

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.)

Prepared By: Commerce and Consumer Services Committee

BILL: CS/SB 2362

SPONSOR: Commerce and Consumer Services Committee and Senators Smith and Fasano

SUBJECT: Research and Development Costs

DATE: March 31, 2005

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Barrett	Cooper	CM	Fav/CS
2.	_____	_____	ED	_____
3.	_____	_____	GE	_____
4.	_____	_____	WM	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

This committee substitute exempts machinery and equipment used predominately for research and development from sales and use tax.

In addition, businesses receiving the exemption may designate one or more state universities or community colleges as recipients of up to 100 percent of the exemption amount for which the business may qualify. In order to receive the funds, the state university or community college must match the funds and use them for research and development. Funds from the Trust Fund for University Major Gifts may be used as matching funds for donations of exemption proceeds. 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 state university or community college.

Finally, the Office of Program, Policy, and Government Accountability and Enterprise Florida, Inc., are required to evaluate the impact of the exemption and recommend to the Governor and Legislature whether or not the exemption should be re-enacted.

This committee substitute substantially amends sections 212.052, 212.08, and 1011.94 of the Florida Statutes.

II. Present Situation:

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.
- 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 their own use for research or development is exempt from sales and use tax imposed on the cost of the manufactured, produced, compounded, processed, or fabricated product. Subsection (3) provides that the sales and use tax exemption does not apply to any product of research or development used in the ordinary course of business, or that is offered for sale.

Section 212.052(4), F.S., provides for penalty of a person or affiliated group who makes a fraudulent claim under s. 212.052, F.S.

Section 212.08(5)(j), F.S., provides 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 all sales and use tax for industrial machinery and equipment used in semiconductor technology facilities that is used predominantly in semiconductor wafer research and development activities.

Section 212.08(5)(j)8., F.S., provides that 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 the funds, the state university or community college must match the funds and use them for research and development.

Trust Fund for University Major Gifts

In 2002, the Legislature created the Trust Fund for University Major Gifts to provide donors with an incentive in the form of matching grants for donations for the establishment of permanent endowments.¹ These funds may also be used as incentives for sales tax exemption matching funds received by colleges and universities under s. 212.08(5)(j)8., F.S., which is the exemption

¹ Section 1011.94, F.S.

for machinery and equipment used in semiconductor, defense, or space technology productions and research and development.

The funds must be invested, with the proceeds of the investment used to support libraries and instruction and research programs as defined by the State Board of Education. The matches are subject to appropriation.

According to the Division of Colleges and Universities, the matching gift program has established more than 2,300 permanent endowments worth \$1.24 billion from 1979 through 2004²

Prior to 2004, a significant waiting list was established as eligible donations exceeded legislative appropriations. In 2004, the Legislature appropriated \$94.8 million to match all gifts through December 1, 2003. According to the Department of Education, there is more than \$43.6 million in new requests for state matching funds as of January 10, 2005.

The State Board of Education is required to specify the process for submission, documentation, allocation, and approval of requests for matching funds.

III. Effect of Proposed Changes:

Section 1 amends s. 212.052, F.S., to delete an exception to the sales tax exemption for research and development costs. Currently, tangible personal property purchased and used for research and development is subject to sales tax. This change will allow certain tangible personal property used predominately for research and development to become exempt from sales tax as provided in **Section 2** of this committee substitute.

Section 2 creates s. 212.08 (18), F.S., to exempt from sales and use tax machinery and equipment used predominately for research and development activities.

The term “predominately” is defined to mean at least 50 percent of the time. The term “machinery and equipment,” as it relates to research and development costs, is defined as:

“molds, dies, machine tooling, other appurtenances or accessories to machinery and equipment, testing and measuring equipment, test beds, computers, and software, whether purchased or self-fabricated, and, if self fabricated, includes materials and labor for design, fabrication, and assembly.”

The Department of Revenue is authorized to adopt rules to administer this exemption. To receive the exemption, the purchaser must provide specific documentation. This section also provides for punishment for fraudulent claims.

A business receiving this exemption may designate one or more state universities or community colleges to receive up to 100 percent of the exemption amount. In order to receive the funds, the

² Education Policy and Research, Division of Colleges and Universities, *Information Brief*, Vol. 2, Issue 2, January 27, 2005.

state university or community college must agree to match the funds in cash, programs, services, or other in-kind support on a dollar for dollar basis for research and development activities upon the request of the business. Unless the business and state university or community college agree otherwise, the business has the rights to any patents, royalties, or real or intellectual property.

This section requires that the exemption be reviewed by the Legislature by July 1, 2015. The Office of Program, Policy, and Government Accountability and Enterprise Florida, Inc., are required to evaluate the impact of the exemption and recommend to the Governor and Legislature whether or not the exemption should be re-enacted.

Section 3 amends s. 1011.94 (1), F.S., to authorize that funds from the Trust Fund for University Major Gifts be used as matching funds for donations of exemption proceeds, pursuant to s. 212.08 (18) (a), F.S., (as created in Section 2 of this committee substitute), to state universities and community colleges.

Section 4 provides an effective date of July 1, 2005.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

Subsection (b) of s. 18, Art. VII, State Constitution, provides that except upon approval of each house of the Legislature by two-thirds vote of the membership, the legislature may not enact, amend or repeal any general law if the anticipated effect of doing so would be to reduce the authority that municipalities or counties have to raise revenue in the aggregate, as such authority exists on February 1, 1989.

By creating a sales tax exemption for machinery and equipment used predominately for research and development, the committee substitute reduces the municipalities' and counties' sales tax base, thereby reducing their revenue-raising authority. The fiscal impact of the committee substitute on counties and municipalities is an estimated \$6.1 million in FY 2005-2006. (See Tax/Fee Issues) Therefore, the measure will require a two-thirds vote of the membership of each house of the Legislature.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

On February 4, 2005, the Revenue Estimating Conference adopted estimates for the fiscal impact of this committee substitute. It is estimated the state will lose \$39.9 million in sales tax revenue per fiscal year as a result of this exemption. See the table below for a more detailed explanation of the impact.

Fiscal Impact (millions of dollars)		
	Cash	Recurring
State Impact	(29.4)	(33.3)
Local Impact	(6.1)	(6.9)
Total Impact	(35.5)	(39.9)

B. Private Sector Impact:

Businesses that purchase machinery and equipment that is used predominately for research and development will not be subject to sales tax on purchases of such equipment.

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

The Department of Revenue states that within the definition for machinery and equipment, reference is made to “other appurtenances or accessories to machinery and equipment,” which can prove difficult to administer without guidance on the meaning of such language.

VII. Related Issues:

None.

VIII. Summary of Amendments:

None.

This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.
