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 Finance and Tax Committee

BILL:	PCS/SB 2504
INTRODUCER:	Finance and Tax Committee
SUBJECT:	The Corporate Income Tax
DATE:	April 17, 2009 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	ODonnell	McKee	FT	**Pre-meeting**
2.			CM	
3.			GA	
4.			WPSC	
5.			RC	
6.				

Please see Section VIII. for Additional Information:

A. COMMITTEE SUBSTITUTE.....	x	Statement of Substantial Changes
B. AMENDMENTS........................		Technical amendments were recommended
		Amendments were recommended
		Significant amendments were recommended

I. Summary:

Congress approved the American Recovery and Reinvestment Act of 2009 (ARRTA) which made three changes to the federal tax code that, if adopted by Florida, would likely reduce corporate tax receipts over the next two to three fiscal years. ARRTA provides a one-year extension for bonus depreciation and additional expensing. Additionally, ARRTA allows some taxpayer/debtors to defer the recognition of ordinary income from a cancellation of their recourse debt that occurs between 2009 and 2010 earlier this year,

The Proposed Committee Substitute (the bill) contains special provisions that have the effect of not adopting the three ARRTA changes that would otherwise reduce corporate tax receipts in FY 2009-10 and FY 2010-11.

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 cancellation of debt income to add back the deferred income for Florida tax purposes. The effect of the bill is to 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 Revenue Estimating Conference has produced consensus estimates for bonus depreciation, and income discharged by the reacquisition of a debt instrument premised on Florida adopting the federal code inclusive of the ARRTA provisions. All amounts are General Revenue.

The Revenue Estimating Conference has determined that adopting the Internal Revenue Code without decoupling from bonus depreciation and expensing causes recurring negative $129.6 cash in FY 2009-10 and positive $16.6 cash in FY 2010-11; without decoupling from income discharged by reacquisition causes negative $58.6 cash in FY 2009-10 and negative $114.6 cash in FY 2010-11; and without decoupling from income discharged by reacquisition causes an indeterminate impact.

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

This bill substantially amends, creates, or repeals the following sections of the Florida Statutes: ss. 220.03, 220.13.

II. Present Situation:

Florida levies a tax on all corporations, organizations, associations and other artificial entities that derive from this state, or any other, attributes not inherent to natural persons, such as perpetual life. The tax is levied on the privilege tax measured by net income at the rate of 5.5 percent on income derived from the state. Florida does not require commonly controlled corporations engaged in a unitary business to compute their state taxable income on a combined basis. Corporations who are members of an affiliated groups have the choice of filing as a separate entity or as a consolidated group. Florida adopts (piggy-backs)the federal definition of taxable income. 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 $5,000 exemption.

A corporation paying tax in Florida receives the same benefit in Florida for deductions allowed in determining its federal taxable income as it does on the federal return. 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 incorporates changes that have been made to the determination of federal taxable income made during the previous year. The bill adopting the federal code is referred to as the "piggyback bill."

The Depreciation Deduction
Under federal tax law, a corporation is generally entitled to reduce its income over time to reflect the diminished value of an asset in a manner that bears some relationship its useful life. The way the federal government structures the deduction might be broadly stated as follows: 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. Using a straight-line depreciation method, the deduction reduces federal taxable income by $2,000 each year for 5 years. Under Florida law, absent an explicit Florida exception, the federal deduction flows to the Florida tax return and reduces Florida taxable income.

Economic Stimulus Act of 2008 and Florida's Response

The federal Economic Stimulus Act of 2008 provided two tax benefits to corporations: (1) it allowed corporations to accelerate their depreciation by taking a deduction equal to 50% of the cost of property placed in service in 2008 with an additional deduction for the remainder, 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 Revenue Estimating Conference determined that Florida adoption of the federal code would reduce state revenue 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, HB 5065 (Ch. 2008-206, L.O.F), adopted the federal tax code without bonus depreciation and increased expensing by adding the deductions back to Florida taxable income. The 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 since their federal basis was reduced with no allowance for recapture of the deduction on a Florida return in the future.

To remedy the problem, SB 1112 was approved by the Governor on March 17, 2009 (Ch. 2009-18 L.O.F.). The bill spread out recapture of bonus depreciation or additional expensing amounts over 7 years. In the first year and in each of the 6 subsequent taxable years, the taxpayer subtracts from taxable income one-seventh of the amount by which taxable income had been increased by the original add-back.

The 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. 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 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 over the next two to three years. The Act provides a one-year extension for bonus depreciation and additional expensing. Additionally, the Act allows some taxpayer/debtors to defer the recognition of ordinary income from a cancellation of their recourse debt that occurs between 2009 and 2010.

Code Section 108(i) was added to the Code pursuant to the Recovery Act and provides some relief to taxpayers for COD income resulting from certain debt acquisitions, modifications and forgiveness. Generally, C corporations, or other taxpayers that have issued debt in connection with the conduct of a trade or business, may elect to defer COD income arising from an "acquisition" of a debt during the calendar years 2009 and 2010.

- Acquisitions in 2009 –5 year deferral followed by 5 year ratable inclusion in gross income.

- Acquisitions in 2010 –4 year deferral followed by 5 year ratable inclusion in gross income.

An election under Section 108(i) can be made with respect to acquisitions of debt by the issuer or a by a party that is “related” to the issuer under Code Section 267(b) or 707(b). An “acquisition” for purposes of Code Section 108(i) includes:

- The acquisition of the debt for cash;
- The acquisition of the debt in exchange for new debt (including a deemed exchange resulting from a debt modification under Treas. Reg. Section 1.1001-3);
- The acquisition of the debt in exchange for corporate stock or a partnership interest of the issuer/borrower;
- The contribution of the debt to capital by the holder/creditor; and
- The complete forgiveness of the debt by the holder/creditor.

The ability to defer federal income recognition over a period of time operates on a Florida income tax return in like fashion to the acceleration of deductions to income as by way of bonus depreciation. And, as with bonus depreciation, deferring income is expected to have a negative impact on Florida taxable income in the short term with an expected recovery at some point in the future.

III. Effect of Proposed Changes:

The bill updates the Florida Income Tax Code to reflect changes Congress made to the Internal Revenue Code by adopting the 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 2009-10 and FY 2010-11.

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 cancellation of debt 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.

Other Potential Implications:

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

If the ARRTA provisions are not eliminated from the computation of Florida income, the following estimates of negative impact were made by the Revenue Estimating Conference.

- Bonus depreciation and expensing is indeterminate in FY 2009-10 and recurring negative $129.6 cash in FY 2009-10 and positive $16.6 cash in FY 2010-11.
- Income discharged by reacquisition is indeterminate in FY 2009-10 and recurring negative $58.6 cash in FY 2009-10 and negative $114.6 cash in FY 2010-11.
- Income discharged by reacquisition is indeterminate in FY 2009-10, FY 2009-10 and FY 2010-11.

B. Private Sector Impact:

Florida businesses that pay Florida corporate income tax will be required to add back to their income the amount of bonus depreciation and this may, therefore, dampen the purchase of capital assets in Florida during 2009.

C. Government Sector Impact:

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

PCS by Finance and Tax Committee:
The prior version of the bill was a shell bill, therefore all substantive issues in the PCS arise from proposed committee amendments.

B. Amendments:

None.