

Sales Tax Exemptions for Manufacturing and Research and Development Would Provide Florida With Needed Economic Development Tools

Florida has long been trying to enhance the manufacturing sector of the state's economy. Some positive steps have been taken, but manufacturing still lags behind most of the nation. Two tax exemptions being considered by the 2005 Legislature would be a significant help to that sector, making Florida firms more competitive with other states, encouraging expansion and creating jobs.

Legislators are considering changing a current partial sales tax exemption for machinery and equipment purchased by expanding manufacturers to a full exemption. They are also considering a sales tax exemption for machinery and equipment predominantly used for research and development activities.

Florida TaxWatch finds that these exemptions are consistent with the state's efforts to make Florida manufacturers more competitive by bringing the taxation of this industry sector more in line with other states. Florida TaxWatch also concludes that these exemptions make sound fiscal sense and should pay for themselves through increased economic activity. The state's economic development organization, Enterprise Florida, strongly supports these exemptions.

Florida Manufacturing Sector Is Relatively Small and Getting Smaller

Manufacturing has been a relatively small part of Florida's economy. Florida ranks 47th in the nation in the percentage of its Gross State Product (GSP) contributed by that sector. Manufacturing employment comprises 4.4% of the state's workforce, while the national average is more than twice that amount (9.1%). In fact, of all workforce components, this accounts for the largest difference between Florida and the rest of the nation.

Although manufacturing has been declining nationally for the last ten years, it has been declining in Florida faster, and has been for 30 years. The University of Central Florida estimates the state loses more than 11,000 manufacturing jobs per year.

Florida manufacturers are generally small businesses. Ninety-five percent have fewer than 100 employees and 72% have less than ten employees.

Similarly, research and development spending in Florida is less than the state's size would suggest. Thirteen other states spend more in total dollars on R&D than does Florida and the state ranks 26th in per capita federal R&D funding.

Many other states' tax treatment in both of these areas is more favorable than Florida's. Thirty-six other states offer full exemptions for manufacturing machinery and equipment (or do not have a sales and use tax) and four other states tax it at reduced rates, including Louisiana, which is phasing out the tax. Twenty-four states either do not tax research and development equipment or tax it at a reduced rate.

Florida Should Reduce Taxation of Inputs to Production

Florida TaxWatch has a long history of supporting manufacturing incentives and the elimination of taxes on inputs to production. Florida, in effect, taxes many inputs such as machinery and equipment twice - once when the equipment is bought and again when the product produced is purchased (as the costs of inputs go into the price.)

In March 2003, Florida TaxWatch's Task Force on Tax System Modernization recommended that both of these exemptions, and others, be enacted. Its report states:

"The Task Force supports modifications to tax law that reduce or eliminate taxes on inputs to production; specifically, exemptions that encourage manufacturing and research and development activity that, in turn, create wealth and high-wage jobs for our communities. These exemptions also allow Florida to keep pace with other competitor states that offer similar exemptions."

Promoting manufacturing is desirable because it results in high-wage jobs. According to the Agency for Workforce Innovation, the sector's average annual wages are almost \$41,000, much higher than the average for all sectors of \$33,500.

Legislation Would Address Uneven Application of Current Exemptions

Current taxation of machinery and equipment is unevenly, and unfairly, applied across Florida and favors new companies over those already in the state. The state's 6% sales and use tax is generally applied to manufacturing machinery and equipment but purchases by new manufacturers is exempt if the equipment is received within 12 months. Further, purchases by semiconductor companies are exempt and space and defense are partially (25%) exempt. Machinery and equipment purchased to expand a manufacturer's productive capacity by at least 10% is exempt after the first \$50,000 in tax is paid. That means that a

manufacturer must spend \$833,000 before the exemption kicks in. Printers get a full exemption. New and expanding mining operations can only take the exemption as a credit against severance taxes due and must show the creation of new jobs. Further, purchases pursuant to federal procurement are subject to a \$100,000 threshold.

Similarly, while R&D machinery and equipment is also generally taxed, a full exemption is provided to semiconductor wafer research and a partial (25%) exemption is provided for defense or space research.

House Bill 27 and Senate Bill 2312 would provide a full sales tax exemption for machinery and equipment purchased for an expanding manufacturing or spaceport facility. It also removes the \$100,00 threshold for federal procurement cases and expands the mining exemption.

House Bill 81 and Senate Bill 2362 fully exempts machinery and equipment used predominantly (at least 50%) for research and development from the sales and use tax. It also allows the business to designate state universities or community colleges to receive the exemption amount for use in R&D.

Accountability Language Ensures Exemptions Will Be Continued Only If They Add Value

At the request of a sponsor, Florida TaxWatch helped draft accountability language for the bills to ensure that the continuation of the exemptions is contingent on them providing value to the state. It subjects the exemption to review by the Legislature after ten years. It requires the Office of Program Policy Analysis and Government Accountability (OPPAGA) and Enterprise Florida to study the exemptions, including the estimated annual cost of the exemption and an estimate of the economic impact of increased manufacturing and research and development activities. The report will be submitted to the Legislature and contain the findings and recommendations as to whether the exemption should be re-enacted by the Legislature.

The manufacturing machinery exemption is estimated to have a negative combined state and local fiscal impact of \$29.6 million. The research and development exemption is expected to cost \$39.9 million.

In March 2003, Florida TaxWatch's Task Force on Tax System Modernization and Florida State University performed econometric modeling on these exemptions (as well as other production inputs) and found that they should have a positive long-term payoff for the state. The forecasts showed a net positive impact on gross state product, employment, income and state revenues in 3-4 years.

A new study done by the University of Central Florida also showed a positive fiscal impact from the exemptions. Although the magnitude of the impact was

much larger than that estimated by the Task Force, it echoed the basic premise of positive return in 3-4 years.

Conclusion

The sales tax exemptions for machinery and equipment used in manufacturing and research and development activities should be enacted by the 2005 Legislature. They should prove to be a boon to Florida's manufacturing sector and increase R&D in the state. The enhanced research and development environment in the state should also help Florida attract additional production activity.

The exemptions would help small business, increase the state's competitiveness and remove the inequities found in the current application of this taxation. Econometric modeling has shown that these exemptions should have a positive fiscal impact for the state. Accountability language in the bills can help ensure this is the case.

The Legislature is currently facing one its best budget years. Increased revenue estimates earlier this month mean that more than \$2 billion dollars in new revenue will now be added by the Conference Committee to well-received budgets already passed by the House and Senate.

There is not a better time to pass these needed tax cuts, particularly since they can improve Florida's competitiveness and fiscal position for the future.

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Florida TaxWatch Research Institute, Inc.

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Florida TaxWatch is a private, non-profit, non-partisan research institute that over its 25 year history has become widely recognized as the watchdog of citizens' hard-earned tax dollars. Its mission is to provide the citizens of Florida and public officials with high quality, independent research and education on government revenues, expenditures, taxation, public policies and programs and to increase the productivity and accountability of Florida Government.

Florida TaxWatch's empirically sound research recommends productivity enhancements and explains the statewide impact of economic and tax and spend policies and practices on citizens and businesses. Florida TaxWatch has worked diligently and effectively to help state government shape responsible fiscal and public policy that adds value and benefit taxpayers.

This diligence has yielded impressive results: since 1979, policy makers and government employees have implemented three-fourths of Florida TaxWatch's cost-saving recommendations, saving the taxpayers of Florida more than \$6.2 billion--approximately \$1,067 in added value for every Florida family.

The organization enjoys a credible reputation and statewide exposure with the television, radio and newspaper media, which regularly report on its research and recommendations.

Florida TaxWatch has a historical understanding of state government, public policy issues, and the battles fought in the past necessary to structure effective solutions for today and the future. It's the only statewide organization devoted entirely to Florida taxing and spending issues.

Supported by voluntary, tax-deductible memberships and grants, Florida TaxWatch is open to any organization or individual interested in helping to make Florida competitive, healthy and economically prosperous by supporting a credible research effort that promotes constructive taxpayer improvements. Members, through their loyal support, help Florida TaxWatch to bring about a more effective, responsive government that is accountable to the citizens it serves.

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