

# 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.)

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Prepared By: Education Committee

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BILL: CS/CS/SB 2362

SPONSOR: Education Committee, Commerce and Consumer Services Committee, and Senator Smith

SUBJECT: Research and Development Costs/Tax Exemptions and State Matching

DATE: April 21, 2005

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

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Barrett</u>	<u>Cooper</u>	<u>CM</u>	<u>Fav/CS</u>
2.	<u>Matthews</u>	<u>O'Farrell</u>	<u>ED</u>	<u>Fav/CS</u>
3.	_____	_____	<u>GE</u>	_____
4.	_____	_____	<u>WM</u>	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

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## I. Summary:

This bill exempts certain machinery and equipment used predominately for research and development from the sales and use tax.

In addition, a business 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 semiconductor account located within 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 reenacted.

This bill substantially amends sections 212.052 and 212.08 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; or
- 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 a penalty for any 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

The Trust Fund for University Major Gifts provides donors with an incentive in the form of matching grants for donations for the establishment of permanent endowments.<sup>1</sup> The trust fund is composed of several different accounts including the challenge grant account and an account for semiconductor matches. The funds may be used to match certain eligible donations made to state universities. The 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 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 board is required to specify the process for submission, documentation, allocation, and approval of requests for matching funds. 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 2004<sup>2</sup>

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. There are currently no funds in the challenge grant account of the trust fund; instead, the Legislature is funding matches directly through the General Appropriations Act based on the list of eligible donations provided by the State Board of Education. However, there is approximately \$5.7 million remaining in the semiconductor account in the trust fund. Given the state of the semiconductor companies, it may be unrealistic to expect that these semiconductor companies may be engaging in any research that would draw down the \$5.7 million at any time in the near future.

### 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 bill.

**Section 2** amends s. 212.08(5)(j), F.S., to exempt from the sales and use tax machinery and equipment used predominately for research and development activities. The bill eliminates prescriptive application procedures and requires certification by the Office of Tourism, Trade, and Economic Development for claiming an exemption on certain industrial machinery and equipment used in semiconductor, defense, or space technology facilities. To receive the

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<sup>1</sup> Section 1011.94, F.S.

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

exemption, the vendor or purchaser claiming the exemption must provide specific documentation. This section also provides for punishment for fraudulent claims. The Department of Revenue may adopt rules to administer the exemption. The definition of research and development for purposes of the exemption is revised to eliminate certain limitations on the claimed exemption such as routine product testing or market research.

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 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. By revising the exemption in s. 212.08(5)(j), F.S., the pledge may be matched from the \$5.7 million currently held in the semiconductor match account located in the Trust Fund for University Major Gifts. 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 produced as a result of the gift or pledge.

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 reenacted. In fact, Enterprise Florida, Inc., is authorized to contract with an independent research organization to conduct an assessment of the impact of the sales tax exemption on research and development.

**Section 3** 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 bill reduces the municipalities' and counties' sales tax base, thereby reducing their revenue-raising authority. The fiscal impact of the bill on counties and municipalities is an estimated \$6.1 million in FY 2005-2006. Therefore, the measure would require a two-thirds vote of the membership of each house of the Legislature.

In addition, pursuant to Senate Rule 4.8, any bill which is affected by the provisions of section 18, Article VII, of the State Constitution must be reviewed by the Committee on Community Affairs. Accordingly, this bill should be referred to the appropriate committee prior to passage unless the rule is waived.

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 bill. 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. In addition, these businesses may be encouraged to share or entrust research to the state universities and community colleges because of the match from the state.

C. Government Sector Impact:

The bill, in effect, requires the state to completely fund the match. General Revenue would be hit twice for funds, initially with the sales tax exemption and at the end with the state match.

There may be a positive fiscal impact at the state universities and community colleges who share research responsibilities with an eligible company. This positive impact could be mitigated, however, if any patents or royalties from the patents arising from the research remains with the business and not the state university or community college.

Finally, the bill authorizes Enterprise, Florida, Inc., to contract with an independent research organization. The costs associated with such a contract are indeterminate at this time. However, since the bill requires OPPAGA to also conduct an assessment, the need for the contract with another research entity is not readily apparent.

**VI. Technical Deficiencies:**

The Department of Revenue has indicated that the reference within the definition for machinery and equipment to “other appurtenances or accessories to machinery and equipment,” is ambiguous and may prove difficult to administer without guidance on the meaning from the Legislature.

**VII. Related Issues:**

None.

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

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## **VIII. Summary of Amendments:**

None.

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