounts for 85.1% percent of all subcontracts awarded by prime contractors who have received federal contracts for work to be done in Florida by DOD and NASA.⁵

Florida Corporate Income Tax

Florida levies corporate income tax on corporations of 5.5% for income earned in Florida.⁶ The calculation of Florida corporate income tax starts with a corporation's federal taxable income.⁷ 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.⁸ 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.⁹ 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.¹⁰

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 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 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 valued at more than \$250,000. The term does not include subcontracts executed before July 1, 2015.

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 grants a Florida small business subcontractor divided by the apportionment factor described in s. 220.15, F.S.

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, 2016.

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 should contain documentation including copies of contracts, tax records, or employment records. For a

⁵ United States Office of Management and Budget, *USASpending.gov*; <http://usaspending.gov/> (last accessed on Mar. 5, 2015).

⁶ Section 220.11, F.S.

⁷ Section 220.12, F.S.

⁸ See s. 220.15, F.S.

⁹ Section 220.15, F.S.

¹⁰ Section 220.14, F.S.

multiyear qualified subcontract award, DEO must certify the full amount of the award in the year it was awarded; however, 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, and no more than \$2.5 billion in aggregate qualified subcontract awards for all applicants.

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.

DEO is authorized to establish application, approval, and accountability processes. Additionally, DEO may consult Enterprise Florida, Inc., and the Florida Defense Support Task Force to administer this incentive program.

B. SECTION DIRECTORY:

Section 1: Creates s. 288.1046, F.S., establishing the Defense Works in Florida Incentive.

Section 2: Amends s. 220.13, F.S., relating to adjusted federal income.

Section 3: Provides an effective date of July 1, 2015.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

See FISCAL COMMENTS.

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 impact on certain defense contractors who apply for and receive the incentive.

D. FISCAL COMMENTS:

The Revenue Estimating Conference met on February 18, 2015, and determined that, based on 2012 tax return information there is enough activity to have an impact of at least \$2.2 million annually. The bill provides for a cap of \$5.5 million annually which, based on the cap for total qualified subcontract awards, is the maximum amount that may be awarded through the program.¹¹

¹¹ Florida Legislature, Office of Economic & Demographic Research, Revenue Estimating Conference, Impact Conference, 2/20/15 *Revenue Impact Results*, <http://edr.state.fl.us/Content/conferences/revenueimpact/archives/2015/pdf/impact0220.pdf>.

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 DOR may adopt rules to administer this program.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES