The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

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

Prepared By: The Professional Staff of the Committee on Commerce and Tourism

BILL:	SB 1692
INTRODUCER:	Senator Rodriguez
SUBJECT:	Corporate Income Tax
DATE:	March 22, 2019
REVISED:	

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	McKay	McKay	CM	**Pre-meeting**
2.			FT	
3.			AP	

I. Summary:

SB 1692 requires all members of a unitary business (water's edge group) to file a combined corporate income tax return and to allocate income to Florida using a single apportionment computation. The water's edge group is required to file a domestic disclosure spreadsheet disclosing the income reported to each state, the state tax liability, and the method used to apportion or allocate income to each state. The bill also specifies transition rules.

The bill provides that funds recaptured by operation of the bill's provisions must be appropriated in the General Appropriations Act to various school districts to reduce required local effort.

The Revenue Estimating Conference has not yet estimated the fiscal impact of this bill.

The Department of Revenue estimates that implementation of this bill would require expenditures of $88,500 in Fiscal Year 2019-2020, and $27,950 in Fiscal Year 2020-2021.

The bill provides an effective date of July 1, 2019.

II. Present Situation:

Florida's Current Corporate Income Tax System

Florida levies a tax on all corporations, organizations, associations and other artificial entities that have attributes not inherent to natural persons, such as perpetual life, and that derive income from the state. The tax is levied on the privilege and measured by net income at the rate of 5.5 percent on net income derived from the state.[1]

[1] Section 220.11, F.S.

Florida does not require commonly controlled corporations engaged in a unitary business to compute their state taxable income on a combined basis. Corporations that are members of an affiliated group have the choice of filing on a separate entity basis or as a consolidated group. To file on a consolidated basis, the parent company of an affiliated group subject to Florida tax must consolidate its taxable income with each member of the group. Each member must consent to consolidation. The group must have filed a consolidated federal return for the year. The group must be composed of the same members as those filing the federal return and each member must apportion its income in the same manner.[2]

Florida adopts the federal definition of taxable income.[3] A taxpayer's net income is its adjusted federal income, or the share of its adjusted federal income for the year that is apportioned to Florida, plus non-business income allocated to Florida, less the $50,000 exemption of net income.[4]

State income taxation of a multistate business conducted in corporate form is primarily restricted by the Commerce Clause and the Due Process Clause of the U.S. Constitution. The former delegates the power to regulate commerce among the states to the federal government. The restraint it provides flows primarily from the negative implications of the clause, allowing only the federal government to regulate said commerce. Congress, through Public Law 86-272, has exercised its authority in this regard and has prevented states from imposing tax liability for activities considered nominal, such as solicitation.

The Due Process Clause prohibits states from reaching beyond their borders to impose tax. States are afforded significant latitude in taxing the income of multistate businesses. However, a state may not tax income wholly attributable to another jurisdiction, even on an apportioned basis.[5] Many states, including Florida, recognize this constraint by permitting the allocation of income. Florida subtracts non-business income from adjusted federal income.[6]

After allocation, corporations that conduct business both in Florida and outside the state apportion their business income among those states. Each state provides its own formula to apportion income. Florida generally uses a three factor formula apportionment consisting of a sales factor representing 50 percent, payroll at 25 percent and property at 25 percent.[7] There are special formulary apportionment rules for specific industries.[8]

Section 220.15(5), F.S., defines the sales factor. The numerator of the sales factor is the total sales of the taxpayer in Florida during the taxable year and the denominator is the total sales of the taxpayer everywhere during that time. All sales everywhere are included in the denominator of the sales factor. The receipt from a sale of tangible property is sourced to the state where it is delivered. If delivery is to Florida, the receipt is added to the numerator and denominator of the sales factor for apportionment purposes. Section 220.15(5), F.S., does not specifically address

[2] Section 220.131, F.S.
[3] Section 220.12, F.S.
[4] Section 220.14, F.S.
[5] *Allied Signal, Inc. v. Director,* 504 U.S. 768 (1992).
[6] Section 220.13(1)(b)(4), F.S..
[7] Section 220.15(1), F.S.
[8] Section 220.151, F.S.

the sourcing of the sale of a service. The sale of a service is either apportioned to the state in which the customer is located, or the state to which the majority of the income producing activity (also known as cost of performance) can be attributed. The Department of Revenue adopted a rule in the 1970's generally sourcing sales of services based on the income producing activity. A cost of performance basis may be used for the sourcing of some services.

Under federal law, multiple-entity groups that share 80 percent ownership can elect to file a single consolidated federal income tax return for the group. Multiple-entity groups currently may file separate corporate tax returns for each corporation doing business in Florida, or may file a consolidated return for all of their group's income.[9] Both separate and consolidated returns presently allow certain transfers to pass through entities that may have the effect of reducing Florida net income.

Consistent with and bounded by the Due Process Clause, a state may determine that affiliated companies operate as a single business with income subject to a single apportionment factor.[10] This is referred to as the unitary business principle. This principle has been adopted by several states that determined that separate accounting did not accurately measure contributions to income resulting from the group's functional integration, centralization of management, and economies of scale.[11]

III. Effect of Proposed Changes:

This bill mandates combined reporting for the state's corporate income tax. Corporations that are members of a "water's edge group" are required to file a return combining income from those entities, and apportion the combined income to Florida based upon a statutory formula. The current statutory provisions allowing consolidated returns are replaced with provisions defining and mandating water's edge group reporting.

Section 1 amends s. 220.03, F.S., to change or include the following definitions:

- "Taxpayer" is redefined to replace a reference to consolidated returns with a reference to members of a water's edge group, consistent with the changes in section 5 of the bill;
- "Tax haven" is defined as a jurisdiction which has been identified as a tax haven or as having a harmful preferential tax regime by the Organization for Economic Cooperation and Development (OECD),[12] or meets specified criteria; and
- "Tax regime" means a set or system of rules, laws, regulations, or practices by which taxes are imposed on any person, corporation, or entity or on any income, property, incident, indicia, or activity pursuant to government authority.

[9] Section 220.131, F.S.
[10] See Mobil Oil Corp. v. Comm'r of Taxes of Vt., 445 U.S. 425 (1980).
[11] Exxon Corp. v. Department of Revenue, 447 U.S. 207 (1980).
[12] The OECD is an international organization of 36 countries dedicated to economic development. It has identified 53 preferential tax regimes. S*ee* OECD releases latest results on preferential regimes and moves to strengthen the level playing field with zero tax jurisdictions, available at: http://www.oecd.org/tax/beps/oecd-releases-latest-results-on-preferential-regimes-and-moves-to-strengthen-the-level-playing-field-with-zero-tax-jurisdictions.htm, (last visited March 22, 2019).

- "Water's edge group" means a group of corporations related through common ownership whose business activities are integrated with, dependent upon, or contribute to a flow of value among the members. (Membership requirements are specified in section 4 of the bill.)

Section 2 amends s. 220.13, F.S., to restrict deductions used to calculate adjusted federal income and to include the taxable income of one or more taxpayers which constitute a water's edge group. A deduction is not allowed to water's edge groups for net operating losses, net capital losses, or excess contribution deductions under the federal tax code for a member of a water's edge group that is not a United States member. In addition, carryovers of net operating losses, net capital losses, or excess contributions may be subtracted only by the member of the water's edge group that generates the carryover. Dividends received by a member of a water's edge group for dividends paid by another member of the water's edge group are subtracted from taxable income to the extent they had been included in taxable income.

Section 3 repeals s. 220.131, F.S., which defines adjusted federal income for affiliated groups and authorizes the filing of a consolidated return. This type of return is replaced by the return required for a water's edge group.

Section 4 creates s. 220.136, F.S., to define membership in a water's edge group.

A corporation with 50 percent or more of its outstanding voting stock directly or indirectly owned or controlled by a water's edge group is presumed to be a member of the group.[13] A corporation having less than 50 percent of its outstanding voting stock directly or indirectly controlled by a water's edge group is a member of the group if the businesses activities of the corporation show that the corporation is a member of the group. Ownership and control of voting stock is determined under federal law. All income of members of a water's edge group is presumed to be unitary.

Excluded from water's edge groups are corporations that conduct business outside the United States and have 80 percent or more of their property and payroll assignable to locations outside the United States. Those corporations do not use combined water's edge reporting, and instead will file separate Florida income tax returns, avoiding the water's edge reporting requirements. This exclusion does not apply to foreign corporations incorporated in a "tax haven" as defined by the bill.

Section 5 creates s. 220.1363, F.S., describing special reporting requirements for water's edge groups to determine the amount of group income apportionable to Florida. Income of the members is apportioned to Florida as a single tax payer based on three-factor apportionment of property, payroll, and sales. Under the water's edge reporting method:

- The adjusted federal income for purposes of s. 220.12, F.S., (net income defined), means the sum of adjusted federal income for all members of the group determined for a concurrent taxable year;
- The numerators and denominators of the apportionment factors are calculated for all members of the water's edge group combined;

[13] Compared to the 80 percent common ownership necessary to file a consolidated return.

- Intercompany sales transactions are not included in the sales factor;[14]
- The net proceeds for sales of intangibles made to entities outside the group are included in the sales factor;
- Sales that are not allocated or apportioned to any taxing jurisdiction ("nowhere sales") are not included in the sales factor; and
- The income attributable to the Florida activities of a corporation exempt from taxation under federal law is excluded, even if another member of the water's edge group has nexus with Florida and is subject to tax.

If a parent corporation is a member of the water's edge group and has nexus with this state, a single water's edge group return must be filed in the name and under the federal employer identification number of the parent corporation.

If members of a water's edge group have different taxable years, the taxable year of a majority of the members of the water's edge group is the taxable year of the water's edge group.

A water's edge group must file a computation schedule that:
- Combines the federal income of all members of the water's edge group;
- Shows all intercompany eliminations;
- Shows Florida additions and subtractions under s. 220.13, F.S.; and
- Shows the calculation of the combined apportionment factors.

Additionally, the group is required to file a domestic disclosure spreadsheet, which discloses the income reported to each state, the state tax liability, the method used to apportion or allocate income to each state, and other information provided for by rule as may be necessary to determine the proper amount of tax due to each state and to identify the water's edge group.

Section 6 amends s. 220.14, F.S., to replace a reference to consolidated returns with members of a water's edge group, consistent with the changes in section 4 of the bill.

Section 7 repeals parts of s. 220.15, F.S., to remove the ability of a member of an affiliated group to have amounts from another member of the group be included in gross income only to the extent that the amount exceeds directly related expenses of the recipient.

Sections 8-14 amend ss. 220.183, 220.1845, 220.1875, 220.191, 220.192, 220.193, and 220.51, F.S., respectively, to remove references to consolidated returns, which are repealed in section 3 of the bill. Specifically:

- Section 220.183, F.S., is amended to remove the authorization for taxpayers who file a Florida consolidated return as a member of an affiliated group to be allowed the community contribution tax credit on a consolidated return basis;

[14] The treatment of these intercompany transfers is another principal difference between tax treatment under water's edge group combined reporting and the current consolidated reporting.

- Section 220.1845, F.S., is amended to delete the authorization for taxpayers who file a consolidated return as a member of an affiliated group to receive the contaminated site rehabilitation tax credit up to the amount of tax imposed on the consolidated group;
- Section 220.1875, F.S., is amended to deny credits for contributions to non-profit scholarship-funding organizations on Florida consolidated returns;
- Section 220.191, F.S., is amended to remove the capital investment tax credit for consolidated groups;
- Sections 220.192 and 220.193, F.S., are amended to delete the renewable energy technologies investment tax credit and the renewable energy production credit on consolidated returns; and
- Section 220.51, F.S., is amended to delete rule-making authority relating to consolidated reporting for affiliated groups.

Section 15 amends s. 220.64, F.S., which pertains to special rules relating to taxation of banks and savings associations, to replace references to consolidated returns with water's edge provisions.

Section 16 amends s. 288.1254, F.S., to remove the entertainment industry tax credit on Florida consolidated returns.

Section 17 amends s. 376.30781, F.S., to correct a cross reference to s. 220.1845, F.S.

Section 18 creates transitional rules. For the first taxable year beginning on or after January 1, 2020, a taxpayer that previously filed a separate Florida return and is part of a water's edge group must compute its income together with all members of the water's edge group and file a combined corporate tax return with all members of the water's edge group. An affiliated group of corporations that previously filed Florida consolidated returns are prohibited from filing consolidated returns for taxable years beginning January 1, 2020, and must file a combined corporate tax return with all members of the water's edge group. An affiliated group of corporations which filed a Florida consolidated corporate income tax return pursuant to an election in s. 220.131(1), F.S., must cease filing a Florida consolidated corporate income tax return using that method for taxable years beginning on or after January 1, 2020, and must file a combined Florida corporate income tax return with all members of its water's edge group. For taxable years beginning on or after January 1, 2020, a tax return for a member of a water's edge group must be a combined Florida corporate income tax return that includes tax information for all members of the water's edge group, filed by a member that has a nexus with this state.

Section 19 provides that funds recaptured pursuant to the provisions of this bill must be appropriated in the General Appropriations Act to the various school districts to reduce the required local effort millage.

Section 20 provides that the bill takes effect July 1, 2019.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. State Tax or Fee Increases:

None.

E. Other Constitutional Issues:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

The Revenue Estimating Conference has not yet estimated the fiscal impact of this bill.

B. Private Sector Impact:

This bill could increase tax burdens on corporate groups to the extent that they will have to report income that is currently untaxed.

C. Government Sector Impact:

The bill provides that funds recaptured pursuant to this bill "must be appropriated" in the General Appropriations Act to various school districts to reduce required local effort.

The Department of Revenue estimates that implementation of this bill would require expenditures of $88,500 in Fiscal Year 2019-2020, and $27,950 in Fiscal Year 2020-2021.

VI. Technical Deficiencies:

None.

VII. Related Issues:

The term "special industry corporation" is not defined in the bill, or in the Florida Statutes.

Lines 602-607 of the bill delegate permissive rulemaking authority to the department, but also provide legislative intent to grant the department "extensive authority" to adopt rules, and specifies topics the rules should encompass. If the legislature wants to ensure the department adopts rules the "may" on line 602 should be "shall." Further, under the nondelegation doctrine, the legislature "may not delegate the power to enact a law or the right to exercise unrestricted discretion in applying the law,"[15] and the nondelegation doctrine precludes the legislature from delegating its powers "absent ascertainable minimal standards and guidelines."[16]

VIII. Statutes Affected:

This bill substantially amends sections 220.03, 220.13, 220.14, 220.15, 220.183, 220.1845, 220.1875, 220.191, 220.192, 220.193, 220.51, 220.64, 288.1254, and 376.30781 of the Florida Statutes.

The bill creates sections 220.136 and 220.1363 of the Florida Statutes.

The bill repeals section 220.131 of the Florida Statutes.

IX. Additional Information:

A. Committee Substitute – Statement of Changes:
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

B. Amendments:

None.

[15] *Sloban v. Florida Board of Pharmacy*, 982 So.2d 26, 29 (Fla. 1st DCA 2008) (citing *Sims v. State*, 754 So.2d 657, 668 (2000)).
[16] *Sloban v. Florida Board of Pharmacy*, 982 So.2d 26, 30 (Fla. 1st DCA 2008) (citing *Dep't of Bus. Reg., Div. of Alcoholic Beverages*; *Tobacco v. Jones*, 474 So.2d 359, 361 (Fla. 1st DCA 1985)).