HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 391 Exemptions from Tax On Sales, Use, & Other Transactions
SPONSOR(S): Economic Development & Tourism Subcommittee, 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	9 Y, 3 N, As CS	Tecler	West
2) Economic Affairs Committee		Tecler	Creamer

SUMMARY ANALYSIS

In order to encourage capital investment and new job opportunities in Florida's manufacturing sector, CS/HB 391 streamlines the industrial machinery and equipment sales or use tax exemption. The bill expands eligibility by removing a requirement that limits the tax exemption to new manufacturers or expanding manufacturers that increase productive output by at least five percent. The bill also allows a manufacturer to receive a tax exemption for equipment upgrades at an existing facility. The tax exemption is limited to machinery and equipment purchased and used in Florida to manufacture, process, compound, or produce tangible goods for sale. 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 CS/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:

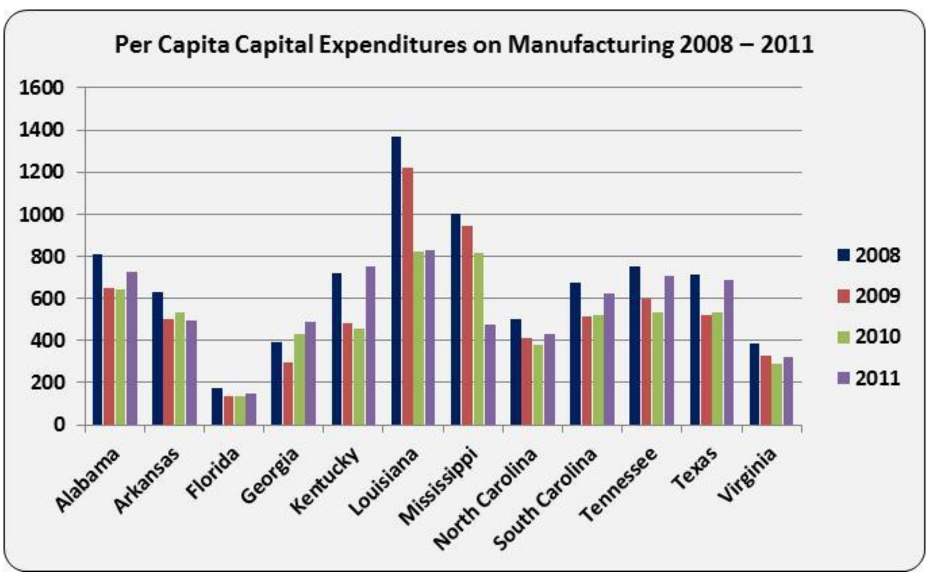
Present Situation

Florida has a diverse manufacturing sector that encompasses traditional industries, such as food and beverage processing, 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 skilled labor and higher wages for employees.

Manufacturing is a capital intensive industry because substantial investments in technology and equipment are required before production is initiated or transitioned to different purposes. Because capital investment is generally made upfront and subject to depreciation, manufacturers are sensitive to taxes levied on certain types of property, machinery and equipment. In general, a strong manufacturing base generates gains in economic output and increases the productivity of labor, which may provide a higher standard of living for state economies.



[4]

In recent years, competitor states have worked to intensify and diversify their manufacturing sectors by eliminating taxes that discourage productivity. When measuring capital intensity by expenditures per

[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.

capita (see Chart pg. 2), Florida manufacturers have invested in less property, machinery and equipment than any other southern state.[5]

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 not be exempt from the sales tax. The burden of this tax increases the cost of replacing fixed assets and may contribute to the low level of capital investment seen in the state's manufacturing sector.[6] Over time, 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 sales 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

[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.

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.

Current law provides exemptions for purchased machinery and equipment used in industrial production, research and development, energy production, 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. 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

[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.).

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*

  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. DOR may conduct audits to enforce exemption requirements.

Effect of Proposed Changes

CS/HB 391 streamlines the industrial machinery and equipment sales or use tax exemption provided under current law. Specifically, the bill expands eligibility by removing a requirement that limits the tax exemption to new manufacturers or expanding manufacturers that increase productive output by at least five percent. The bill also allows a manufacturer to receive a tax exemption for equipment upgrades at an existing facility. 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 limits the tax exemption to industrial machinery and equipment purchased and used within this state to manufacture, process, compound, or produce items of tangible personal property for sale. The bill repeals sales or use tax exemptions related to machinery and equipment purchased and used in spaceport activities or to fulfill a federal procurement contract. However, manufacturers engaged in these activities may qualify for the streamlined tax exemption provided by this bill.

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[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.

The bill obligates the purchaser to furnish the seller with a signed certificate stating that the purchase will be used in compliance with the tax exemption's requirements. The certificate relieves the seller of the responsibility of collecting the tax on the sale of the purchase. If DOR determines the purchaser was not entitled to the exemption, the bill provides that DOR will seek recovery of the tax from the purchaser. The bill also makes technical changes to the tax code, corrects several cross-references, and renames the title of the exemption. The chart below provides the cumulative effect of CS/HB 391.

CS/HB 391 – 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	Qualified
M&E used in spaceport activities.	Repealed	Repealed	Repealed
M&E used under federal procurement contracts.	Repealed	Repealed	Repealed
M&E used in semiconductor, defense, or space technology production.	Current law	Current law	Current law
Manufacturers engaged in spaceport activities or fulfilling a federal procurement contract may qualify for the streamlined exemption provided under CS/HB391.			
Outdated Requirements			
5% increase in productive output.	Eliminated	Eliminated	Eliminated

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

B. SECTION DIRECTORY:

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

Sections 2-7: Amend ss. 212.0602, 220.183, 290.0056, 290.007, 627.5105, and 1011.94, F.S., making technical changes and conforming cross-references.

Section 8: 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 CS/HB 391. Related to the requirement that limits the sales tax exemption to new manufacturers or expanding manufacturers that increase productive output by at least 5%, the Department of Economic Opportunity found that eliminating this provision will have a negative fiscal impact on state revenues. DEO projects a $57.7 million revenue reduction in 2013-14, and a $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 CS/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:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On April 10, 2013, the Economic Development & Tourism Subcommittee adopted a strike-all amendment as a committee substitute. The committee substitute:

- Provides the sales or use tax exemption is applicable to industrial machinery and equipment purchased and used within Florida to manufacture, process, compound, or produce items of tangible personal property for sale.
- Deletes a requirement that limits the tax exemption to new manufacturers or expanding manufacturers that increase productive output by at least five percent.
- Repeals sales or use tax exemptions related to industrial machinery and equipment purchased and used in spaceport activities or to fulfill a federal procurement contract.
- Obligates the purchaser to furnish the seller with a signed certificate stating that the purchase will be used in compliance with the tax exemption's requirements.
- Makes technical changes to the tax code, corrects several cross-references, and renames the title of the exemption.

The analysis has been updated to reflect the committee substitute.