HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 1237 Corporate Income Tax
SPONSOR(S): Gelber
TIED BILLS: **IDEN./SIM. BILLS:** SB 2766

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) Government Efficiency & Accountability Council		Levin/Dykes	Cooper
2) Policy & Budget Council			
3)			
4)			
5)			

SUMMARY ANALYSIS

Corporations doing business in Florida must pay a corporate income tax of 5.5 percent on income earned in Florida. For those corporations that confine their business activity to one state, the traditional separate accounting methods can be relied upon to produce a sufficiently accurate measurement of income for state taxation purposes.

But when a corporate taxpayer is doing business both in and out of the taxing state, this income measurement becomes more difficult. As a result, most states have created some method to apportion multi-state income among the states. In Florida, net income is defined as the share of adjusted federal income apportioned to this state pursuant to s. 220.15, F.S. Apportionment is weighted by factors of sales (50 percent), property (25 percent) and payroll (25 percent). All business income is apportioned, and non-business income is allocated between states pursuant to s. 220.16, F.S., less the exemption allowed by s. 220.14, F.S. Currently, corporations may opt to file either separate tax returns for each legal entity doing business in Florida, or consolidated returns that include all the members of the affiliated group of corporations used in filing federal corporate income taxes.

HB 1237 would mandate "combined" reporting, which would require all corporations that are members of a newly defined "water's edge group" to file a tax return combining income from those entities and then apportioning the combined income to Florida based upon a statutory formula.

The changes would become effective in the first taxable year beginning on or after January 1, 2009.

This bill has not been to a Revenue Estimating Impact Conference.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

LOWER TAXES:
Corporations would be required to pay corporate income tax on a combined "water's edge" basis.

B. EFFECT OF PROPOSED CHANGES:

Current Situation:

Florida levies a corporate income tax at the rate of 5.5 percent. To calculate the base of this tax, Florida requires corporations to apportion earned income into Florida using a three factor formula. The factors and weights are: sales – 50 percent; payroll – 25 percent; and property – 25 percent. Thus, corporations operating solely in Florida pay tax on 100% of their net income. Corporations operating both in Florida and in other parts of the United States pay taxes depending on the portion of their total sales, payroll, and property located in Florida, as opposed to those portions located in all states. Corporations which are members of federally defined affiliated groups have the choice of filing as a separate entity or as a consolidated group.

Florida exempts "foreign source income" from its corporate income tax. Income, such as dividends, paid to a corporation operating in Florida by subsidiaries located in foreign countries is not included in the calculation of Florida income. Similarly, the sales, payroll and property of the foreign subsidiary are not a part of the apportionment factor. Florida law provides for the allocation of business and non-business income of a corporation. Business income is apportioned to the state in which it is earned. Non-business income is allocated between the states pursuant to s. 220.16, F.S. Non-business income includes, but is not limited to, interest, royalties, rents, and dividends from businesses unrelated to the activity being carried on in a particular state.

Some states require commonly controlled corporations engaged in a unitary business to compute their state taxable income on a combined basis.[1] There are two basic approached to dealing with unitary group members that are incorporated in a foreign country or conduct most of their business abroad. One approach is called worldwide combination, under which the combined report includes all members of the unitary business group, regardless of the country in which the group member is incorporated or the country in which the group member conducts business. A more common alternative is a water's edge combination, under which the combined report excludes group members that are incorporated in a foreign country or conduct most of their business abroad.[2] A common approach is to exclude 80/20 companies, which are corporations whose business activity outside the US is 80 percent or more of the corporation's total business activity.

[1] The Supreme Court upheld the unitary method of taxation in Container Corporation of America v. Franchise Tax Board, 463 U.S. 159, 103 S. Ct. 2933, 77 L.Ed.2d 545 (1983)

[2] Generally, the term "water's edge" refers to the fact that this method of reporting does not extend beyond the water's edge, i.e., the geographic boundaries of the United States, in determining what activities a state will tax.

Proposed Changes:

Section 220.03, F.S., contains the definitions used in the Corporate Income Tax:

"Taxpayer" is redefined to eliminate the concept of taxpayers who file consolidated returns and replaces it with the requirement that the taxpayers include corporations that are members of a water's edge group. "

"Tax haven" is defined as a jurisdiction which has been designated as a tax haven or as having a harmful preferential "tax regime."

A "water's edge group" is defined as a group of corporations related through common ownership and the business activities of which are integrated with, dependent upon, or contributing to a flow of value among members of the group. When 50 percent or more of the outstanding voting stock of a corporation is under direct or indirect ownership or control of the group, the corporation is considered to be part of a water's edge group. Excluded from water's edge groups are corporations which conduct business outside the United States and have 80 percent or more of their property and payroll assignable to locations outside the United States. All income of a water's edge group is presumed to be apportionable business income, and the taxpayer has the burden of proof regarding the issues of whether the corporation is part of a water's edge group and whether or not the income is apportionable income. Corporations meeting the ownership and control tests are presumed to be unitary and part of the group, unless facts and circumstances of the individual case demonstrate the contrary.

"Adjusted federal income" is redefined in s. 220.12, F.S., to include the taxable income of one or more taxpayers which constitute water's edge groups. A deduction is denied to water's edge groups for net operating losses, capital losses, or excess contribution deductions under ss. 170(d)(2), 172, 1212, or 404 of the Internal Revenue Code of 1986, as amended, for a member of a water's edge group that is not a United States member. 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 220.136, F.S., water's edge groups; special reporting requirements, is created, and it mandates the "water's edge group reporting method" be used for a group of entities conducting a unitary business by adding combined net income and the additions and deductions provided by s. 220.13, F.S., for members of the group and apportioning the results as provided in ss. 220.15 and 220.151, F.S.

If members of a water's edge group have different taxable years, they must all use the single designated "filing member's" taxable year. 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."

Conforming amendments made by the bill include changes to:

s. 220.14, F.S., which permits water's edge groups only one corporate exemption from adjusted federal income, when filing a combined water's edge group return;

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

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

s. 220.1845, F.S., the contaminated site rehabilitation tax credit, to strike the authorization for taxpayers who file a consolidated return as a member of an affiliated group to receive the credit up to the amount of tax imposed on the consolidated group;

s. 220.187, F.S., concerning credits for contributions to non-profit scholarship-funding organizations, to deny the credit for Florida consolidated returns as affiliated groups.;

s. 220.19, F.S., authorizing the grant of child care tax credits is also amended to strike the language allowing taxpayers filing a consolidated return to claim the credit;

s. 220.191, F.S., the capital investment tax credit, is amended so as to be unavailable for consolidated groups;

ss. 220.192 and 220.193, F.S., on the renewable energy technologies investment tax credit, and the renewable energy production credit are also similarly limited;

s. 220.15 (3), F.S., which permitted the DOR to promulgate regulations concerning consolidated reporting is eliminated;

s. 220.64, F.S., relating to the franchise tax, is amended so that the franchise tax applies to water's edge group tax when not manifestly incompatible; and

s. 376.30781, F.S., is amended to correct a reference.

Transition rules provide that for the first taxable year beginning on or after January 1, 2009, a taxpayer that previously filed a Florida return and is part of a water's edge group shall compute its income together with all members of the water's edge group and file a separate corporate tax return or may elect to combine it tax return with all members of the affiliated group. Corporations which previously filed Florida consolidated returns are prohibited from filing consolidated returns for taxable years beginning after January 1, 2009.

Section 220.131, F.S., adjusted federal income; affiliated groups is repealed.

Section 19 of the bill directs appropriation of the funds recaptured by enactment of this legislation. $50 million is appropriated from General Revenue to the State University System for workforce education, $50 million is appropriated from General Revenue to community colleges for workforce education, and the remainder of the funds shall be appropriated from General Revenue to the various school districts to reduce the required local effort.

The act takes effect January 1, 2009.

C. SECTION DIRECTORY:

Section 1 makes legislative findings and states legislative intent.

Section 2 amends s. 220.03, F.S., relating to definitions.

Section 3 amends s. 220.13, F.S., amending the definition of adjusted federal income.

Section 4 creates s. 220.136, F.S., relating to water's edge groups special reporting requirements.

Section 5 amends s. 220.14(3), F.S., concerning exemptions from the corporate income tax.

Section 6 repeals a portion of s. 220.15 (5)(c), F.S., relating to apportionment of adjusted federal income.

Section 7 repeals s. 220.183(1)(f), F.S., relating to the community contribution tax credit.

Section 8 repeals s. 220.1845(1)(d), F.S., concerning authorization to grant community contribution tax credits.

Section 9 repeals ss. 220.187 (5)(c) and (d), F.S., concerning credits for contributions to nonprofit scholarship funding organizations.

Section 10 repeals s. 220.19 (1)(g), F.S., concerning child care credits.

Section 11 repeals a portion of s. 220.191(3)(c), F.S., capital investment tax credits.

Section 12 repeals a portion of s. 220.192(2), F.S., relating to renewable energy technologies investment tax credits.

Section 13 repeals a portion of s.220.193 (3), F.S., relating to Florida renewable energy production credits.

Section 14 repeals s. 220.51(3), F.S., relating to rules and regulations for consolidated reporting.

Section 15 amends s. 220.64, F.S., relating to provisions applicable to franchise tax.

Section 16 amends s. 376.30781(9), F.S., relating to partial tax credits for rehabilitation of drycleaning solvent- contaminated sites.

Section 17 provides transition rules.

Section 18 repeals s. 220.131, F.S., relating to adjusted federal income for affiliated groups.

Section 19 appropriates funds.

Section 20 provides an effective date.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   The Revenue Estimating Conference has not reviewed this proposal. See FISCAL COMMENTS.

2. Expenditures:

   The Department of Revenue may have additional expenditures to promulgate rules and train personnel. The Department has yet to provide an analysis of what will be required in order 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:

See FISCAL COMMENTS.

D. FISCAL COMMENTS:

The revenue impacts from this proposal are very uncertain at this time. The uncertainty arises from not knowing the composition of the groups of corporations that will have to file on a combined basis and the characteristics (income, sales, property and payroll) of each member of the group. For example, if a corporation that is not currently a taxpayer in Florida is included in a group filing a consolidated return, the inclusion of that corporation can result in more or less tax revenue to the state depending on the characteristics of the corporation. If the corporation has little income, and its property, payroll and sales are all outside Florida, the inclusion of the corporation may result in less taxes being paid to Florida, since the effects on the apportionment factors may outweigh the addition of a small amount of income to the apportionable income of the group. Conversely, if the corporation has high income, the inclusion of the corporation may result in more taxes being paid to Florida, again depending on the effect its property, payroll and sales have on the apportionment factor.

Existing informal estimates of the effects of this proposal come from two sources: (1) The 2007 Florida Tax Handbook listed a positive revenue impact of $364.5 million if this proposal had been in effect in FY 2007-08[3]; (2) In 2003, the Multistate Tax Commission estimated that Florida could have received between $170 million and $365 million in FY 2000-01 from requiring combined reporting.

III. COMMENTS

[3] Handbook estimates should be viewed as an indication of the approximate or relative value impact of a proposal and not as an accurate point estimate. See Note at p. ix, 2007 Florida Tax Handbook, for an explanation of the Handbook's limitations.

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

The mandates provisions contained within Article VII, section (18(a), (b), and (c), Florida Constitution, are inapplicable because: the bill does not require counties or municipalities to spend funds or take actions requiring the expenditure of funds; the bill does not reduce the authority cities and counties have to raise revenue in the aggregate; and the bill does not reduce the percentage of a state tax shared with counties and municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The Department will be required to enact rules to implement water's edge taxation.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

D. STATEMENT OF THE SPONSOR

Simply put, this bill puts money in the pockets of hard-working Floridians as it lowers property taxes by making our corporate income tax more fair. It also invests $100 million into workforce development to spur the economy.

This legislation addresses unfair corporate tax reporting practices used by multi-state corporations. By closing many of the loopholes that large corporations use but that Florida only businesses do not, we can give a little competitive advantage back to Florida only businesses.

This bill will also give us a head start in eliminating the required local effort that would be required by the property tax proposal about to pass the Taxation and Budget Reform Committee. That proposal would require the legislature to replace over $9 billion in RLE. Replacing some now without raising a regressive tax like the sales tax is much better for the economy.

IV. AMENDMENTS/COUNCIL SUBSTITUTE CHANGES

N/A