

**HOUSE OF REPRESENTATIVES STAFF ANALYSIS
FINAL BILL ANALYSIS**

BILL #: HB 7127 PCB WMC 19-03 Corporate Income Tax
SPONSOR(S): Ways & Means Committee, Avila
TIED BILLS: IDEN./SIM. **BILLS:** CS/CS/SB 576

| REFERENCE | ACTION | ANALYST | STAFF DIRECTOR or BUDGET/POLICY CHIEF |
|--|-----------|---------|--|
| Orig. Comm.: Ways & Means Committee | 11 Y, 6 N | Curry | Langston |
| FINAL HOUSE FLOOR ACTION: 71 Y's 41 N's | | | |
| GOVERNOR'S ACTION: Approved | | | |

SUMMARY ANALYSIS

HB 7127 passed the House on April 25, 2019, and subsequently passed the Senate on May 2, 2019. The bill was approved by the Governor on June 28, 2019, ch. 2019-168, L.O.F., and became effective on that date.

Florida imposes a 5.5 percent tax on certain income of corporations doing business in Florida. Florida uses federal taxable income from federal tax returns as a beginning point to calculate corporate income tax owed to Florida. Florida updates its utilization of the Federal Internal Revenue Code (IRC) by adopting the code as it exists on January 1 in any given year. Adopting the code on an annual basis ensures the Florida tax code reflects any relevant changes to the IRC that were made during the prior year.

In 2018, Florida's adoption of the IRC as of January 1, 2018, had the effect of capturing the substantial corporate income tax base expansion enacted by Congress in December 2017 in the Tax Cuts and Jobs Act. At the same time, the legislature created a temporary, one-year automatic tax cut and refund mechanism for corporate income tax payers in the event that tax collections in FY 2018-19 grew beyond certain levels following the federal law changes.

The bill:

- Updates the Florida corporate income tax code by adopting the Internal Revenue Code as in effect on January 1, 2019;
- For Florida corporate income tax purposes, provides for a subtraction of global intangible low-taxed income (GILTI) from taxpayers' federal taxable income;
- Extends the current automatic tax rate adjustment and refund mechanism for an additional two years to include calculations based on revenue collections in fiscal years 2019-2020 and 2020-2021;
- Requires corporate income taxpayers with taxable years beginning during 2018 or 2019 calendar years to submit certain information from their federal tax returns to the Department of Revenue (Department) and to certify the accuracy and truthfulness of the information; and
- Requires the Department to create a secure online application for taxpayers to submit the required information beginning September 3, 2019, and to impose penalties for failure to timely comply.

The bill provides for a \$120,000 nonrecurring appropriation from the General Revenue Fund to the Department and authorizes the Department to adopt emergency rules to implement the bill.

The bill takes effect upon becoming a law and operates retroactively to January 1, 2019, except the provisions relating to subtraction of amounts related to GILTI apply retroactively to January 1, 2018.

According to the Revenue Estimating Conference, the provisions of the bill will have a negative, indeterminate impact on General Revenue collections. See FISCAL COMMENTS section.

This document does not reflect the intent or official position of the bill sponsor or House of Representatives.

STORAGE NAME: h7127z.WMC.DOCX

DATE: 5/2/2019

I. SUBSTANTIVE INFORMATION

A. EFFECT OF CHANGES:

Present Situation

Federal Tax Code Conformance

Florida levies a 5.5 percent tax on the taxable income of corporations and financial institutions doing business in Florida.¹ Florida utilizes the taxable income determined for federal income tax purposes as a starting point to determine the total amount of Florida corporate income tax due.² This means that a corporation paying taxes in Florida generally receives the same benefits from deductions allowed when determining taxable income for federal tax purposes as it does when determining taxable income for state taxation purposes.

Florida maintains its relationship with the federal Internal Revenue Code (IRC) by annually adopting the IRC as it exists on January 1.³ By doing this, Florida adopts any changes related to determining federal taxable income that were made during the previous year.

In support of their Florida corporate income tax returns, Florida taxpayers are required to submit information regarding the determination of their federal taxable income. However, because the purpose of this information has always been to aid the Department's evaluation of each individual taxpayer's Florida return, the information is not currently collected in a manner that can be quickly or easily summarized and analyzed from the standpoint of Florida's corporate income tax base as a whole.

Recent Federal Legislation

On December 22, 2017, the federal government passed the Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018 (Tax Cuts and Jobs Act).⁴ On February 9, 2018, they passed the Bipartisan Budget Act of 2018 which contained tax extender legislation.⁵ The acts made substantial changes to the taxation of individuals and business entities in all industries and contained numerous significant amendments to the Internal Revenue Code. One of the most significant changes that the Tax Cuts and Jobs Act made was amending IRC section 11(b) to permanently reduce the federal corporate income tax rate from 35 percent to 21 percent for taxable years beginning after December 31, 2017. Additionally, numerous changes were made to the calculation of federal taxable income. On balance, the federal tax base was substantially expanded.

Many of the recent federal law changes will affect the federal taxable income of Florida corporate income taxpayers, in both a positive and negative direction. The combined effect of the changes are expected to result in higher federal taxable income for Florida corporate income taxpayers in the aggregate.

Adjustments to Federal Income

¹ s. 220.11(2), F.S.

² s. 220.12, F.S.

³ ss. 220.03(1)(n) and (2)(c), F.S.

⁴ Public Law No. 115-97, H.R. 1 (December 22, 2017). The act was originally introduced as the Tax Cuts and Jobs Act.

⁵ Public Law No. 115-123, H.R. 1892 (February 9, 2018). Tax extenders are temporary tax laws that have a set expiration date, but are typically kept alive through extensions. Because lawmakers generally extend these laws they are collectively referred to as "tax extenders."

Add Backs and Subtractions

Under current law, one step in calculating the Florida corporate income tax due is to adjust federal taxable income by applying certain add backs and subtractions to the corporation's federal taxable income.⁶ These adjustments are intended to adjust taxable income for Florida tax purposes and to reflect, in part, federal provisions or treatments that the state has elected not to accept. Some of the items that are added back to the federal taxable income, pursuant to s. 220.13(1), F.S., include certain federal deductions taken for interest,⁷ tax credits taken for research and development,⁸ and certain deductions taken for depreciation.⁹

Section 220.13(1)(b), F.S., provides for certain items to be subtracted from the taxable income. Some of these items include net operating losses,¹⁰ foreign source dividends,¹¹ and foreign income.¹² After the add backs and subtractions are applied, the amount of adjusted federal income attributable to Florida is determined and income that is apportioned to Florida is subject to Florida corporate income tax.¹³

Global Intangible Low-Taxed Income

Section 951A, IRC, was created under the Tax Cuts and Jobs Act.¹⁴ This section includes a newly created income type, Global Intangible Low-Taxed Income (GILTI), and requires a U.S. shareholder of a 10-percent owned controlled foreign corporation to include GILTI in their federal income. The inclusion of GILTI in the taxpayer's income is similar to subpart F income under IRC Section 951, in that the income is deemed repatriated in the year earned. GILTI is also treated in the same manner as subpart F income for purposes of applying specific sections of the IRC, pursuant to section 951A(f), IRC. However, GILTI is not subpart F income. It is a new class of foreign source income.

Section 951A(b)(1), IRC, defines GILTI as the excess, if any, of the shareholder's net controlled foreign corporation tested income for the taxable year over the shareholder's net deemed tangible income return for such tax year. Under the GILTI provisions, taxpayers are allowed a 50 percent deduction of GILTI for 2018 through 2025. This deduction will decrease to 37.5 percent in 2026. As a result of the 50 percent GILTI deduction, the effective tax rate on GILTI income will be 10.5 percent prior to 2026.

GILTI is included in the computation of the federal taxable income, which is the starting point for the Florida corporate income tax computation. However, under current Florida law, there is no specific subtraction for GILTI. Section, 220.13(1)(b)2., F.S., provides for a subtraction from federal taxable income to the extent therein included, for certain foreign income. Specifically, the statute refers to dividends treated as received from sources without the United States as determined under section 862, IRC and all amounts included in taxable income under s. 78 or s. 951, IRC.

It is not clear at this time whether income from GILTI would pass the constitutional test created by the Kraft General Foods, Inc., v. Iowa Dept. of Revenue and Finance case.¹⁵ In that case, the U.S. Supreme Court reviewed whether a state discriminated against a taxpayer who was permitted to deduct domestic dividends from its federal income but was required to include foreign dividend income in the

⁶ s. 220.13, F.S.

⁷ s. 220.13(1)(a).2, F.S.

⁸ s. 220.13(1)(a).17, F.S.

⁹ s. 220.13 (1)(e), F.S.

¹⁰ s. 220.13(1)(b)1, F.S.

¹¹ s. 220.13(1)(b)2.a, F.S.

¹² s. 220.13(1)(b)2.b., F.S.

¹³ s. 220.15, F.S. Section 220.14(1), F.S, provides that the first \$50,000 of net income is exempt from Florida corporate income tax.

¹⁴ Public Law 115-97.

¹⁵ Kraft General Foods, Inc. v. Iowa Dept. of Revenue and Finance, 505 U.S. 71 (1992)

income subject to state income tax with no equivalent deduction. The U.S. Supreme Court held that states that adopt the federal definition of income as a starting point for state income tax must make an adjustment for the removal of foreign dividend income when the state also excludes domestic dividend income from the state income tax computation. In a larger sense, the Court's holding in Kraft implies that a state may not treat foreign operations less favorably than equivalent domestic operations.

This rule particularly applies to those states which have "separate" reporting (where each corporation calculates its tax liability separately for state income tax purposes) as opposed to "combined" reporting (where multiple corporations file a single return for all related companies involved in a common business, even if they are located outside the state, and then the tax burden is apportioned based on the amount of income attributable to that state). Combined-reporting states include all domestic income attributable to the state in the tax base, so domestic and foreign income are more likely to be treated similarly under GILTI provisions. Separate-reporting states do not inherently include all domestic income attributable to the state. Under the Kraft decision, this treatment may mean that domestic and foreign income are being treated differently in separate-reporting states, and may therefore cause discrimination against foreign commerce.

Florida uses the federal definition of income as the starting point for calculating state income tax,¹⁶ and is a separate-reporting state.¹⁷ As such, including GILTI income in the Florida tax base may be inconsistent with the Supreme Court's holding in Kraft, and may lead to legal challenges asserting discrimination against foreign commerce.

Automatic Refunds and Tax Rate Reduction

Section 220.1105, F.S., requires an automatic downward adjustment of the corporate income tax rate for taxable years beginning on or after January 1, 2019, if the actual net collections for fiscal year 2018-2019 exceed "adjusted forecasted collections." Any tax rate adjustment would sunset for taxable years beginning on or after January 1, 2020. For purposes of determining the tax rate reduction, the term "net collections" means the total amount of corporate income taxes collected in 2018-2019 fiscal year, including related interest and penalties, less refunds. The term "adjusted forecasted collections" means the amount of net collections forecasted for 2018-2019 fiscal year by the Revenue Estimating Conference on February 23, 2018, multiplied by 1.07.

If "net collections" exceed "adjusted forecasted net collections" in the 2018-2019 fiscal year, the tax rate for taxable years beginning on or after January 1, 2019, will be reduced. The tax rate adjustment will be calculated by multiplying the current 5.5 percent tax rate by the quotient of the adjusted forecasted collections divided by the net collections.

Section 220.1105, F.S., additionally requires any collections in excess of "adjusted forecasted net collections" during 2018-2019 to be refunded to eligible corporate taxpayers no later than March 1, 2020, according to a process set forth in statute. Taxpayers eligible for refunds are those with taxable years beginning between April 1, 2017, and March 31, 2018, and whose final tax liability for that period is greater than zero. An eligible taxpayer's refund will equal the total excess collections multiplied by that taxpayer's final tax liability as a percentage of the total liabilities of all eligible taxpayers.

Effect of Proposed Changes

The bill updates the Florida corporate income tax code by adopting the Internal Revenue Code as in effect on January 1, 2019.

¹⁶ ss. 220.12 and 220.13, F.S.

¹⁷ s. 220.131, F.S.

For Florida tax purposes, the bill also requires taxpayers to subtract all amounts related to GILTI (s. 951A, IRC) from the taxpayer's federal taxable income. It also adds language clarifying that any subtractions of foreign income types for Florida tax purposes are only allowed to the extent that such amounts are not deductible in determining federal taxable income.

Further, the bill extends the current temporary, automatic tax rate and refund mechanism for an additional two years to include rate cut and refund calculations based on net collections in fiscal years 2019-2020 and 2020-2021. Any resulting tax rate reductions would sunset for taxable years beginning on or after January 1, 2022. These changes also include providing DOR with an additional two months within which to determine and distribute any excess refunds, and clarification of which taxpayer returns are to be used in determining each taxpayer's share of any excess refunds.

The bill also requires every corporate income taxpayer with taxable years beginning during 2018 or 2019 calendar years, and who is required to file a tax return, to submit to the Department the following information:

- The taxpayer's name; federal taxpayer identification number; taxable year beginning date; taxable year ending date; whether a consolidated return for the taxpayer is required or elected under s. 220.131, F.S.;
- The taxpayer's NAICS code for business activity that generates the greatest proportion of gross receipts of the taxpayer;¹⁸
- The taxpayer's "taxable income" as that term is defined in s. 220.13(2), F.S., and the taxpayer's Florida apportionment fraction pursuant to s. 220.15, F.S., for the taxable year;
- The amount of GILTI included in federal taxable income under s. 951A, IRC, and the amount of the related s. 250, IRC, deduction as it pertains to s. 951A, IRC;
- The amount of foreign derived intangible income computed for the federal return for the taxable year and the amount of the related s. 250, IRC, deduction as it pertains to foreign derived intangible income;
- The amount of business interest expense deducted on the federal return under s. 163, IRC, including any carryover; the amount of current year business interest expense, including any carryover, that was not deducted due to the limitation in s. 163(j), IRC; and the amount of business interest expense carried over from previous taxable years;
- The amount of federal net operating loss deduction under s. 172, IRC, applied in determining federal taxable income and the amount of federal net operating loss carryover that was not applied due to the limitation in s. 172(a)(2), IRC;
- The total amount of Florida net operating loss carryover available after the filing of the return for the taxable year and;
- The total amount of the Florida alternative minimum tax credit carryover available after the filing of the return for the taxable year.

The bill further requires the Department to create by September 3, 2019, a secure online application for taxpayers to submit the required information. The information submitted must be certified as true and correct by an officer of the taxpayer or one duly authorized to act on the taxpayer's behalf. The taxpayer must submit the required information the earlier of 10 days after the extended due date of the Florida corporate income tax return, or 10 days after the date the Florida corporate income tax return is filed, but not earlier than September 3, 2019. Taxpayers who fail to provide the information by the required submission date, will be subject to a penalty of \$1,000 or one percent of the taxpayer's corporate income tax due for the most recent taxable year, whichever is greater. However, the Department is authorized to settle or compromise any such penalty if the Department determines that the noncompliance is due to reasonable cause and not to willful negligence, willful neglect, or fraud.

¹⁸ The term "NAICS" means those classifications contained in the North American Industry Classification System, as published in 2007 by the Office of Management and Budget, Executive Office of the President.

In addition to the Department's existing audit and investigation authority, the bill provides that the Department may perform any additional financial and technical audits and investigations which are necessary to verify the accuracy of the information submitted by the taxpayer, including examining the accounts, books, and financial records of the taxpayer.

For fiscal year 2019-2020, the bill provides for the sum of \$120,000 in nonrecurring funds to be appropriated from the General Revenue Fund to the Department and authorizes the Department to adopt emergency rules to implement the bill.

The bill takes effect upon becoming a law and operates retroactively to January 1, 2019, except the provisions relating to subtraction of amounts related to GILTI apply retroactively to January 1, 2018.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

See FISCAL COMMENTS section.

2. Expenditures:

The bill appropriates \$120,000 in nonrecurring General Revenue to the Department to implement the provisions of the bill.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

By adopting recent changes to the Internal Revenue Code, Florida maintains the linkage between the federal and Florida tax codes which simplifies compliance for Florida corporate income taxpayers.

D. FISCAL COMMENTS:

According to the Revenue Estimating Conference, the provisions of the bill will have a negative, indeterminate impact on General Revenue collections. The decoupling from the Global Intangible Low Taxed Income (GILTI) provisions of the Federal Tax Cuts and Jobs Act will likely cause downward revisions to the future corporate income tax forecasts that support the General Revenue fund. In addition, the ability for the GILTI decoupling to apply retroactively produces a multi-year impact in FY 2019-20 from those prior year reversals. Finally, the tax rate cut and refund mechanism introduces additional uncertainty regarding the net revenue effect of the bill.