

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

BILL: CS/SB 2934

SPONSOR: Commerce, Economic Opportunities, and Consumer Services Committee and Senator Fasano

SUBJECT: Tax on Sales, Use, and Other Transactions

DATE: April 1, 2004 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Kruse	Maclure	CM	Favorable/CS
2.	_____	_____	ED	_____
3.	_____	_____	FT	_____
4.	_____	_____	AGG	_____
5.	_____	_____	AP	_____
6.	_____	_____	_____	_____

I. Summary:

The committee substitute exempts from sales and use tax, if used predominantly for research and development activities, machinery and equipment including molds, dies, machine tooling, and other appurtenances or accessories to machinery and equipment, testing equipment, test beds, computers, and software, whether purchased or self-fabricated, and, if self-fabricated, materials and labor for design, fabrication, and assembly.

The committee substitute authorizes a business to designate one or more state universities or community colleges as recipients of up to 100 percent of the amount of the exemption for which the business may qualify. For a university or community college to receive the amount of the exemption, the institution must provide a match of the funds in cash, programs, services, or other in-kind support on a one-to-one basis for research or development activities upon the request of a business. All rights to patents, royalties, or real or intellectual property will be vested in the business unless otherwise agreed to by the business and the university or community college.

The committee substitute establishes a scheduled phase-in of the exemption. Beginning July 1, 2004, the tax imposed will be applicable to 80 percent of the cost of the machinery and equipment used predominantly for research and development. Over the next three years, the schedule lowers the tax to 60 percent, 40 percent, and 20 percent, respectively, and then completely exempts machinery and equipment used predominantly for research and development beginning July 1, 2008.

This committee substitute substantially amends section 212.052, Florida Statutes.

II. Present Situation:

Research and Development Spending

Florida

According to the National Science Foundation, industry spending in Florida on research and development in 2000 was \$3.2 billion dollars.¹ The average amount of industry spending in Florida on research and development between 1987 and 2000 was \$2.9 billion, with an annual growth rate of 3.2 percent.²

National

A recent brief issued by the National Science Foundation's Science Resource Statistics (SRS) division reported that:

U.S. research and development (R&D) increased by 1 percent between 2002 and 2003 after controlling for inflation. Since 2000, there has been little change in total U.S. R&D in real terms (constant or inflation-adjusted dollars). After adjusting for inflation, total R&D increased 1 percent between 2000 and 2001 and declined a marginal amount between 2001 and 2002. ... Nominal total 2003 R&D performance (current-year dollars) in the United States is projected at \$283.8 billion, up from an estimated \$276.4 billion in 2002 and \$274.2 billion in 2001. The preliminary data and projections continue a trend toward rising total R&D expenditures despite the decline in 2002 of industrial R&D, which historically has fueled growth in total R&D. The business activities of many R&D-performing firms were curtailed following the stock market decline and concurrent economic slowdown of 2001 and 2002. The same sectors that saw impressive increases in the late 1990s (e.g., telecommunications and computer and electronic products) were among those that experienced declines in sales, share prices, and R&D investment in 2001 and 2002. Industrial R&D has declined only two other times in the past 50 years—in 1970 and 1993. Such economic indicators as gross domestic investment in equipment and software suggest, however, that industrial R&D grew modestly in 2003.³

Research and Development Taxation

Section 212.052, F.S., provides for certain sales and use tax exemptions for research or development activities. 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.

¹ National Science Foundation, *State distribution of expenditures for R&D, by performing sector and source of funding: 2000* (Table 7B), available at, <http://www.nsf.gov/sbe/srs/nsf03313/pdf/tab7b.pdf> (last visited March 26, 2004).

² Office of Economic and Demographic Research, Revenue Impact Conference, March 26, 2004, analysis of SB 2934 (Machinery & Equipment, R&D activities), available at http://www.state.fl.us/edr/conferences/revenueimpact/Impact_pdf/2004/page177-178.pdf (last visited March 28, 2004).

³ National Science Foundation, Science Resource Statistics, *U.S. R&D Projected to Have Grown Marginally in 2003*, 1 (February 2004), available at <http://www.nsf.gov/sbe/srs/infbrief/nsf04307/nsf04307.pdf> (last visited March 26, 2004).

- 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.

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 promotion, management studies, or research in connection with literary, historical, social science, psychological, or other similar non-technical activities.

Section 212.052(2), F.S., provides that any person who manufactures, produces, compounds, processes, or fabricates tangible personal property for the taxpayer's own use directly and solely in research or development is not subject to the tax imposed by ch. 212, F.S., upon the cost of the manufactured, produced, compounded, processed, or fabricated product. However, the tax imposed by ch. 212, F.S., at the time of purchase or rental, is due on the purchase, rental, or repair of real property or tangible personal property employed in research or development.

Section 212.052(4), F.S., provides for a penalty of the payment of taxes due, together with penalties set forth in s. 212.085, F.S., for a person or affiliated group who makes a fraudulent claim under s. 212.052, F.S. Subsection (5) requires the Department of Revenue to promulgate rules governing the implementation of s. 212.052, F.S.

Section 212.08(5)(j), F.S., provides, among other things, that machinery and equipment may be exempt from 25 percent of the sales and use tax if it is used predominately in defense or space research and development activities in a defense or space technology research and development facility. This paragraph also provides for an exemption from sales and use tax for industrial machinery and equipment used in semiconductor technology facilities to manufacture, process, compound, or produce semiconductor technology products for sale or use by the company. Such machinery and equipment must be used predominantly in semiconductor wafer research and development activities. A business certified to receive the exemption under this paragraph may elect to designate one or more state universities or community colleges as recipients of up to 100 percent of the amount of the exemption for which they may qualify. "To receive these funds, the institution must agree to match the funds so earned with equivalent cash, programs, services, or other in-kind support on a one-to-one basis in the pursuit of research and development projects as requested by the certified business. The rights to any patents, royalties, or real or intellectual property must be vested in the business unless otherwise agreed to by the business and the university or community college."⁴

⁴ Section 212.08(5)(j)8., F.S.

Other States' Research and Development Tax Exemptions

According to Enterprise Florida, Inc. (EFI), which has overall responsibility for the retention and recruitment of businesses to the state, there are other states that exempt or substantially discount taxes on machinery and equipment used for research and development activities. In addition, some states have other types of tax policies related to research and development.

California has a research and development tax credit that is available to taxpayers under both the personal income tax and the corporation tax. To meet eligibility requirements, research activities must be related to the development of information which is technological in nature, intended for application to the development of a new or improved business product of the taxpayer, and performed in the state of California. Expenses associated with research activity must be for employee compensation directly related to research activities, certain contract expenses paid to non-employees under contract for research activities, and the costs of non-depreciated personal tangible property used to conduct research. The tax credit amount is equal to 15 percent of the excess of qualified research and development expenditures during the current year over the calculated base amount, which is calculated using the average annual gross receipts for the previous three years multiplied by a base-period percentage (13.6 percent in California). There are 31 other states that have research and development tax credits. Of those 31 states, all but Hawaii calculate the credit in the same manner as California.⁵

III. Effect of Proposed Changes:

The committee substitute exempts from sales and use taxation, if used predominantly for research or development, machinery and equipment including molds, dies, machine tooling, and other accessories to machinery and equipment, testing equipment, test beds, computers, and software, whether purchased or self-fabricated, and, if self-fabricated, materials and labor for design, fabrication, and assembly.

The committee substitute provides a business authorized to receive the exemption the option to designate one or more state universities or community colleges as recipients of up to 100 percent of the amount of the exemption for which the business may qualify. For a university or community college to receive the amount of the exemption, the institution must provide a match of the funds in cash, programs, services, or other in-kind support on a one-to-one basis in the pursuit of research and development projects as requested by the certified business. All rights to patents, royalties, or real or intellectual property will be vested in the business unless otherwise agreed to by the business and the university or community college.

The committee substitute establishes a scheduled phase-in of the sales and use tax exemption. Beginning July 1, 2004, the tax imposed will be applicable to 80 percent of the cost of the machinery and equipment used predominantly for research and development. Over the next three years, the schedule lowers the tax to 60 percent, 40 percent, and 20 percent, respectively, and then completely exempts machinery and equipment used predominantly for research and development beginning July 1, 2008.

⁵ Legislative Analyst's Office (California's Nonpartisan Fiscal and Policy Advisor), *An Overview of California's Research and Development Tax Credit* (November 2003), available at <http://www.lao.ca.gov/2003/randd%5Fcredit/113003%5Fresearch%5Fdevelopment.html> (last visited March 24, 2004).

The committee substitute takes effect July 1, 2004.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

This committee substitute appears to initially fall under subsection (b) of s. 18, Art. VII, of the State Constitution. Subsection (b) requires a two-thirds vote of the membership of each house of the Legislature in order to enact a general law reducing the authority that municipalities and counties had on February 1, 1989, to raise revenues in the aggregate. By providing a sales and use tax exemption for industrial machinery and equipment purchased for use predominantly in research and development activities, this committee substitute has the effect of creating an exemption to the local option county sales surtax. In this manner, the committee substitute reduces revenue-raising authority for those counties that may have had authority for local option sales surtaxes on February 1, 1989. If the exemption were fully implemented, local revenue loss associated with the local option sales tax for all counties is estimated to be approximately \$1.7 million for fiscal year 2004-2005, and would be an amount less than that for those counties that may have had the requisite authority in 1989. However, the committee substitute uses a percentage phase-in which is anticipated to have a lower fiscal impact. Therefore, the committee substitute appears to be exempt from the requirements of subsection (b) due to the insignificant negative fiscal impact as permitted under subsection (d) of s. 18, Art. VII, State Constitution.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

On March 26, 2004, the Revenue Impact Conference (RIC) found that the original bill, which provided for a full tax exemption effective July 1, 2004, would have a total impact on state and local revenue of \$32.5 million, on cash and recurring funds.⁶ (See chart below.)

⁶ Office of Economic and Demographic Research, Revenue Impact Conference, March 26, 2004, analysis of SB 2934 (Machinery & Equipment, R&D activities), *available at* http://www.state.fl.us/edr/conferences/revenueimpact/Impact_pdf/2004/page177-178.pdf (last visited March 26, 2004).

Issue/Fund	<u>Fiscal Year 2004-2005</u>							
	General Revenue		Trust		Local		Total	
	Cash	Recurring	Cash	Recurring	Cash	Recurring	Cash	Recurring
SB 2934	\$ (27.3)	\$ (27.3)	\$ (0.1)	\$ (0.1)	\$ (5.1)	\$ (5.1)	\$ (32.5)	\$ (32.5)

The committee substitute, however, provides a scheduled, multi-year phase-in of the tax exemption. (See **Effect of Proposed Changes** discussion, above.) The RIC has not reviewed the fiscal impact the scheduled phase-in may have on state and local revenue.

The extent to which a business may avail itself of the exemption created by the committee substitute depends upon the ability of a business to devote financial resources toward research and development, which in turn depends on how the economy is performing at the time the business is considering a decision to invest in research and development. (See **Present Situation** discussion, above.)

B. Private Sector Impact:

Beginning July 1, 2004, a business will pay a progressively reduced rate of sales and use tax on machinery or equipment purchased predominantly for research and development until 2008 when the tax is completely removed. (See **Effect of Proposed Changes** discussion, above.)

C. Government Sector Impact:

The Department of Revenue may need to promulgate additional administrative rules to implement the committee substitute. Section 212.052(5), F.S., provides the department with authorization to promulgate rules governing the implementation and operation of the section amended by the committee substitute.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Amendments:

None.