HOUSE OF REPRESENTATIVES
FINAL BILL ANALYSIS

BILL #:	HB 7093	**FINAL HOUSE FLOOR ACTION:**	
SUBJECT/SHORT TITLE	Corporate Income Taxation	81 **Y's** 26 **N's**	
SPONSOR(S):	Ways & Means Committee and Renner	**GOVERNOR'S ACTION:**	Approved
COMPANION BILLS:	CS/HB 502		

SUMMARY ANALYSIS

HB 7093 passed the House on March 5, 2018. The bill was amended in the Senate on March 8, 2018, and returned to the House. On March 9, 2018, the House concurred in the Senate amendments as amended by the House. The Senate also concurred in the House amendments and subsequently passed the bill.

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.

The federal government recently passed major tax reform legislation. The the federal action make numerous significant changes to the taxation of corporations, some of which will reduce and many of which will increase federal taxable income for many Florida taxpayers. By fiscal year 2020-21, the combined effect of the changes from the federal tax changes 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 IRC 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 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.

The bill requires the Department of Revenue to examine how the Tax Cuts and Jobs Act will affect the state corporate income tax, conduct public workshops, and to submit a comprehensive report. The bill also requires an automatic downward adjustment of the corporate income tax rate for one year if certain conditions are met. Further, excess income tax collections during fiscal year 2018-2019 must be refunded to corporate income tax payers no later than March 1, 2020, under a process described in the bill.

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

During the 2018-2019 fiscal year, this bill is expected to have an indeterminate revenue impact in both magnitude and direction due to the uncertainty of the effect of the recent changes to the federal law. Thereafter, the impact is expected to be positive but indeterminate.

The bill was approved by the Governor on March 23, 2018, ch. 2018-119, L.O.F., and became effective on that date.

I. SUBSTANTIVE ANALYSIS

A. EFFECT CHANGES:

Current Situation

Florida levies a 5.5 percent tax on certain 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 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

---

[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.

legislation.[13] The acts make substantial and broad changes to the taxation of individuals and business entities 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 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

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

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

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.

<u>Prior Law</u>

IRC Section 199 provided that a corporation could claim a nine percent deduction of 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.

<u>New Law</u>

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

<u>Prior Law</u>

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

<u>New Law</u>

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

---

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

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 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.

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, 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 deduction allowed for federal tax purposes. Instead, the bill requires taxpayers to add-back the bonus depreciation deduction amount to the taxpayer's taxable income. The taxpayer is then permitted to subtract from income one-seventh (1/7) of the deduction for the current taxable year and the following six taxable years.

The bill requires the Department of Revenue to examine how the Tax Cuts and Jobs Act will affect the state corporate income tax and the businesses that pay the tax, conduct public workshops, and submit a report by February 1, 2019, to the Governor, the President of the Senate, and the Speaker of the House of Representatives. The report should include a comprehensive discussion of the potential effects of federal tax reform on the state corporate income tax structure and revenues, options for changes the Legislature could make which may be needed to integrate state and federal law, estimates of potential fiscal impact of each option, and any other information the Department of Revenue deems useful to the Legislature. The department should also consult with the Revenue Estimating Conference on the development of the required report. The 2019 Legislature is required to consider the report to determine whether adjustments to the automatic tax rate adjustment mechanism described below are needed.

The bill requires an automatic downward adjustment of the corporate income tax rate for one year if the actual net collections for fiscal year 2018-2019 exceed the forecasted net collections by seven percent, after which 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 Revevene Estimating Conference on February 23, 2018, multiplied by 1.07.

If "net collections" exceed "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

[16] I.R.C. Section 951A.

calculated by multiplying the tax rate imposed for taxable years beginning on or after January 1, 2018, by the quotient of the adjusted forecasted collections divided by the net collections. The resulting tax rate shall be rounded to the nearest thousandth, and rounded down if the fourth digit to the right of the decimal is the number five. The 2019 Legislature shall consider the Department of Revenue's report to determine if adjustments to the automatic tax rate mechanism are needed.

The bill requires any excess collections received during 2018-2019 to be refunded to eligible corporate taxpayers no later than March 1, 2020 according to a process set forth in the bill. 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. Excess collections are the amount by which actual collections exceed adjusted forecast collections as defined above. An eligible taxpayer's refund will equal the total excess collections multiplied by that taxpayer's final tax liability as a percentage of the totlal liabilities of all eligible taxpayers.

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

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   During the 2018-2019 fiscal year, this bill is expected to have an indeterminate revenue impact in both magnitude and direction due to the uncertainty of the effect of the recent changes to the federal law. Thereafter, the impact is expected to be positive but indeterminate.

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.