HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: PCB WMC 18-04 Corporate Income Taxation
SPONSOR(S): Ways & Means Committee
TIED BILLS: **IDEN./SIM. BILLS:**

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
Orig. Comm.: Ways & Means Committee	11 Y, 5 N	Curry	Langston

SUMMARY ANALYSIS

Florida imposes a 5.5 percent tax on the taxable income of corporations and financial institutions doing business in Florida. Florida uses federal taxable income as a beginning point to calculate corporate income tax owed to Florida. Florida updates its utilization of the Federal Internal Revenue Code 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 Internal Revenue Code that were made during the prior year.

On December 22, 2017, the federal government passed the Tax Cuts and Jobs Act and on February 9, 2018, passed the Bipartisan Budget Act of 2018 which contained tax extender legislation. The acts make numerous significant changes to the taxation of corporations, some of which will reduce federal taxable income for many Florida taxpayers, including granting accelerated deductions for expensing and depreciation of capital assets put into service after September 27, 2017. Many of the other changes made by the acts are expected to increase federal taxable income of Florida taxpayers. By fiscal year 2020-21, the combined effect of the changes from the two federal acts are expected to result in higher federal taxable income for Florida corporate income taxpayers in the aggregate, though by an unknown amount.

The bill updates the Florida corporate Income Tax Code by adopting the Internal Revenue Code as in effect on January 1, 2018. However, similar to acts in 2009, 2011, and 2013, the bill does not allow taxpayers, for Florida tax purposes only, to utilize the accelerated capital asset depreciation deductions allowed for federal tax purposes. Instead, the bill requires taxpayers to spread over a seven year period the amount of the accelerated deductions provided by federal law changes.

For fiscal years 2018-2019 through 2020-2021, the bill requires permanent, downward adjustments of the Florida corporate income tax rate following each year, if actual collections exceed currently forecasted collections during those years by certain amounts. Further, amounts received during fiscal years in which net collections exceed adjusted forecasted collections must be used to offset future revenue reductions resulting from unspecified nonrecurring tax relief measures.

The bill authorizes the Department of Revenue to adopt emergency rules to implement the bill.

The Revenue Estimating Conference has not reviewed this bill. Based on conference analysis of similar legislation, staff estimates the annual impacts of the bill to be indeterminate in both magnitude and direction.

The bill is effective upon becoming law and applies retroactively to January 1, 2018.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Current Situation

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 federal Code 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.

Add Backs and Subtractions

To calculate the Florida corporate income tax due, the federal taxable income is adjusted by applying certain add backs and subtractions.[4] These adjustments are intended to adjust taxable income for Florida tax purposes and to reflect 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)(a), F.S., include federal deductions taken for interest,[5] tax credits taken for research and development,[6] and certain deductions taken for depreciation.[7]

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[8] foreign source dividends,[9] and foreign income.[10] After the addbacks 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.[11]

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).[12] On February 9, 2018, they past the Bipartisan Budget Act of 2018 which contained tax extender legislation.[13] The acts make substantial changes to the taxation of individuals and business entities in all industries and contains several 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

---

[1] s. 220.11(2), F.S.
[2] s. 220.12, F.S.
[3] See s. 220.0, F.S.
[4] s. 220.13, F.S.
[5] s. 220.13(1)(a)(2), F.S.
[6] s. 220.13(1)(a)(17), F.S.
[7] s. 220.13 (1)(e), F.S.
[8] s. 220.13(1)(b)(1), F.S.
[9] s. 22013(1)(b)(2)(a), F.S.
[10] s. 22013(1)(b)(2)(b), F.S.
[11] 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.
[12] Public Law No. 115-97, H.R. 1 (December 22, 2017). The act was originally introduced as the Tax Cuts and Jobs Act.
[13] 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."

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.

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. By fiscal year 2020-21, the combined effect of the changes are expected to result in higher federal taxable income for Florida corporate income taxpayers in the aggregate, though by an unknown amount.

Major Changes to Federal Taxable Income

Described below are some changes from recent federal legislation expected to have the largest impacts on federal taxable income of Florida corporate income tax payers.

Bonus Depreciation

Under federal tax law a business may capitalize the cost of property used in a trade or business or held for the production of income and recover the cost over time through annual deductions for depreciation or amortization.[14]

Prior Law

Bonus depreciation essentially allows a corporation to take an enhanced depreciation deduction during the first year that certain qualified property is placed into service. Prior to the Tax Cut and Jobs Act, an additional first year bonus depreciation deduction of 50 percent could be taken on qualified property that was placed into service through 2017. The amount of the deduction was phased down to 40 percent in 2018 and 30 percent in 2019.

New Law

The Tax Cut and Jobs Act increases the first year bonus depreciation deduction to 100 percent for long term assets placed in service after September 27, 2017. The act also allows bonus depreciation to be taken for purchases of both new and used property. The 100 percent deduction is scheduled to remain in effect until January 1, 2023, and will phase down in later years as follows:

- 80% for property placed in service after December 31, 2022 and before January 1, 2024.
- 60% for property placed in service after December 31, 2023 and before January 1, 2025.
- 40% for property placed in service after December 31, 2024 and before January1, 2026.
- 20% for property placed in service after December 31, 2025 and before January 1, 2027.

Section 179 "Expensing"

Prior Law

Under Section 179 a corporation could elect to expense up to $500,000 of the cost of qualifying property rather than recover the costs over time through depreciation deductions. The $500,000 amount was reduced (but not below zero) by the amount by which the cost of the qualifying property placed in service during the taxable year exceeded $2 million.

New Law

Under the Tax Cut and Jobs Act, the section 179 deduction amount increases to $1 million. The $1 million amount is reduced (but not below zero) by the amount by which the cost of the qualifying property placed in service during the taxable year exceeds $2.5 million.

Interest Deductions

[14] IRC sections 167 and 263(a).

Prior Law

Business interest was generally deductible in the taxable year in which the interest was paid or accrued, subject to certain limitations.

New Law

The Tax Cuts and Jobs Act restricts larger businesses, those with average gross receipts of $25 million or more, from deducting interest payments in excess of 30% of their adjusted taxable income. Any interest amounts that are disallowed may be carried forward to the succeeding five taxable years. Businesses with gross receipts of less than $25 million are not subject to this limitation and may continue to deduct all of their interest payments. Adjusted taxable income for this purpose is the taxable income of the taxpayer computed without regard to (1) any item of income, gain, deduction, or loss which is not properly allocable to a trade or business; (2) any business interest or business interest income; (3) the amount of any net operating loss deduction; and (4) any deduction allowable for depreciation, amortization, or depletion.

Net Operating Loss

Prior Law

Net operating losses (NOL) could be carried back two years and carried forward 20 years to offset the taxable income during those years.

New Law

The Tax Cuts and Jobs Act eliminates the carryback of NOLs making NOLs deductible in current and future taxable years. However, a business is only allowed to deduct NOLs up to 80 percent of its taxable income. Unused NOL amounts are no longer limited to a 20 year carryforward. These amounts may be carried forward and deducted indefinitely until exhausted. These provisions are effective for losses arising in tax years beginning after December 31, 2017.

Amortization of Research and Development Expenditures

Prior Law

IRC Section 174 allows businesses to deduct the amount of certain reasonable research or experimental (R&E) expenditures paid or incurred in connection with a trade or business. Under prior law, a business could elect to forgo a current deduction, capitalize its R&E expenditures, and amortize ratably the costs over the useful life of the research for a period of no less than 60 months.

New Law

Businesses treating R&E expenditures as deductible expenses will no longer be able to recover the costs in the year in which the costs are incurred. Instead, R&E expenditures are required to be capitalized and amortized ratably over a five-year period, beginning with the midpoint of the taxable year in which the expenditure is paid or incurred. This provision applies to amounts paid or incurred in taxable years after December 31, 2021. Costs for research conducted outside of the U.S. must be amortized over a 15-year period. Expenditures for the development of software will also be treated as R&E expenditures.

Domestic Production Activities Deduction

Qualified production activities income is equal to domestic production gross receipts reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts; and (2) other expenses, losses,

or deductions which are properly allocable to those receipts.[15] Domestic production gross receipts are generally qualifying gross receipts that are derived from property that was manufactured, produced, grown, or extracted within the United States.

Prior Law

IRC Section 199 provided that a corporation could claim a nine percent deduction, or the lesser, of the corporation's qualified production activities income or its taxable income for the tax year. The deduction was limited to 50 percent of the W-2 wages paid by the business and properly allocable to domestic production gross receipts during a calendar year.

New Law

The Tax Cuts and Jobs Act repealed IRC Section 199 for tax years beginning after 2017.

Foreign Income

Under prior law, generally foreign income earned by a foreign subsidiary that was owned by a U.S. corporation was not subject to U.S. tax until the income was distributed as dividends to the U.S. corporation. To mitigate double taxation on the earnings of the foreign corporation, a credit could be taken for the foreign income taxes paid which would offset, in whole or in part, the U.S taxes owed on the foreign income. The corporation could also elect to deduct the foreign income taxes paid in lieu of claiming the credit.

Foreign Dividends

Prior Law

Taxes were paid when foreign income was distributed as dividends to the U.S. corporation.

New Law

The system of taxing U.S. corporations on the foreign earning of their foreign subsidiaries when these earnings are distributed is replaced with a dividend-exemption system. Under the dividend-exemption system, 100 percent of the foreign-source portion of dividends paid by a foreign corporation to a U.S. corporate shareholder that owns 10 percent or more of the foreign corporation is exempt from U.S. taxation. No foreign tax credit or deduction is allowed for any foreign taxes (including withholding taxes) paid or accrued with respect to any exempt dividend. Deductions for expenses properly allocable to an exempt dividend (or stock that gives rise to exempt dividends) will be taken into account for purposes of determining the U.S. corporate shareholder's foreign-source income. This provision is effective for distributions made after 2017.

Global Intangible Low-Taxed Income

Prior Law

There was no prior federal law regarding "Global Intangible Low-Taxed Income" (GILTI). However, I.R.C. Section 951 requires U.S. corporations that are shareholders of a controlled foreign corporation to include subpart F income in their gross income for the tax year.

New Law

GILTI is a newly created income type within subpart F.[16] Generally, GILTI is (i) a shareholder's pro rata share of a controlled foreign corporation's aggregate net income, minus (ii) a deemed 10 percent return on the controlled foreign corporation's aggregate basis in depreciable tangible property. Under the

[15] Repealed I.R.C Section 199(c)(1).
[16] I.R.C. Section 951A.

GILTI provisions, shareholders who own at least 10 percent of the voting stock of any controlled foreign corporation must include GILTI in their gross income for the tax year even if the income was not distributed.

Under the new law, shareholders 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.

Proposed Changes

The bill updates the Florida corporate Income Tax Code by adopting the Internal Revenue Code as in effect on January 1, 2018. However, similar to acts in 2009, 2011, and 2013, the bill does not allow taxpayers, for Florida tax purposes only, to utilize the bonus depreciation and section 179 "expensing" allowed for federal tax purposes. Instead, the bill requires taxpayers to spread over a seven year period the amount of these accelerated deductions provided by federal law changes.

For fiscal years 2018-2019 through 2020-2021, the bill requires permanent, downward adjustments of the Florida corporate income tax rate following each year, if actual collections exceed currently forecasted collections during those years by certain amounts. For purposes of determining the tax rate reduction, the term "net collections" means corporate income tax receipts less refunds during the fiscal year. The term "adjusted forecasted collections" for each fiscal year means the Revenue Estimating Conference forecasts of net collections agreed to February 9, 2018, multiplied by 1.03. If "net collections" in a year exceed the "adjusted forecasted collections", then the tax rate applicable to taxable years beginning on or after January 1 of that year will be reduced. The tax rate adjustment will be calculated by multiplying the tax rate imposed for taxable years beginning on or after January 1 of the preceding year (i.e., the preexisting tax rate) by the quotient of the adjusted forecasted collections for the fiscal year divided by the net collections for the fiscal year. The resulting tax rate shall be rounded to the nearest thousandth, and rounded down if the fourth digit to the left of the decimal is the number five.

The bill further requires that amounts received during fiscal years in which net collections exceed adjusted forecasted collections must be used to offset future revenue reductions resulting from unspecified nonrecurring tax relief measures.

The bill authorizes the Department of Revenue to adopt emergency rules to implement the bill.

B. SECTION DIRECTORY:

Section 1. Amends s. 220.03(1)(n) and (2)(c), F.S., adopting the 2018 version of the Internal Revenue code.

Section 2. Creates s. 220.1105, F.S., creating an automatic corporate income tax rate reduction mechanism based on tax collections in fiscal years 2018-19 through 2020-21.

Section 3. Amends s. 220.11(2), F.S., creating paragraphs (a) and (b); incorporating references to s. 220.1105, F.S.; providing for the adjustment of the tax rate imposed.

Section 4. Amends s. 220.13(1)(e), F.S., incorporating reference to the Tax Cuts and Jobs Act of 2017; creates new subparagraph (3); providing for the treatment by this state of certain depreciation and expensing of assets that are allowed for federal income tax purposes.

Section 5. Amends s. 220.63(2), F.S., creating paragraphs (a) and (b); incorporating references to s. 220.1105, F.S.; providing for the adjustment of the franchise tax rate imposed on banks and savings associations.

Section 6. Provides emergency rulemaking authority to the Department of Revenue to implement the provisions of this bill.

Section 7. Provides an effective date upon becoming law and provides retroactive applicability to January 1, 2018.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   The Revenue Estimating Conference has not reviewed this bill. Based on conference analysis of similar legislation, staff estimates the annual impacts of the bill to be indeterminate in magnitude and direction.

2. Expenditures:

   None

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:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

   None.

2. Other:

   None.

B. RULE-MAKING AUTHORITY:

The bill grants the Department of Revenue emergency rulemaking authority to implement the provisions of this bill.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On February 22, 2018, the Ways and Means Committee adopted an amendment regarding the calculation of the tax rate adjustment. The amendment specifies that the tax rate adjustment will be calculated by multiplying the tax rate imposed for taxable years beginning on or after January 1 of the preceding year by the quotient of the adjusted forecasted collections for the fiscal year divided by the net collections for the fiscal year. The resulting tax rate shall be rounded to the nearest thousandth, and rounded down if the fourth digit to the left of the decimal is the number five.

This analysis is drawn to the bill as amended.