

**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 Committee on Finance and Tax

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BILL: CS/CS/SB 980

INTRODUCER: Finance and Tax Committee; Commerce and Tourism Committee; and Senator Soto

SUBJECT: Defense Contracting

DATE: March 31, 2015

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

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Siples</u>	<u>McKay</u>	<u>CM</u>	<b>Fav/CS</b>
2.	<u>Babin</u>	<u>Diez-Arguelles</u>	<u>FT</u>	<b>Fav/CS</b>
3.	_____	_____	<u>AP</u>	_____

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

COMMITTEE SUBSTITUTE - Substantial Changes

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**I. Summary:**

CS/CS/SB 980 authorizes a defense industry prime contractor to reduce its net income subject to tax in Florida by an amount equal to four percent of payments made under certain subcontracts awarded to a Florida small business subcontractor. Each prime contractor is limited to \$125 million in subcontract awards per calendar year and the entire program is limited to \$1.25 billion in subcontract awards per calendar year.

The Revenue Estimating Conference has not reviewed the impact of the bill. Staff estimates that the bill will reduce General Revenue receipts by \$2.25 million annually.

The bill is effective July 1, 2015.

**II. Present Situation:**

**Florida's Defense Industry**

Florida is home to three of 10 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 repositioning 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 fifth 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, 61,597 contracts have been awarded to prime contractors by the DoD and the National Aeronautics and Space Administration for work done in the State of Florida for federal fiscal years 2014 and 2015.<sup>5</sup> Combined, these contracts have a total value of approximately \$11.8 billion. There have been almost 2,600 subcontracts awarded through those 61,597 contracts, valued at more than \$1.8 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*, (Jan. 2013) available at <http://www.enterpriseflorida.com/wp-content/uploads/Factbook-20133.pdf> (last visited Mar. 24, 2015).

<sup>2</sup> EFI, *Florida Defense Industry Economic Impact Analysis* (Jan. 2013) available at <http://www.enterpriseflorida.com/wp-content/uploads/Haas-Study-20131.pdf> (last visited Mar. 24, 2015).

<sup>3</sup> EFI, *Defense and Homeland Security*, available at <http://www.enterpriseflorida.com/wp-content/uploads/brief-defense-homeland-security-florida.pdf> (last visited Mar. 24, 2015).

<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 and National Aerospace and Space Administration, prime contracts, performed in Florida, and by fiscal years 2014 and 2015), available at <http://usaspending.gov/> (last visited Mar. 24, 2015). Results change daily as new contracts are added.

<sup>6</sup> United States Office of Management and Budget, USASpending.gov (information may be obtained by using search criteria for Department of Defense, subaward contracts, performed in Florida, and by fiscal years 2014 and 2015), available at <http://usaspending.gov/> (last visited Mar. 24, 2015). Results change daily as new contracts are added.

<sup>7</sup> L. Elaine Halchin, Congressional Research Service, *Overview of the Federal Procurement Process and Resources*, (Sept. 11, 2012) available at <https://www.fas.org/sgp/crs/misc/RS22536.pdf> (last visited Mar. 24, 2015).

## 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 by 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 \$50,000.

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

Florida provides several incentives that 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 net income by an amount equal to four percent of the value of subcontracts awarded to certain subcontractors.

#### Requirements to Qualify for the Defense Works in Florida Incentive

##### *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 incentive. Qualified defense work is defined as a contract 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 250 employees or fewer at the time the subcontract is awarded, 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. Section 220.11(3), F.S.

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

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

***Subcontract***

The incentive is only available for subcontracts for “qualified defense work” worth more than \$250,000 and executed after July 1, 2015.

**Claiming the Defense Work in Florida Incentive**

The bill provides that the prime contractor may claim the incentive 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 of certification to the applicant and a copy of the letter to the Department of Revenue. For multi-year contracts, the DEO must 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 incentive in the taxable years beginning on or after January 1, 2016. The prime contractor can take the subtraction in the taxable years in which payments are made to the subcontractor.

**Limitations on Certifications by the DEO**

The bill limits each prime contractor to \$125 million in aggregate awards.

The maximum amount of certifications the DEO may certify in a calendar year for all contractors is \$1.25 billion in aggregate awards.

**Section 2** amends s. 220.13(b)(1), F.S., to include the four 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, 2015.

**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 not reviewed the impact of this bill. Staff estimates that the bill will reduce General Revenue Fund receipts by \$2.25 million in Fiscal Year 2015-2016 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 Department of Revenue indicates that there will be an insignificant fiscal impact.<sup>14</sup>

VI. **Technical Deficiencies:**

None.

VII. **Related Issues:**

The bill grants rulemaking authority to the DEO and the Department of Revenue to administer the provisions of the bill.

VIII. **Statutes Affected:**

This bill substantially amends section 220.13 of the Florida Statutes.

This bill creates section 288.1046 of the Florida Statutes.

IX. **Additional Information:**

A. Committee Substitute – Statement of Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

**CS/CS by Finance and Tax on March 30, 2015:**

- Reduces the limit of each prime contractors' qualifying subcontract awards from \$250 million to \$125 million per year.

<sup>13</sup> Revenue Estimating Conference Impact Conference Results, *House Bill 529* (Feb. 18, 2015) available at [http://edr.state.fl.us/content/conferences/revenueimpact/archives/2015/\\_pdf/impact0220.pdf](http://edr.state.fl.us/content/conferences/revenueimpact/archives/2015/_pdf/impact0220.pdf) (last visited Mar. 24, 2015).

<sup>14</sup> Florida Department of Revenue, *Senate Bill 980 Fiscal Analysis* (Mar. 2, 2015) (on file with the Senate Committee on Commerce and Tourism).

- Reduces the total amount of annual subcontract awards under the program from \$2.5 billion to \$1.25 billion per year.

**CS by Commerce and Tourism on March 16, 2015:**

Clarifies that in the computation of the adjusted federal income for Florida corporate tax purposes, the subtraction of the four percent of a certified qualified subcontract award is to be divided by the apportionment factor.

**B. Amendments:**

None.