

STORAGE NAME: h1023a.gg

DATE: April 20, 1999

**HOUSE OF REPRESENTATIVES
AS FURTHER REVISED BY THE COMMITTEE ON
GENERAL GOVERNMENT APPROPRIATIONS
ANALYSIS**

BILL #: HB 1023

RELATING TO: Limited Liability Companies

SPONSOR(S): Representative LaCasa

COMPANION BILL(S): SB 1682 (I)

ORIGINATING COMMITTEE(S)/COMMITTEE(S) OF REFERENCE:

- (1) FINANCIAL SERVICES YEAS 8 NAYS 0
 - (2) FINANCE AND TAXATION YEAS 12 NAYS 0
 - (3) GENERAL GOVERNMENT APPROPRIATIONS YEAS 10 NAYS 0
 - (4)
 - (5)
-

I. SUMMARY:

The bill amends statutes regulating the tax liability and the operation of certain limited liability companies (LLCs) by:

- specifically exempting a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes from Florida's corporate income tax pursuant to chapter 220, F.S.;
- requiring an LLC to dissolve if its membership falls below one person;
- expressly providing that a membership interest in an LLC that is disregarded as an entity separate from its owner for federal income tax purposes be considered "intangible personal property" for purposes of determining intangible tax liability; and
- exempting from the annual intangible tax any membership interest in an LLC that is classified as a partnership for federal income tax purposes or membership interest in a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes. In short, this would exempt an ownership interest in an LLC that met the aforementioned description from the annual tax.

In addition, the bill will correct a potential misconception that the whole of s. 220.02, F.S., would be effective for tax years beginning on or after January 1, 1997 by correcting a footnote reference. This will clarify that *only the provisions in subsection 220.02(11)*, which provides that parent corporations and their subchapter S subsidiaries would not be considered separate corporations, would be effective with respect to tax years beginning on or after January 1, 1997.

Although there is no official estimate on the intangibles tax exemption at this time, the preliminary estimate is projected to decrease state revenues by \$4.25 million.

[See Section VI. Amendments or Committee Substitute Changes]

II. SUBSTANTIVE ANALYSIS:

A. PRESENT SITUATION:

The Florida Limited Liability Company Act of 1982 created the limited liability company (LLC) in Florida. The LLC is a hybrid entity. For liability purposes, it is treated as a corporation, and for federal taxation purposes, it is treated as a partnership. The Florida Limited Liability Company Act was enacted in part to attract capital to Florida by offering limited liability in conjunction with federal tax advantages.

There are two types of LLCs: (a) member-managed, which resembles partnerships in that the members participate in the control and direction of the company and (b) manager-managed, in which a manager directs the company and members are passive like shareholders in a corporation. An LLC is corporate in nature, but is typically not publicly traded. Only one person is needed to form an LLC.

Table 1. outlines the authority, duration of existence, owners, management, tax liability and civil liability of LLCs.

TABLE 1. The authority, duration of existence, ownership, management, tax liability and civil liability for LLCs	
BUSINESS ENTITY	LIMITED LIABILITY COMPANY
Authority	Chapter 608, Florida Statutes
Duration	Perpetual duration
Owners	Members
Management	Elected managers or members manage the company
Tax Liability	Entity is not subject to state corporate income tax. ¹ Entity subject to intangible tax. ² Members pay federal income taxes on dividends Merging LLCs incur no documentary stamp tax liability.
Liability	Managers of an LLC managed by a manger or managers are shielded from personal liability for wrongful acts committed by the LLC, other managers, other members, or employees but are held accountable for their own misfeasance.

LLCs are corporate in structure yet are managed much a like a partnership with LLC members managing the company. Further, LLCs shield their members from personal liability in a manner similar to the way in which a corporation shields a manager or director from personal liability.

The growth in the number of LLCs is a relatively recent phenomenon due in large part to changes in how they are treated under federal tax law. The U.S. Internal Revenue Service (IRS) first ruled in 1988 that under certain conditions, an LLC could qualify as a partnership for purposes of the federal income tax. In determining whether an LLC was to be classified as a partnership, and therefore entitled to the pass-through tax treatment, or classified as an association taxable as a corporation,

¹In 1998, the Legislature passed SB 704, which became Chapter 98-101, Laws of Florida. The new law exempted LLCs from state corporate income tax and decreased the minimum number of members required to form an LLC from two to one. Prior to the enactment of this law, LLCs were taxed at a rate of 5.5 percent of their net income for the taxable year.

²Section 199.023(1)(a), F.S., defines "intangible personal property" as all stocks or shares of incorporated or unincorporated companies, business trusts, and mutual funds.

the IRS examined the nature of an organization by analyzing the LLC's articles of organization.³ Recently, the IRS issued new regulations allowing an LLC to elect its federal tax classification on a special tax form (61 Fed. Reg. 66584 (1996)).

Section 220.02, F.S., exempts from state income tax any LLC that is classified as a partnership for federal income tax purposes and that is formed under Chapter 608, F.S., or is qualified to do business in the state as a foreign LLC.

An LLC would be required to pay tax on any intangible property in accordance with chapter 199, F.S. (See, s. 199.023(3), F.S.). Furthermore, ownership interest in an LLC would also qualify as intangible personal property (See, s. 199.023(1)(a), F.S.).

Tax Treatment for S Corporations and Subsidiaries

Effective January 1, 1997, s. 1361 of the Internal Revenue Code was amended to permit an S corporation to own more than 80 percent of another corporation, which is known as a qualified subchapter S subsidiary.⁴ The S corporation could then make an election under s. 1361(a)(3), of the I.R.S. Code, and the qualified subchapter S subsidiary would not be treated as a separate corporation for federal tax purposes.

In Florida, subchapter S corporations are not subject to the Florida corporate income tax. Prior to July, 1, 1998, however, wholly-owned subsidiaries of qualified subchapter S corporations were generally subject to Florida corporate income tax liability. Chapter 98-101, Laws of Florida, changed this tax treatment so that qualified subchapter S subsidiaries would not be treated as separate entities from their parent corporations for purposes of payment of the Florida corporate income tax. This provision was made effective with respect to tax years beginning on or after January 1, 1997.⁵

B. EFFECT OF PROPOSED CHANGES:

The bill amends statutes regulating the tax liability and the operation of certain limited liability companies (LLCs) by:

- specifically exempting a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes from Florida's corporate income tax pursuant to chapter 220, F.S.;
- requiring an LLC to dissolve if its membership falls below one person;
- specifically providing that a membership interest in an LLC that is disregarded as an entity separate from its owner for federal income tax purposes be considered "intangible personal property" for purposes of determining intangible tax liability; and
- exempting from the annual intangible tax any membership interest in an LLC that is classified as a partnership for federal income tax purposes or membership interest in a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes. In short, this would exempt from the annual tax any interest owned in an LLC that met the aforementioned description. **[See Section VI. Amendments or Committee Substitute Changes]**

³See, e.g., Rev. Rul. 93-53, 1993-2 C.B. 312, holding that a Florida LLC which had associates, an objective to carry on business and divide the gains from such business, centralized management, and limited liability could still be classified as a partnership because it did not possess other characteristics of a corporation, such as continuity of life and free transferability of interests.

⁴An S corporation is a corporation that has a limited number of shareholders and is not generally subject to federal or Florida corporate income tax liability. The shareholders, however, are subject to personal income tax liability.

⁵What may have been an inadvertent oversight, this retroactive application of tax treatment was footnoted to subsection (1) of section 220.02, instead of subsection (11). This bill corrects that oversight.

In addition, the bill will correct a potential misconception that the whole of s. 220.02, F.S., would be effective for tax years beginning on or after January 1, 1997 by correcting a footnote reference. This will clarify that *only the provisions in subsection 220.02(11)*, which provides that parent corporations and their subchapter S subsidiaries would not be considered separate corporations, would be effective with respect to tax years beginning on or after January 1, 1997.

The bill provides an effective date of July 1, 1999.

C. APPLICATION OF PRINCIPLES:

1. Less Government:

a. Does the bill create, increase or reduce, either directly or indirectly:

(1) any authority to make rules or adjudicate disputes?

No

(2) any new responsibilities, obligations or work for other governmental or private organizations or individuals?

Yes. According to the Department of Revenue, they will need to investigate whether an LLC has made the proper election with the I.R.S. to substantiate its tax exempt status.

(3) any entitlement to a government service or benefit?

No

b. If an agency or program is eliminated or reduced:

(1) what responsibilities, costs and powers are passed on to another program, agency, level of government, or private entity?

N/A

(2) what is the cost of such responsibility at the new level/agency?

N/A

(3) how is the new agency accountable to the people governed?

N/A

2. Lower Taxes:

a. Does the bill increase anyone's taxes?

No

b. Does the bill require or authorize an increase in any fees?

No

c. Does the bill reduce total taxes, both rates and revenues?

Yes. Certain LLCs will be granted an exemption from certain tax liability.

d. Does the bill reduce total fees, both rates and revenues?

No

e. Does the bill authorize any fee or tax increase by any local government?

No

3. Personal Responsibility:

a. Does the bill reduce or eliminate an entitlement to government services or subsidy?

No

b. Do the beneficiaries of the legislation directly pay any portion of the cost of implementation and operation?

N/A

4. Individual Freedom:

a. Does the bill increase the allowable options of individuals or private organizations/associations to conduct their own affairs?

Yes. Certain LLCs will be granted an exemption from certain tax liability.

b. Does the bill prohibit, or create new government interference with, any presently lawful activity?

N/A

5. Family Empowerment:

a. If the bill purports to provide services to families or children:

(1) Who evaluates the family's needs?

N/A

(2) Who makes the decisions?

N/A

(3) Are private alternatives permitted?

N/A

(4) Are families required to participate in a program?

N/A

(5) Are families penalized for not participating in a program?

N/A

- b. Does the bill directly affect the legal rights and obligations between family members?

N/A

- c. If the bill creates or changes a program providing services to families or children, in which of the following does the bill vest control of the program, either through direct participation or appointment authority:

- (1) parents and guardians?

N/A

- (2) service providers?

N/A

- (3) government employees/agencies?

N/A

D. STATUTE(S) AFFECTED:

Amends s. 199.023, s. 199.185, s. 220.02 (1998 Supp.), s. 220.03, s. 220.13, s. 608.741, and s. 608.441, F.S.

E. SECTION-BY-SECTION ANALYSIS:

Section 1. Amends s. 220.02, F.S. (1998 Supp), clarifying legislative intent exempting LLCs from tax liability under chapter 220, F.S, to specifically include a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes.

Section 2. Amends subsection (2) of section 7 of chapter 98-101, Laws of Florida, specifically designating that the provisions in subsection 220.02(11), relating to subchapter S subsidiary corporations are effective with respect to tax years beginning on or after January 1, 1997.

Section 3. Amends s. 220.03, F.S. (1998 Supp.), specifically exempting a single member LLC that is disregarded as an entity separate from its owner for federal income tax purposes from the definition of "corporation."

Section 4. Amends s. 220.13, F.S. (1998 Supp.), specifically exempting a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes from the definition of "taxable income."

Section 5. Amends s. 608.471, F.S., (1998 Supp), specifically exempting a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes from paying tax pursuant Chapter 220, F.S.

Section 6. Amends s. 608.441, F.S., requiring LLCs to dissolve if the number of members falls below one.

Section 7. Amends 199.023, F.S. (1998 Supp.), providing that a membership interest in an LLC that is disregarded as an entity separate from its owner for federal income tax purposes be considered "intangible personal property" for purposes of determining intangible tax liability.

Section 8. Amends s. 199.185, F.S. (1998 Supp.), providing that any interest as a member in an LLC that is classified as a partnership for federal income tax purposes or is a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes be exempt from the annual intangible tax. **[See Section VI. Amendments or Committee Substitute Changes]**

Section 9. Provides an effective date of July 1, 1999.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE AGENCIES/STATE FUNDS:

1. Non-recurring Effects:

See section III. D Fiscal Comments.

2. Recurring Effects:

See section III. D Fiscal Comments.

3. Long Run Effects Other Than Normal Growth:

See section III. D Fiscal Comments.

4. Total Revenues and Expenditures:

See section III. D Fiscal Comments.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS AS A WHOLE:

1. Non-recurring Effects:

See section III. D Fiscal Comments.

2. Recurring Effects:

See section III. D Fiscal Comments.

3. Long Run Effects Other Than Normal Growth:

See section III. D Fiscal Comments.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

1. Direct Private Sector Costs:

None

2. Direct Private Sector Benefits:

3. Effects on Competition, Private Enterprise and Employment Markets:

None

D. FISCAL COMMENTS:

Although there is no official estimate on the intangibles tax exemption for any membership interest in an LLC that is classified as a partnership for federal income tax purposes or membership interest in a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes at this time, the preliminary estimate is projected to decrease state revenues by \$4.25 million. **[See Section VI. Amendments or Committee Substitute Changes]**

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

This bill does not require counties or municipalities to spend funds or to take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill will not reduce the authority of municipalities and counties to raise revenues.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

This bill will not reduce the state tax shared with counties and municipalities.

V. COMMENTS:

The bill exempts from the annual intangible tax any membership interest in an LLC that is classified as a partnership for federal income tax purposes or membership interest in a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes. In addition, the bill exempts a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes from Florida's corporate income tax. Consequently, if an LLC does not make the specific election with the IRS that classifies it as a partnership for federal income tax purpose, tax liability may incur under Chapter 199, or Chapter 220, F.S. **[See Section VI. Amendments or Committee Substitute Changes]**

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

On March 29, 1999, the Committee on Financial Services adopted one title amendment offered by Rep. LaCasa which substituted "business entities" for "limited liability companies" in the "relating to" clause to eliminate a potential two subject issue in the bill.

On April 9, 1999 on Finance and Taxation adopted one amendment offered by Rep. LaCasa which removes the intangible tax exemption for LLCs.

VII. SIGNATURES:

COMMITTEE ON FINANCIAL SERVICES:

Prepared by:

Michael A. Kliner

Staff Director:

Susan L. Cutchins

AS REVISED BY THE COMMITTEE ON FINANCE AND TAXATION:

Prepared by:

Carol L. Dickson-Carr

Staff Director:

Alan Johansen

AS FURTHER REVISED BY THE COMMITTEE ON GENERAL GOVERNMENT APPROPRIATIONS:

Prepared by:

Juliette Noble

Staff Director:

Cynthia P. Kelly