HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 391 Exemptions from Tax On Sales, Use, & Other Transactions
SPONSOR(S): Magar and others
TIED BILLS: **IDEN./SIM. BILLS:** CS/SB 518

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Economic Development & Tourism Subcommittee		Tecler	West
2) Finance & Tax Subcommittee			
3) Economic Affairs Committee			

SUMMARY ANALYSIS

In order to encourage capital investment and new job opportunities in Florida's manufacturing sector, HB 391 streamlines industrial machinery and equipment sales or use tax exemptions provided under current law. Specifically, the bill expands eligibility for these exemptions by removing productive output requirements related to machinery and equipment purchased and used to manufacture items for sale or to meet the production quota of a federal procurement contact. Taken together, the provisions of this bill may reduce the tax burden of manufacturers expanding operations and upgrading machinery and equipment within this state.

The Revenue Estimating Conference has not yet scored the provisions of HB 391. However, the bill may have a recurring negative impact on state revenue and local government.

The bill provides an effective date of upon becoming a law.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

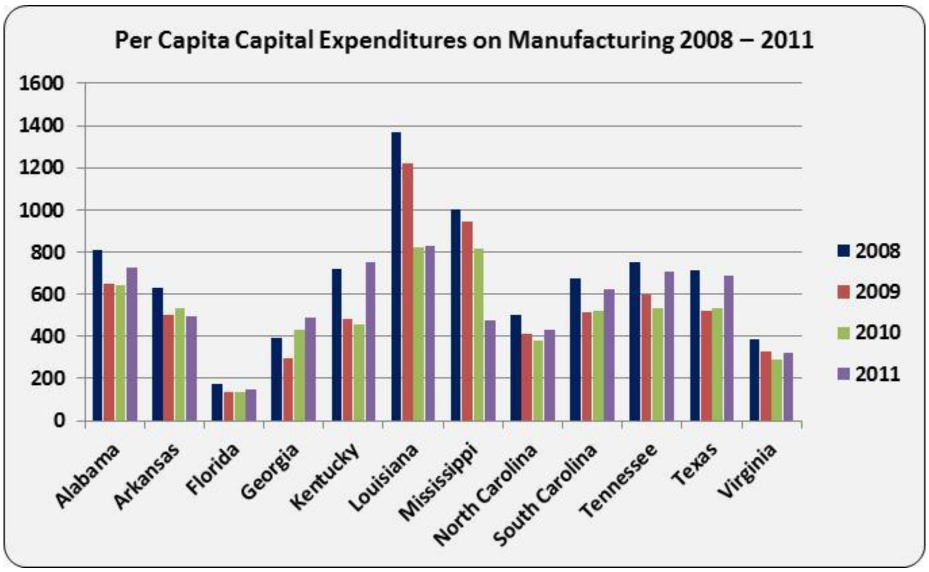
Present Situation

Florida has a diverse manufacturing sector that encompasses traditional industries, such food and beverage processing, and technology-driven industries that produce medical devices, pharmaceuticals, and aerospace equipment. The sector is comprised of more than 18,000 employers and 315,300 workers,[1] with nearly 53 percent of all manufacturers in the state operating as small businesses with less than 20 employees.[2] Workers employed in Florida's manufacturing sector earn an average annual wage of $52,372, which is more than $10,000 above the average annual wage for all private non-agricultural sectors.[3]

Capital investment in the manufacturing sector

In order to remain competitive, manufacturing companies must regularly upgrade or acquire new fixed assets such as property, plant, machinery and equipment. As demand and variable costs fluctuate, investments in machinery and equipment are made to expand production or improve operational efficiency. Over the long term, investments in fixed assets may lead to a higher demand for labor and higher wages for employees.

Industries such as manufacturing, chemical production and mineral extraction, are defined as capital intensive because substantial investments in technology and equipment are required before production is initiated or transitioned to different purposes. As fixed costs cannot be removed or reduced during times of market decline, such industries are sensitive to taxes assessed on property, machinery and equipment. Capital intensive industries generate a higher rate of economic output and increase the productivity of labor, which may provide a higher standard of living for state economies.



[4]

In recent years, Florida's competitor states have worked to intensify and diversify their manufacturing sectors. If capital intensity is measured by capital expenditures per capita (see Chart pg. 2), Florida manufacturers have invested in less fixed assets per capita than any other southern state.[5]

[1] Current Employment Statistics, Florida Department of Economic Opportunity, December of 2012, http://www.floridajobs.org/labor-market-information/data-center/statistical-programs/current-employment-statistics, last visited April 8, 2013.

[2] Manufacturing and Trade Data by State, National Association of Manufacturers, http://www.nam.org/Statistics-And-Data/State-Manufacturing-Data/Manufacturing-by-State.aspx, last visited April 8, 2013.

[3] Occupational Employment Statistics and Wages, Florida Department of Economic Opportunity, 2012, http://www.floridajobs.org/labor-market-information/data-center/statistical-programs/occupational-employment-statistics-and-wages, last visited April 8, 2013.

[4] Chart and data related to Per Capita Capital Expenditures on Manufacturing was provided by Florida TaxWatch.

Taxation of machinery and equipment

Florida is one of only four southern states that imposes a tax on the sale or use of machinery and equipment. The state provides several exemptions from this tax; however, current law may require an existing manufacturer to meet one of the following requirements, in order to qualify for an exemption:

- Expand current business operations.

  (Florida and Kentucky are the only states in the south with this requirement)
- Increase the level of productive output.

  (Florida is the only state in south with this requirement)
- Purchase machinery and equipment used to produce energy, facilitate research and development, or manufacture products related to aerospace, semiconductors, national defense or pollution control.

When upgrades to machinery and equipment are related to the production of a non-qualifying good or directed at improving the operational efficiency of an existing facility, a manufacturer may no longer be exempt from this tax. This additional tax burden increases the costs of replacing fixed assets and may contribute to the low level of capital investment seen in the state's manufacturing sector.[6] Overtime, higher costs and insufficient capital investment may reduce the competiveness of Florida's existing manufacturers and discourage prospective manufacturers from expanding operations to the state.

Competitor States

Among the twelve southern states, Arkansas, Georgia, Louisiana, North Carolina, South Carolina, Tennessee, Texas and Virginia exempt machinery and equipment purchases from the state sales tax. Three states, Alabama, Kentucky and Mississippi, tax the sale of machinery and equipment used in the manufacturing process, but at rates far below the general sales tax. The chart below indicates the sale tax rate and whether a full machinery and equipment exemption is provided.

State Sales Tax Rates and Machinery & Equipment Exemptions[7]

	FL	**AR**	**GA**	**LA**[8]	**NC**[9]	**SC**	**TN**	**TX**	**VA**[10]	**AL**[11]	**MS**[12]	**KY**[13]
M&E Sales/Use Tax Rate	6.0%	6.0%	4.0%	4.0%	4.75%	6.0%	7.0%	6.25%	4.0%	1.5%	1.5%	0.15%
Full M&E Exemption	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No

Florida's tax exempt machinery & equipment

Unless the transaction is exempt, each sale, admission charge, storage, or rental is taxable under ch. 212, F.S. Generally, the sales tax is added to the price of a taxable good and collected from the purchaser at the time of sale. As a complement to the sales tax, the state levies a use tax on transactions not otherwise exempt or taxed at the time of sale.

[5] Data provided by Florida Taxwatch. It should be noted that Federal and state disaster recovery incentives in Louisiana and Mississippi may have front-loaded capital expenditures that would have otherwise been delayed to future years.
[6] Manufacturing: An Economic Driver for Jobs and Florida's Future, Florida TaxWatch, August 2011.
[7] Data compiled from state tax collection agencies and on file with the Economic Development and Tourism Subcommittee.
[8] Localities in Louisiana may impose a local option sales tax on machinery and equipment.
[9] Certain machinery and equipment in North Carolina are subject to a 1% excise tax with a maximum of $80 per item.
[10] Localities in Virginia may impose a local option sales tax on machinery and equipment.
[11] The general sales tax rate in Alabama is 4.0%. Machinery and equipment purchases may also qualify for the state's tax abatement program.
[12] The general sales tax rate in Mississippi is 7.0%. Machinery and equipment purchased by ship manufacturers are tax exempt.
[13] The general sales tax rate in Kentucky is 6.0%. Machinery and equipment purchased by new or expanding manufacturers are tax exempt.

Current law provides exemptions for purchased machinery and equipment used in industrial production, research and development, power generation, aviation, and pollution control. The chart below lists the exemptions that are available for industrial machinery and equipment and applicability of such exemptions to various points in a business growth cycle. Taken together, these exemptions are generally more available to new and expanding businesses.

Current Industrial Machinery & Equipment Sales Tax Exemptions Applicability by Business Growth Cycle			
Exemption	**New Business**	**Expanding Business**	**Upgrading Business**
M&E used to manufacture, process, compound, or produce for sale items of tangible personal property.	Qualified	Qualified, but requires a 5% increase in productive output	Not qualified
M&E used in spaceport activities	Qualified	Qualified	Not qualified
M&E used under federal procurement contracts	Not qualified	Qualified, but requires a 10% increase in productive output	Not qualified
M&E used in semiconductor, defense, or space technology production	Meet application, certification, and permit requirements of two or more agencies.	Meet application, certification, and permit requirements of two or more agencies	Meet application, certification, and permit, requirements of two or more agencies

- *Industrial M&E used to increase productive output*

  Section 212.08(5)(b), F.S., exempts industrial machinery and equipment purchased and used exclusively for spaceport activities or to manufacture, process, compound, or produce for sale items of tangible personal property.[14] This exemption is limited to new or expanding businesses.[15] A new business must purchase machinery and equipment before the initiation of productive operations. Delivery of such items must be made within 12 months of that date. However, an expanding business not engaged in spaceport activities, must demonstrate to the Department of Revenue (DOR) that it has increased the productive output of a facility by at least 5 percent.[16]

  In order to receive the exemption a business must apply to DOR to request the issuance of a temporary tax exemption permit. The permit must be returned to DOR after all the machinery and equipment is purchased. In cases where a business is denied a temporary tax exemption permit, a business may later receive a refund on taxes paid if such business is found to have met the requirements for an exemption. DOR may conduct audits to enforce exemption requirements.

- *Industrial M&E used under federal procurement contracts*

[14] "Industrial Machinery and Equipment" means tangible personal property or other property that has a depreciable life of 3 years or more and is used as an integral part in the manufacturing, processing, compounding, or production of tangible personal property for sale or is exclusively used in spaceport activities. Buildings, structural components, and heating and air-conditioning systems, generally do not meet the definition of industrial machinery and equipment unless closely related to the industrial machinery and equipment that it houses, supports, or such building or structural component can be expected to be replaced when the machinery and equipment are replaced. Heating and air-conditioning systems are not industrial machinery and equipment unless the sole justification for their installation is to meet the requirements of the production process. The term may include parts and accessories that are consistent with the exemption provided in s. 212.08, F.S.

"Spaceport Activities" means activities directed or sponsored by Space Florida on spaceport territory pursuant to its powers and responsibilities under the Space Florida Act.

[15] This exemption does not apply to industrial machinery or equipment purchased or used by electric utility companies, communications companies, oil or gas exploration or production operations, publishing firms that do not export at least 50 percent of their finished product out of the state, or any firm subject to regulation by the Division of Hotels and Restaurants of the Department of Business and Professional Regulation.

[16] Productive output is determined by dividing the output for 12 continuous months (after completion of the installation of purchased machinery or equipment) by the output for the 12 continuous months immediately preceding the installation. The time period for measuring productive output must begin no later than 2 years after completion of the installation of the new machinery and equipment. In 2012, the Legislature reduced the productive output requirement from 10 percent to 5 percent (See HB 7087, Chapter No. 2012-32 L.O.F.).

Section 212.08(5)(d), F.S., exempts industrial machinery and equipment purchased by an expanding business, which manufactures tangible personal property in accordance with federal procurement regulations.[17] This exemption is limited to an expanding business that increases implicit productive output by at least 10 percent.[18] Currently, a new business is not eligible for this exemption.

Eligible machinery or equipment purchases must be related to production contracts with the United States Department of Defense and Armed Forces, the National Aeronautics and Space Administration, and other federal agencies for which the contracts are classified for national security reasons. The amount of the exemption is reduced or offset by business's percentage of gross receipts attributable to cost-reimbursement contracts. DOR issues the exemption as a refund on taxes paid.

- *Industrial M&E used in semiconductor, defense, or space technology production*

Section 212.08(5)(j), F.S., exempts industrial machinery and equipment purchased and used to manufacture, process, compound or produce semiconductor, defense or space technology products for sale or for use by qualifying facilities.[19] A business certified to receive this exemption may elect to designate one or more state universities or community colleges as the recipients of the refund. In order to qualify, a business must submit an application to Enterprise Florida, receive a two-year certification issue by DEO, and receive a business a tax exemption permit issued by DOR.

Effect of proposed changes

HB 391 streamlines industrial machinery and equipment sales or use tax exemptions provided under current law. Specifically, the bill expands eligibility for these exemptions by removing the productive output requirements related to machinery and equipment purchased and used to manufacture, process, compound, or produce tangible items for sale or to meet the production quota of a federal procurement contact. If enacted into law, the bill's provisions may reduce the tax burden of manufacturers expanding operations and upgrading machinery and equipment within this state. The bill does not reduce the applicability of the exemption when industrial machinery and equipment are purchased and used in spaceport activities.

Related to the federal procurement contracts exemption, a business utilizing this provision will no longer have the amount of such exemption reduced or offset by the percentage of gross receipts attributable to cost-reimbursement contracts. The bill will allow a business to claim the exemption "up front" and not as a refund on taxes paid, which is the process currently provided under existing law. The bill may also allow a new business to claim a federal procurement contract exemption.

The bill eliminates the processing requirements related to applying for and receiving a tax exemption permit issued by DOR. However, DOR under rule making authority provided in ch. 212, F.S., may adopt rules to implement this exemption. The bill also makes a conforming change to the tax code and renames the title of the exemption. The chart below provides the cumulative effect of HB 391 on exemption eligibility.

Exemption Eligibility Under HB 391 by Business Growth Cycle			
M&E Exemptions	New Business	Expanding Business	Upgrading Business

[17] Exempt purchases are limited to machinery and equipment as defined by s. 212.08(5)(d), F.S. This exemption does not apply to industrial machinery or equipment purchased or used by businesses listed in s. 212.08(5)(b)5., F.S. or any business that can measure an increase in productive output as provided in s. 212.08(5)(b)6., F.S.

[18] The percentage of increase is measured by calculating the deflated implicit productive output for the calendar year during which the installation of the machinery or equipment is completed or during which commencement of production utilizing such items is begun divided by the implicit productive output for the preceding calendar year. Commencement of production must begin no later than two years following completion of installation of the machinery or equipment.

[19] This exemption also applies to building materials purchased to manufacture or expand clean room facilities.

M&E used to manufacture, process, compound, or produce for sale items of tangible personal property.	Qualified	Qualified	Qualified
M&E used in spaceport activities	Qualified	Qualified	Qualified
M&E used under federal procurement contracts	Qualified	Qualified	Qualified
Additional Requirements			
Productive output requirement	Eliminated	Eliminated	Eliminated
Statutory process for issuing a tax exemption permit.	Eliminated	Eliminated	Eliminated

The bill provides an effective date of upon becoming a law.

B. SECTION DIRECTORY:

Section 1: Amends paragraphs (b), (d), and (h) in s. 212.08(5), F.S., revising limitations, conditions, criteria, and definitions related to machinery and equipment exempt from the tax imposed by ch. 212, F.S.; and conforming cross-references.

Section 2: Provides an effective date of upon becoming a law.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   The Revenue Estimating Conference has not yet scored the provisions of HB 391. However, the Department of Economic Opportunity found that the elimination of the requirement that items of tangible personal property acquired by expanding facilities increase productive output by not less than 5 percent will have a negative fiscal impact on state revenues. This bill projects a $57.7 million revenue reduction in 2013-14, $115.3 million reduction each year thereafter for the State.

2. Expenditures:

   None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   The Revenue Estimating Conference has not yet scored the provisions of HB 391. However, the bill may have a recurring negative fiscal impact on local government.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

By reducing the tax burden of existing manufacturers, the bill may encourage capital investment and new job opportunities in Florida's manufacturing sector. The bill may also encourage prospective manufacturers to relocate to the state.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

The county/municipality mandates provision of Art. VII, section 18, of the Florida Constitution may apply because this bill may reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of state tax shared with counties or municipalities.

Subsection (d) provides an exemption from this prohibition. Laws determined to have an insignificant fiscal impact, which means an amount not greater than the average statewide population for the applicable fiscal year times $0.10 (which is $1.9 million for FY 2012-2013), are exempt.

The Revenue Estimating Conference has not evaluated the fiscal impact of this bill. As such, it is indeterminate whether the bill will have a significant impact on the ability of counties and municipalities to generate and share tax revenues.

If the bill does qualify as a mandate, final passage must be approved by two-thirds of the membership of each house of the Legislature.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The bill does not provide additional rule-making authority.

C. DRAFTING ISSUES OR OTHER COMMENTS:

Regarding the exemption provided in s. 212.08(5)(b), F.S., the bill removes the requirement that qualified industrial machinery equipment purchases must be used within the state. It is unclear if removing this requirement will allow tax-exempt machinery and equipment purchased in Florida to be used by a business outside of Florida.

The bill also removes provisions related the Department of Revenue's authority to issue exemption permits to qualified businesses. Sellers of industrial machinery and equipment may not know if their items are tax exempt without a permit issued by the Department and presented by the purchaser.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES