

# SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based only on the provisions contained in the legislation as of the latest date listed below.)

BILL: SB 1682

SPONSOR: Senator Klein

SUBJECT: Limited Liability Companies

DATE: March 26, 1999

REVISED: 3/29/99

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Fournier</u>	<u>Wood</u>	<u>FR</u>	<u>Favorable</u>
2.	<u>Schmeling</u>	<u>Maclure</u>	<u>CM</u>	<u>Fav/1 amendment</u>
3.	<u>                    </u>	<u>                    </u>	<u>                    </u>	<u>                    </u>
4.	<u>                    </u>	<u>                    </u>	<u>                    </u>	<u>                    </u>
5.	<u>                    </u>	<u>                    </u>	<u>                    </u>	<u>                    </u>

## I. Summary:

This bill provides a Florida corporate income tax exemption for single-member limited liability companies that are disregarded as entities separate from their owners for federal income tax purposes. This bill also provides that ownership interests in a limited liability company that is classified as a partnership for federal income tax purposes, or a single-member limited liability company that is disregarded as an entity separate from its owner for federal income tax purposes, are not subject to intangible personal property tax.

This bill amends sections 220.02, 220.03, 220.13, 608.471, 608.441, 199.023, and 199.185, Florida Statutes.

## II. Present Situation:

The Florida Limited Liability Company Act of 1982 created the limited liability company (LLC) in Florida. A LLCs is an entity with characteristics of both a corporation and a partnership. For legal purposes, an LLC is treated like a corporation and therefore affords its members certain protections from liability. For federal income tax purposes, however, an LLC may be classified as a partnership, in which case the earnings or losses of the LLC are passed through to the members, rather than treating the LLC as a separate taxable entity. 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.

Under its corporate income tax code, ch. 220, F.S., Florida levies a tax of 5.5 percent on the taxpayer's net income for the taxable year (s. 220.11, F.S.). The stated intent of the code is to impose a tax on all corporations and other artificial entities that derive from the state attributes not inherent in natural persons, such as perpetual life, transferable ownership, and limited liability for all owners (s. 220.02(1), F.S., 1998 Supp.). LLCs that are classified as a partnership for federal income tax purposes and formed under ch. 608, F.S., or qualified to do business in this state as foreign LLCs are not subject to this tax (*id.* and s. 608.471, F.S., 1998 Supp.). Single-

member LLCs, which are not partnerships under current law, are currently required to file corporate income tax returns.

Under the Florida corporate income tax code, a taxpayer's net income for state tax purposes is based on the taxpayer's adjusted federal income (s. 220.12, F.S., 1998 Supp.). In the case of an LLC, except for LLCs classified as partnerships for federal income tax purposes, adjusted federal income means "taxable income determined *as if* such limited liability company were required to file or had filed a federal corporate income tax return under the Internal Revenue Code" (s. 220.13(2)(j), F.S., 1998 Supp.)(emphasis provided).

Paragraph (e) of subsection (1) of s. 220.03, F.S. (1998 Supp.), defines "corporation" and provides specifically that the term does not include LLCs that are taxable as partnerships for federal income tax purposes.

Paragraph (d) of subsection (1) of s. 608.441, F.S., provides that a LLCs shall be dissolved if it has fewer than two members.

Paragraph (a) of subsection (1) of s. 199.023, F.S. (1998 Supp.), provides that intangible personal property includes all stocks or shares of incorporated or unincorporated companies, business trusts, and mutual funds.

Paragraph (c) of subsection (1) of s. 199.185, F.S. (1998, Supp.), provides an exemption from intangibles tax for any interest as a partner in a partnership, other than any interest as a limited partner in a limited partnership registered with the Securities and Exchange Commission pursuant to the Securities Act of 1993, as amended.

The Internal Revenue Code prescribes the classification of various organizations for federal tax purposes. Whether an organization is an entity separate from its owners for federal tax purposes is a matter of federal tax law and does not depend on whether the organization is recognized as an entity under local law.<sup>1</sup> A joint venture or other contractual arrangement may create a separate entity for federal tax purposes if the participants carry on a trade, business, financial operation, or venture and divide the profits therefrom. Sections 301.7701-2 and 301.7701-3, C.F.R., provide that certain organizations that have a single owner can choose to be recognized or disregarded as entities separate from their owners for federal tax purposes.

### **III. Effect of Proposed Changes:**

This bill extends the current exemption from corporate income tax, enjoyed by a limited liability company (LLC) classified as a partnership for federal income tax purposes, to a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes. The bill also provides that ownership interests in a LLC is classified as a partnership for federal income tax purposes, or a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes, are not subject to intangible personal property tax.

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<sup>1</sup> 26 C.F.R. 301.7701-1

**Section 1** amends s. 220.02, F.S., 1998 Supp, to provide that a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes, is not subject to corporate income tax.

**Section 2** amends subsection (2) of section 7 of ch. 98-101, L.O.F., to provide a reference clarification regarding qualified subchapter S subsidiaries.

**Section 3** amends s. 220.03, F.S., 1998 Supp, to specifically exclude from the definition of “corporation” single-member LLC that are disregarded as an entity separate from its owner for federal income tax purposes.

**Section 4** amends s. 220.13, F.S., 1998 Supp, to exclude the income of 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” for LLCs.

**Section 5** amends s. 608.471, F.S., 1998 Supp, to provide that a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes is not an artificial entity, is not subject to the Florida Income Tax Code, and will be classified the same for Florida corporate income tax purposes as it is for federal income tax purposes.

**Section 6** amends s. 608.441, F.S., to provide that a LLC is dissolved when it has no members.

**Section 7** amends s. 199.023, F.S., 1998 Supp, to include in the definition of “intangible personal property” interests as a member in a LLC classified as a partnership for federal income tax purposes, and in a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes.

**Section 8** amends s. 199.185, F.S., 1998 Supp, to exempt from Florida intangibles tax, interests in LLCs classified as a partnership for federal income tax purposes, and in a single-member LLC that is disregarded as an entity separate from its owner for federal income tax purposes.

**Section 9** provides that the act will take effect on July 1, 1999.

#### **IV. Constitutional Issues:**

##### **A. Municipality/County Mandates Restrictions:**

While the bill will reduce the amount shared with municipalities and counties, it does not reduce the percentage of a state tax shared with municipalities and counties. Therefore, Article VII, Section 18(b), Florida Constitution does not apply.

##### **B. Public Records/Open Meetings Issues:**

None.

C. Trust Funds Restrictions:

None.

**V. Economic Impact and Fiscal Note:**

A. Tax/Fee Issues:

The fiscal impact of this bill has not been determined

B. Private Sector Impact:

Taxes will be reduced for certain limited liability companies.

C. Government Sector Impact:

None.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

Currently, single-member LLCs, which are not classified partnerships under federal tax law, are required to file corporate income tax returns, and may be included in the income tax return of another entity as a “division” of that entity. In this instance, the LLC’s income is reported and taxed on the tax return of the entity filing it, for both federal and Florida income tax purposes. The Department of Revenue has found the intent of the bill unclear. Specifically, the department maintains that it is unclear from the bill whether the intent is to exempt single-member LLCs from both filing a Florida corporate income tax return and paying the tax, merely to relieve them from the Florida corporate income tax return filing requirement, or to completely exempt their income from taxation even if it is included in the tax return of another entity. It is additionally unclear what is intended by the term “disregarded,” as that term has not been defined.

**VIII. Amendments:**

#1 by Commerce and Economic Opportunities:

Provides that if a single-member limited liability company is disregarded as an entity separate from its owner for federal income tax purposes, its activities are, for purposes of taxation under ch. 220, F.S., treated in the same manner as a sole proprietorship, branch, or division of the owner.

(WITH TITLE AMENDMENT)