

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: PCB GOA 09-01 Corporate Income Tax
SPONSOR(S): Government Operations Appropriations Committee
TIED BILLS: **IDEN./SIM. BILLS:**

	REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
Orig. Comm.:	Government Operations Appropriations Committee	5 Y, 0 N	Diez-Arguelles	Topp
1)	_____	_____	_____	_____
2)	_____	_____	_____	_____
3)	_____	_____	_____	_____
4)	_____	_____	_____	_____
5)	_____	_____	_____	_____

SUMMARY ANALYSIS

Florida imposes a 5.5% tax on the taxable income of corporations doing business in Florida. The determination of taxable income for Florida tax purposes begins with the taxable income used for Federal income tax purposes. This means that a corporation paying taxes in Florida receives the same benefits from deductions allowed in determining its federal taxable income. Florida maintains this relationship by each year adopting the Federal Internal Revenue Code as it exists on January 1 of the year. By doing this, Florida adopts any changes that were made in the previous year to the determination of federal taxable income. The bill adopting the federal code is referred to as the "piggyback bill."

Earlier this year, Congress adopted the American Recovery and Reinvestment Act of 2009 (ARRTA). This act contained three provisions that will reduce Florida corporate tax receipts over the next two years if adopted in Florida. The three provisions are: fifty-percent first year bonus depreciation, additional first year expensing, and deferral of income from cancellation of debt.

This bill updates the Florida Income Tax Code to reflect changes Congress made to the U.S. Internal Revenue Code of 1986 by adopting the Internal Revenue Code as in effect on January 1, 2009. The change will apply retroactively to January 1, 2009. However, the bill contains special provisions that have the effect of not adopting the three changes that reduce corporate tax receipts in FY 09-10 and FY 10-11.

The bill accomplishes this by extending the special provisions for dealing with bonus depreciation and additional expensing adopted by Florida in SB 1112 (2009) for another year.

Also, the bill requires taxpayers taking advantage of the ARRTA provisions allowing for deferral of COD income to add the deferred income for Florida tax purposes; the taxpayer is also allowed to subtract for Florida tax purposes the amounts added to federal taxable income in later years. The effect of these changes is to allow taxpayers to take advantage of the income deferral in the federal return, but place the taxpayer in the same position for Florida tax purposes as they would have been had they not taken advantage of the federal deferral provisions.

The bill gives the Department of Revenue authority to adopt rules to administer the act.

The Revenue Estimating Conference has not completed a fiscal impact of Florida adopting the federal code, including the ARRTA provisions, or completed the fiscal impact of this bill. However, staff estimates that the adoption of the three ARRTA provisions addressed by the bill would result in a substantial reduction in corporate tax revenues in FY 09-10 and FY 10-11. Staff estimates that the provisions of the bill adopting the federal code and providing special treatment for the three ARRTA provisions will eliminate the negative impacts and result in an indeterminate impact on state revenues.

The bill has an effective date of upon becoming law and applies retroactively to January 1, 2009.

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

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HOUSE PRINCIPLES

Members are encouraged to evaluate proposed legislation in light of the following guiding principles of the House of Representatives

- Balance the state budget.
- Create a legal and regulatory environment that fosters economic growth and job creation.
- Lower the tax burden on families and businesses.
- Reverse or restrain the growth of government.
- Promote public safety.
- Promote educational accountability, excellence, and choice.
- Foster respect for the family and for innocent human life.
- Protect Florida's natural beauty.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

CURRENT LAW

Corporate Income Tax Overview

Florida imposes a 5.5% tax on the taxable income of corporations doing business in Florida.¹ For simplicity's sake, the determination of taxable income for Florida tax purposes begins with the taxable income used for Federal income tax purposes.² This means that a corporation paying taxes in Florida receives the same benefits from deductions allowed in determining its federal taxable income. With federal taxable income as a starting point, Florida law then requires a variety of additions and subtractions to reflect Florida-specific policies.

Florida maintains this relationship by each year adopting the Federal Internal Revenue Code as it exists on January 1 of the year. By doing this, Florida adopts any changes that were made in the previous year to the determination of federal taxable income. The bill adopting the federal code is referred to as the "piggyback bill."

Depreciation Deduction

Under federal tax law, a corporation is entitled to reduce its income over time to reflect the cost of an asset it purchases. If a corporation purchases equipment for \$10,000 with an expected useful life of 5 years, it is entitled to reduce its income by annual amounts totaling \$10,000 over 5 years. For example, if the corporation uses the straight-line depreciation method, it can reduce its income by \$2,000 each year for 5 years.

Under Florida law, this treatment for federal tax purposes flows to the Florida tax return and reduces Florida taxable income.

¹ Sec. 220.11, F.S.

² Secs. 220.12 and 220.13, F.S.

Economic Stimulus Act of 2008 and Florida's Response

In early 2008, Congress approved the Economic Stimulus Act of 2008. Among other items, this legislation provided two tax benefits to corporations: (1) it allowed corporations to take an additional depreciation deduction equal to 50% of the cost of property placed in service in 2008, and (2) it allowed for small businesses to completely depreciate property valued up to \$250,000 (instead of \$128,000) placed in service during 2008. The effect of these changes was to increase depreciation and expensing provisions in the year property is placed in service and to decrease depreciation deductions in later years.

On February 22, 2008, the Revenue Estimating Conference determined that if Florida adopted the federal code, including the two provisions, state revenues would decline by \$146.8 million in FY 08-09 and by \$76 million in FY 09-10. The decline would be offset in later years when revenues would be higher than otherwise.

Due to budgetary constraints in FY 08-09, the Legislature decided to adopt the federal tax code, except for the provisions dealing with 50% bonus depreciation and the increased expensing amount. HB 5065 (Ch. 2008-206, L.O.F.) The method chosen to exclude the benefit of the federal provisions from the Florida corporate income tax calculations was to provide an addition to a corporation's Florida taxable income equal to the amount deducted from the federal tax return because of the two provisions. The belief was that this method placed a taxpayer in the same position for Florida tax purposes as if it had not taken advantage of the two provisions or in the same position as if the two provisions did not exist.

Because of the interaction of the federal tax code with the Florida tax code, the adopted method placed a taxpayer choosing to take advantage of the federal provisions in a worse position in Florida than it would have been had it not taken advantage of the federal provisions. In effect, a taxpayer choosing to take advantage of the federal provisions loses the ability to take depreciation deductions in Florida equal to the total amounts taken on the federal return over the life of the asset. A taxpayer taking advantage of the federal provisions would pay higher taxes in Florida than it would if it had not taken advantage of the provisions.

On March 9, 2009, the Legislature passed SB 1112 and it was approved by the Governor on March 17, 2009 (Ch. 2009-18 L.O.F.). The bill replaced the statutory changes made in 2008 with a new process to account for bonus depreciation and additional expensing in the Florida tax return. Specifically, the bill spread out the amount of bonus depreciation or additional expensing claimed by a taxpayer on the federal return over a 7-year period on the Florida return.

SB 1112 accomplished this by providing that a taxpayer claiming bonus depreciation or additional expensing on its federal return must add the amount so claimed to Florida taxable income. In the first year and in each of the 6 subsequent taxable years, the taxpayer can subtract from taxable income one-seventh of the amount by which taxable income was increased. These adjustments to Florida taxable income are available whether the property remains with the taxpayer or is sold or otherwise disposed.

SB 1112 provided that the subtractions can be used by a surviving or acquiring entity following a merger or acquisition. Also, SB 1112 specifically provided that the additions and subtractions can change a taxpayer's net operating loss for Florida tax purposes.

The American Recovery and Reinvestment Act of 2009

Congress has approved the American Recovery and Reinvestment Act of 2009 (ARRTA). ARRTA made three changes to the federal tax code that, if adopted by Florida, would reduce corporate tax receipts in the next two or three years and increase receipts in later years.

Two of the changes are one-year extensions of the bonus depreciation and additional expensing provisions adopted in 2008, discussed above. The third change is intended to facilitate debt restructuring, by allowing taxpayers to defer until 2014 the recognition of income from cancellation of indebtedness (COD) occurring during 2009 and 2010.

Recognition of income from COD occurs because borrowed amounts are not included in gross income at the time of borrowing, since a borrower is obligated to repay the amount borrowed. If, after borrowing funds, a borrower subsequently ceases to be obligated to repay all or a portion of the debt, the borrower recognizes COD income. Unless certain statutory COD exclusions apply, the borrower must include as income on the federal tax return the amount of loan proceeds that it is no longer obligated to repay. COD income is includable as ordinary income.

ARRTA provides taxpayers with an election to defer COD income recognized as a result of the reacquisition of an "applicable debt instrument" that occurs in either 2009 or 2010. Taxpayers making the election must amortize the deferred COD income ratably over a five-year period beginning in 2014. An "applicable debt instrument" is any debt instrument issued by a C corporation or by any other taxpayer in connection with the conduct of a trade or business.

The Revenue Estimating Conference has not yet determined the fiscal impact if Florida adopted the federal code, including the ARRTA provisions. However, it is expected that corporate tax revenues would be substantially lower in FYs 09-10 and 10-11, if Florida adopted the three provisions discussed above. The decline would be offset in later years when revenues would be higher than otherwise.

PROPOSED CHANGES

The bill updates the Florida Income Tax Code to reflect changes Congress made to the U.S. Internal Revenue Code of 1986 by adopting the Internal Revenue Code as in effect on January 1, 2009. The change will apply retroactively to January 1, 2009. However, the bill contains special provisions that have the effect of not adopting the three changes that reduce corporate tax receipts in FY 09-10 and FY 10-11.

The bill accomplishes this by extending the special provisions for dealing with bonus depreciation and additional expensing adopted in SB 1112 (2009) for another year.

Also, the bill requires taxpayers taking advantage of the ARRTA provisions allowing for deferral of COD income to add the deferred income for Florida tax purposes; the taxpayer is also allowed to subtract for Florida tax purposes the amounts added to federal taxable income in later years. The effect of these changes is to allow taxpayers to take advantage of the income deferral in the federal return, but place the taxpayer in the same position for Florida tax purposes as they would have been had they not taken advantage of the federal deferral provisions.

The bill gives the Department of Revenue authority to adopt rules to administer the act.

B. SECTION DIRECTORY:

Section 1: Amends s. 220.03, F.S.

Section 2: Amends s. 220.23, F.S.

Section 3: Provides that the Department of Revenue may adopt rules to administer the act.

Section 4: Provides an effective date of upon becoming law and retroactive application to January 1, 2009.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

The Revenue Estimating Conference has not completed a fiscal impact of Florida adopting the federal code, including the ARRTA provisions, or completed the fiscal impact of this bill. However, staff estimates that the adoption of the three ARRTA provisions addressed by the bill would result in a substantial reduction in corporate tax revenues in FY 09-10 and FY 10-11. Staff estimates that the provisions of the bill adopting the federal code and providing special treatment for the three ARRTA provisions will eliminate the negative impacts and result in an indeterminate impact on state revenues.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to affect county or municipal government.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The bill gives the Department of Revenue authority to adopt rules to administer the act.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/COUNCIL OR COMMITTEE SUBSTITUTE CHANGES

On April 2, 2009, the Government Operations Appropriations Committee adopted one amendment to correct a reference to the Internal Revenue Code.